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Company

Law and Practice

A Comprehensive Text Book on Companies Act 2013

As amended by Companies (Amdt.) Act 2019

Dr. G.K. Kapoor
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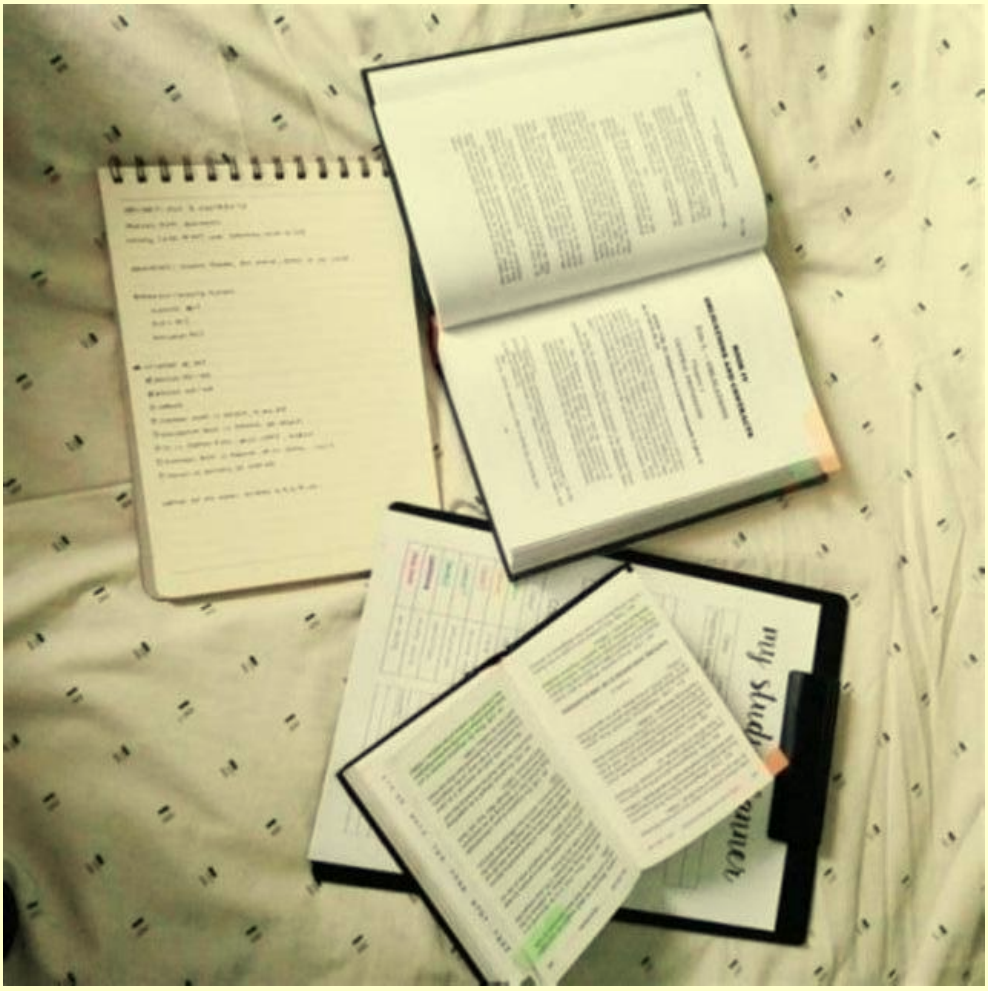
24th Edition
August 2019



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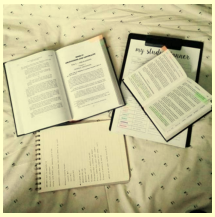

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A Co-winner of NIRC, ICAI Best Teacher Award 2000, Dr. Kapoor is an author of various books on 'Business and Corporate Laws' and 'Management' including Company Law and Practice (Taxmann), Business Law including Company Law (New Age); Business Law, Ethics and Communication for C.A. (IPC); Corporate and Allied Laws for C.A. Final (Sultan Chand); Economic and Labour Laws (Sultan Chand); Business and Society (Sultan Chand). He has 47 years of teaching experience of 'Business and Corporate Laws' and 'Management' at under-graduate, post-graduate and professional level. He has been on the Guest Faculty of the Institute of Chartered Accountants of India, Indian Law Institute, All India Management Association, Indian Institute of Bankers, Indian Institute of Public Administration, International Management Institute (IMI), and Institute for Integrated Learning and Management (IILM). He was conferred an 'Excellence Award for his contribution to Education' by Amity University, Noida in February 2012.

Dr. Sanjay Dhamija, currently is Professor and Dean - Executive Education at the International Management Institute, New Delhi. He is a doctorate in Finance from IMI, Delhi. He is a Fellow Member of the Institute of Company Secretaries of India (FCS) and of the Institute of Cost Accountants of India (FCMA). He did his M.Com. from Delhi School of Economics and LL.B. from Delhi University. He is also a Chartered Financial Analyst from ICFAI.

Dr. Dhamija has over 29 years of rich experience both in industry and academia. He worked in industry in senior positions for over 16 years with organizations of repute like ABN AMRO Asia Equities (India) Private Limited, HSBC Securities and Capital Markets (India) Private Limited, Escorts Finance Limited and

MMTC of India Limited. Since 2003 he is in academics having worked with ICFAI Business School and Management Development Institute (MDI) before joining IMI in 2009. At MDI he held various positions including Chairperson of Executive Post Graduate Diploma in Management, Chairperson of Continuing Education and Chairperson of Finance and Accounting Area. He was awarded for 'Excellence in Teaching' at MDI and as 'Best Trainer' at IMI. He received Gold Medal from the Institute of Cost Accountants of India for securing highest marks in Advanced Accountancy and Gold Medal from ICFAI for being the Best Outgoing Student. He was awarded 'Best Teacher in Financial Management' at 17th Dewang Mehta Business School Awards. He also received the award for the 'Best case in finance, economics, business and political environment' at the 40th Anniversary Case Conference of the Case Center, UK held at IIM-Bangalore.

He has handled a number of consulting and training assignments for organizations in Government sector, public sector and private sector. He also regularly conducts popular programs on 'Finance for Non Finance Executives' and 'Understanding and Analysis of Financial Statements'. He has authored 'Financial Management & Policy' with James C. Van Horne and 'Financial Accounting for Managers', both with Pearson Education.

PREFACE TO THE TWENTY FOURTH EDITION

It gives us immense pleasure in presenting Twenty Fourth Edition of the Book. We express our gratitude to the readers for the encouraging response to our writing.

Since the publication of the last edition in July 2018, there have been certain significant changes in company law. The Companies (Amendment) Act, 2019 has introduced important changes including re-introduction of commencement of business, physical verification of the registered office, vesting power in Central Government regarding approval for conversion of public company into a private company, extension of period for registration of charges, significant beneficial ownership disclosure, disqualification for appointment of a director, power of Regional Director to compound offences, re-categorization of certain offences. Again, significant changes have been made in SEBI Regulations with respect to IPOs, FPOs, Rights Issues, Bonus Issues, et. al. vide *SEBI (Issue of Capital & Disclosure Requirements) Regulations, 2018.*

Case law reported in second half of 2018 and first half of 2019 has been duly included at the relevant places in the book.

We have taken care to add as well as change discussion in certain areas on the basis of feedback received from the readers and colleagues in various colleges.

We are sure that the readers will appreciate this edition like the earlier ones and continue to give us an opportunity to serve them. We

request you to continue to send your suggestions. These certainly help improve the text.

With Best Wishes,

2nd August 2019.

DR. G. K. KAPOOR
DR. SANJAY DHAMIJA

PREFACE TO THE FIRST EDITION

Legal framework is an important constituent of the Business and Corporate environment. No corporate entity can effectively work and survive without meeting its legal obligation. The law relating to companies is perhaps the most significant and all-pervasive amongst the various corporate legislations. It requires compliance on the part of the companies, their directors and other officers of numerous requirements of the Act. Non-compliance of various provisions of the law relating to companies may result in penal consequences and ill reputation. The Companies Act, 1956, the law in our country in this regard, is a complicated piece of legislation. Numerous amendments made in this legislation over the years from its inception have brought in more and more complexities. The amendments were intended to deal with increased complexities in the Business and Corporate environment. Further, a number of judicial decisions on the subject have added new dimensions to the interpretations of the provisions of this legislation. The Department of Company Affairs, Government of India, has also over the years issued a large number of clarifications. Besides, the Securities & Exchange Board of India (SEBI) has issued a number of guidelines and clarifications to regulate the capital market in India.

The present book represents an impressive and judicious blending of the provisions of the Companies Act, 1956, judicial decisions, the clarifications issued by the Department of Company Affairs and the guidelines and clarifications issued by the SEBI. The text is interspersed with interpretations, explanations and illustrations wherever felt necessary to help the readers to assimilate the provisions in a better way.

The authors have tried to present the provisions of the law in a simple and lucid style, backed by most up-to-date case decisions. The

book has effectively dealt with the secretarial practice aspects also for complying with the procedural matters in the law; a number of specimen notices, minutes and resolutions have been given at relevant places.

SEBI Guidelines for disclosure and investors' protection, originally issued in 1992, have undergone many significant changes. As many as XI clarifications have been issued. The present book has taken due notice of those guidelines and all the XI clarifications have been referred to at appropriate places.

Another feature of the book that readers may appreciate is the Summary at the end of each Chapter containing substantive provisions of law covered in that Chapter.

The work of this kind would not have been possible without reference to the authentic commentaries and other publications on the subject - Indian and foreign. We shall, therefore, like to record our gratitude to the authors and the publishers of those publications. An attempt has been made to acknowledge the contributions wherever material has been quoted.

Although every effort has been made to offer the most authentic position on the subject, claiming cent per cent accuracy will be too tall a claim. Moreover, there may be differences in interpretation. We shall, therefore, be too happy to receive suggestions and comments from our readers which we promise to acknowledge with gratitude.

We are immensely grateful to Shri Y.M. Kale, President, the Institute of Chartered Accountants of India, for being kind enough to write the Foreword of this Book.

Special thanks are due to Shri Vinay Kumar Jain, FCA and a friend, who not only was responsible for initiating this work but also continued to offer his moral support till its completion.

We must also express our thanks to M/s. Taxmann for their co-operation in many ways. Without their help this work would have just not been possible.

Last but not the least, our wives and children do need a mention for their sacrifice and co-operation in providing us with the necessary environment and the sumptuous lunches and the teas during our long sittings over weekends. Without their support, we could not have met the target date.

August 21, 1995.

A.K. MAJUMDAR
DR. G.K. KAPOOR

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SECTION-WISE INDEX

HIGHLIGHTS OF THE COMPANIES (AMENDMENT) ACT, 2019

The Companies (Amendment) Ordinance, 2018 ('2018 Ordinance'), issued on November 2, 2018 brought about significant changes to certain provisions of the Companies Act, 2013 ('Act'). The 2018 Ordinance was passed by the Lok Sabha, though could not be taken up by the Rajya Sabha and which was due to expire on January 21, 2019. In order to give continuity to the amendments introduced by the 2018 Ordinance, it was re-promulgated on January 12, 2019 by another Ordinance *i.e.* the Companies (Amendment) Ordinance, 2019 ('Ordinance') on January 12, 2019 with its provisions effective from November 2, 2018. Again, since Companies (Amendment) Ordinance, 2019 was to cease to operate on 13 March, 2019, to give effect to the Ordinance 2018 and 2019, the Companies (Amendment) Bill, 2019 was introduced and passed on 26th July, 2019 in Lok Sabha and on 31st July by Rajya Sabha. The Companies (Amendment) Act, 2019 received the assent of the President on 1st August and was also notified. Most of the provisions of the Companies (Amendment) Act, 2019 shall be deemed to have come into force from 2 November, 2018.

Following is the summary of the key-changes introduced by the Companies (Amendment) Act, 2019.

1. Section 2 - Definition of 'financial year'

The authority to make application for adopting a different year as 'financial year' has been shifted from 'Tribunal' to 'Central Government'.

2. Section 10A - Re-introduction of Commencement of Business Declaration

The Ordinance has introduced section 10A in the Act which mandates that every company incorporated after commencement of the Ordinance shall not commence business or exercise any borrowing powers unless it satisfies the following two conditions:

(*i*) A declaration is filed by a director within a period of 180 days of the date of incorporation of the company with the Registrar in the prescribed form, stating that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him on the date of making such declaration; and

(*ii*) A declaration is filed by the Company with the Registrar furnishing verification of its registered office within a period of 30 days from its incorporation.

In case no declaration is filed within 180 days of incorporation and the Registrar has reasonable cause to believe that the Company is not conducting any business or operations, the Registrar may initiate the removal of the Company's name from the register of companies.

3. Section 12 - Physical Verification of the Registered Office

Section 12(9) has been introduced through the Ordinance. As per the same, if the Registrar has reasonable cause to believe that the Company is not carrying on any business or operations, he may cause a physical verification of the registered office of the Company in the prescribed manner. If any default is found to be made on such verification, the Registrar may initiate action for removal of the Company's name from the register of companies.

4. Approval for Conversion of Public Company into a Private Company

The Ordinance provides that any alteration of articles of association having the effect of conversion of a public company into a private company will not be valid unless it is approved by an order of the Central Government on an application made in a prescribed manner. Earlier, National Company Law Tribunal ('NCLT') was responsible for granting this approval.

5. Section 53 - Prohibition on issue of shares at discount

Where a company contravenes the provisions of section 53, sub-section (3), as amended by the Ordinance lays down that the company and every officer-in-default shall pay a penalty which may extend to an amount raised through issue of shares at discount or Rs. 5 lakhs, whichever is less and the company shall also be liable to refund the amount with interest at the rate of 12% p.a. from the date of issue of shares to the respective persons to whom the shares were issued.

6. Section 64 - Notice to be given to Registrar for alteration of share capital

Existing law provided for fine on the company and officer-in-default whereas the Ordinance lays down for penalty on the Company and every officer-in-default with Rs. 1000 for each day during default or Rs. 5 lakhs, whichever is less.

7. Section 77 - Registration of Charges

Section 77 of the Act which talks about registration of charges has been amended through the Ordinance. As per such amendment, in case of charges created by the Company before November 2, 2018, the Registrar may, on application by the company, allow registration of the charge, within a period of 300 days of such charge creation. If the registration is not made within 300 days, the registration of the charge can be made within six months from the date of commencement of the Ordinance.

In case of charges created after November 2, 2018 the Registrar may on application by the Company allow registration of the charge within 60 days of such charge creation. If the charge is not registered within the aforesaid period, the registration shall be made within an additional period of 60 days after payment of the prescribed *ad valorem* fees.

8. Section 164 - Disqualification for Appointment of a Director

A new provision for disqualification of a person for appointment as a director has been introduced as per which if a person holds more than the total number of directorships allowed as per the Act, then he will be disqualified for being appointed as director of the Company. The Act allows a person to hold not more than 20 directorships, out of which directorship in public companies cannot exceed 10.

9. Section 441 - Power of Regional Director to Compound Offences

Offences (excluding offences punishable with imprisonment or with imprisonment and fine), carrying maximum amount of fine not exceeding Rs. 25 Lacs will now be compounded by the Regional Director or any authorized officer of the Central Government. The earlier limit was up to Rs. 5 Lacs only, and any matter beyond such limit had to be compounded by the NCLT.

1 History of Company Legislation

1.1 History of company legislation in India

The Company Legislation in India has closely followed the Company Legislation in England. The first legislative enactment for registration of Joint Stock Companies was passed in the year 1850 which was based on the English Companies Act, 1844. This Act recognised companies as distinct legal entities but did not introduce the concept of limited liability. The concept of limited liability, in India, was recognised for the first time by the Companies Act, 1857 closely following the English Companies Act, 1856 in this regard. The Act of 1857, however, kept the liability of the members of banking companies unlimited. It was only in 1858 that the limited liability concept was extended to banking companies also. Thereafter in 1866, the Companies Act, 1866 was passed for consolidating and amending the law relating to incorporation, regulation and winding-up of trading companies and other associations. This Act was based on the English Companies Act, 1862. The Act of 1866 was recast in 1882 to bring the Indian Company law in conformity with the various amendments made to the English Companies Act, 1862. This Act continued till 1913 when it was replaced by the Companies Act, 1913. The Act of 1913 had been passed following the English Companies Consolidation Act, 1908. It may be noted that since the Indian Companies Acts closely followed the English Acts, the decisions of the English Courts under the English Company law were also closely followed by the Indian Courts. Till 1956, the business companies in India were regulated by this Act of 1913. Certain amendments were, however, made in the years 1914, 1915, 1920, 1926, 1930 and 1932. The Act was extensively amended in 1936 on the lines of the English Companies Act, 1929. Minor amendments were made a number of times.

At the end of 1950, the Government of independent India appointed a Committee under the Chairmanship of Shri H.C. Bhaba to go into the entire question of the revision of the Indian Companies Act, with particular reference to its bearing on the development of Indian trade and industry. This Committee examined a large number of witnesses in different parts of the country and submitted its report in March 1952. Based largely on the recommendations of the Company Law Committee,

a Bill to enact the present legislation namely the Companies Act, 1956 was introduced in Parliament. This Act, once again largely followed the English Companies Act, 1948. The major changes that the Indian Companies Act, 1956 introduced over and above the Act of 1913 related to : (*a*) the promotion and formation of companies; (*b*) capital structure of companies; (*c*) company meetings and procedures; (*d*) the presentation of company accounts, their audit, and the powers and duties of auditors; (*e*) the inspection and investigation of the affairs of the company; (*f*) the constitution of Board of Directors and the powers and duties of Directors, Managing Directors and Managers, and (*g*) the administration of Company Law.

The Companies Act, 1956 has been amended several times since then. The major amendments were introduced in the years 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1974, 1977, 1985, 1988, 1991, 2001, 2002, 2006, 2013, 2015 and 2017.

In the wake of economic reforms process initiated from July, 1991 onwards, the Government recognized that many provisions of the Companies Act had become anachronistic and were not conducive to the growth of the Indian corporate sector in the changing environment. Consequently, an attempt was made to recast the Act, which was reflected in the Companies Bill, 1993. The said Bill, however, was subsequently withdrawn. As part of continuing reforms process and in the wake of enactment of the Depositories Act, 1996, certain amendments were, however, incorporated by the Companies (Amendment) Act, 1996.

In the year 1996, a Working Group was constituted to rewrite the Companies Act, following an announcement made by the then Union Minister for Finance in his Budget Speech to this effect. The main objective of the Group was to re-write the Act to facilitate healthy growth of Indian corporate sector under a liberalized, fast changing and highly competitive business environment. Based on the report prepared by the Working Group and taking into account the developments that had taken place in corporate structure, administration and the regulatory framework the world over, the Companies Bill, 1997 was introduced in Rajya Sabha on August 14, 1997 to replace by repealing Companies Act, 1956. In the meantime, as part of reforms process and in view of the urgency felt by the Government, the President of India promulgated the Companies (Amendment) Ordinance, 1998 on October 31, 1998, which was later replaced by the Companies (Amendment) Act, 1999 to surge the capital market by boosting morale of national business houses besides encouraging FIIs as well as FDI in the country. The amendments brought about number of important changes in the Companies Act. These were in consonance with the then prevailing economic environment and to further Government policy of deregulation and globalisation of economy. The corporate sector was given the facility to buy-back company's own shares, provisions relating to investments and loans were rationalized and liberalized besides the requirement of prior approval of the Central Government on investment decisions was dispensed with, and companies were allowed to issue "sweat equity" in lieu of intellectual property. In order to make accounts of Indian companies compatible with international practices, the compliance of Indian Accounting Standards was made mandatory and the provisions for setting up of National Committee on Accounting Standards was incorporated in the Act. For the benefit of investors, provisions were made for setting up of "Investor Education and Protection Fund" besides introduction of facility of nomination to shareholders, debenture holders, etc.

The year 2000, witnessed another bouquet of amendments in the form of Companies (Amendment) Act, 2000 in order to provide certain measures of good corporate governance and for ensuring meaningful shareholders' democracy in the working of companies.

Companies (Amendment) Act, 2001 amended provisions of section 77A relating to buy-back of shares allowing Board of Directors (instead of through special resolution) to buy-back shares up to 10% of the paid-up capital and free reserves provided not more than one such buy-back is made during a period of 365 days.

Companies (Amendment) Acts, 2002: Two Companies (Amendment) Acts were passed in December 2002, namely, Companies (Amendment) Act, 2002 and Companies (Second Amendment) Act, 2002. The Companies (Amendment) Act, 2002 provided for setting-up and regulation of cooperatives as body corporate under the Companies Act, 1956 to be called 'Producer Companies'. The objective of the Companies (Second Amendment) Act, 2002 was to expedite the winding-up process of the companies, facilitate rehabilitation of sick companies and protection of workers interest. The Second Amendment Act proposed to rationalise the procedure relating to winding up so that resources could be utilised for better purposes rather than blocking them in sick undertakings and thus, help in reducing the hardships to workers and other interested parties. The Second Amendment Act provided for repeal of SICA and dissolution of BIFR. At the same time, it sought to establish a National Company Law Tribunal providing it with powers for expediting the winding up procedure.

Companies (Amendment) Act, 2006 brought into force w.e.f. 1-11-2006, introduced provisions with respect to : (A) Directors Identification Number (DIN); and (B) Electronic filing of various returns and forms.

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, *inter alia*, introduced ideas like 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 per cent 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.

Companies (Amendment) Act, 2015: Companies (Amendment) Act, 2015 which received the Presidential assent on 25th May, 2015 and became operative w.e.f. 29th May, 2015 is designed to address some issues raised by stakeholders such as Chartered Accountants and other professionals. Highlights of the amendments include:

1. Omitting requirement for minimum paid up share capital, and consequential changes. (For ease of doing business)
2. Making common seal optional and consequential changes for authorization for execution of documents. (For ease of doing business)

3. Prescribing specific punishment for deposits accepted under the new Act. This was left out in the Act inadvertently. (To remove an omission)
4. Prohibiting public inspection of Board resolutions filed in the Registry. (To meet corporate demand)
5. Including provision for writing off past losses/depreciation before declaring dividend for the year. This was missed in the Act but included in the Rules.
6. Rectifying the requirement of transferring equity shares for which unclaimed/unpaid dividend has been transferred to the IEPF even though subsequent dividend(s) has been claimed. (To meet corporate demand)
7. Enabling provisions to prescribe thresholds beyond which fraud shall be reported to the Central Government (below the threshold, it will be reported to the Audit Committee). Disclosures for the latter category also to be made in the Board's Report. (Demand of auditors)
8. Exemption u/s 185 (Loans to Directors) provided for loans to wholly owned subsidiaries and guarantees/securities on loans taken from banks by subsidiaries. (This was provided under the Rules but being included in the Act as a matter of abundant caution).
9. Empowering Audit Committee to give omnibus approvals for related party transactions on annual basis. (Align with SEBI policy and increase ease of doing business)
10. Replacing 'special resolution' with 'ordinary resolution' for approval of related party transactions by non-related shareholders. (To meet problems faced by large stakeholders who are related parties)
11. Exempt related party transactions between holding companies and wholly owned subsidiaries from the requirement of approval of non-related shareholders. (Corporate demand)
12. Bail restrictions to apply only for offence relating to fraud u/s 447. (Though earlier provision is mitigated, concession is made to Law Ministry & ED)
13. Winding up cases to be heard by 2-member Bench instead of a 3-member Bench. (Removal of an inadvertent error)
14. Special Courts to try only offences carrying imprisonment of two years or more. (To let magistrate try minor violations).

1.2 The Companies (Amendment) Act, 2017 - Salient Features

The Companies (Amendment) Act, 2017 has introduced several amendments to the Companies Act, 2013, realigning provisions to improve corporate governance and ease of doing business in India while continuing to strengthen compliance and investor protection.

Though the 2013 Act was a step in the right direction as it introduced significant changes in areas of disclosures, investor protection, corporate governance, etc., there were multiple instances of conflicts and overreach within the legislation leading to difficulties in its implementation. Accordingly, the Companies Law Committee (**CLC**) was constituted in June 2015 with the mandate of making

recommendations to resolve issues arising from the implementation of the 2013 Act. Based on the recommendations of the report of the CLC, the Government introduced the Companies (Amendment) Bill, 2016 (**Bill**) in the Lok Sabha on 16 March 2016 which was passed by the Lok Sabha on 27 July 2017 and by the Rajya Sabha on 19 December 2017. The Companies (Amendment) Act, 2017 (**Amendment Act**) received the assent of the President on 3 January 2018, but different provisions of the Amendment Act will be brought into force on different dates by the Central Government. Proposing a slew of changes, the Amendment Act seeks to realign many provisions to ease corporate governance and doing business in India while continuing to strengthen compliance and investor protection.

Following is the summary of the important changes made through the Companies (Amendment) Act, 2017:

1. Associate Company

An associate company, in relation to another company, was defined under the 2013 Act as a company in which that other company has a 'significant influence' and included a joint venture company.

'Significant influence' was defined as control of at least 20% of the total share capital or business decisions under an agreement.

*The Amendment Act widens the definition of 'significant influence' by, (*a*) referencing, control of 20% of the total voting power as opposed to the total share capital; and (*b*) including participation in (and not only control of) business decisions.*

The Amendment Act defines the term 'joint venture' as a joint arrangement whereby parties that have joint control of the arrangement have rights to the net assets of the arrangement.

2. Holding Company

The Amendment Act has introduced an explanation to the definition of holding company to clarify that a holding company includes any body corporate. Accordingly, a company incorporated outside India may well be termed as a holding company of its Indian subsidiaries.

3. Subsidiary

One of the tests of a subsidiary company under the 2013 Act was the control of more than one-half of its total share capital by the holding company.

The Amendment Act has changed the criteria to control of 'voting power' instead of control of 'share capital'.

4. Reduction in Minimum Membership

Section 3A has been inserted by the Amendment Act, 2017 which provides for personal liability of members in certain cases. It provides that:

If at any time the number of members of a company is reduced, in the case of a public company, below seven, in the case of a private company, below two, and the company carries on business for more than six months while the number of members is so reduced, every person who is a member of the company during the time that it so carries on business after those six months and is cognisant of the fact that it is carrying on business with less than seven members or two members, as the

case may be, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefor.

5. Issue of shares at a Discount

Issue of shares at a discount to face value was prohibited under the 2013 Act.

The Amendment Act permits companies to issue shares at a discount to its creditors under a statutory resolution plan or debt restructuring scheme in accordance with any guidelines, directions or regulations specified by the Reserve Bank of India.

6. Issue of Sweat Equity Shares

Under the 2013 Act, sweat equity shares could not be issued within 1 year of commencement of business of the company.

The Amendment Act seeks to remove this restriction

7. Private Placement Process

The Amendment Act has substantially revised the provisions on issuance of shares through a private placement process:

i. *The Amendment Act expressly states that a private placement offer cannot be renounced in favour of a third party.*

ii. *The 2013 Act provided that funds raised through private placement could not be utilised until the shares were allotted.*

The Amendment Act provides an additional restriction prescribing non-utilisation of funds until the requisite filing has been made with the RoC. The timeline for the filing has also been reduced to 15 days (from 30 days under the 2013 Act).

iii. *The 2013 Act restricted a company from making a fresh private placement offer while a previous offer was pending.*

The Amendment Act seeks to provide flexibility to raise funds by permitting companies to make more than one issue of securities to such class of identified persons as may be prescribed, subject to a maximum of 50 identified persons or as may be prescribed.

8. Contents of a prospectus

Section 26 of the 2013 Act listed matters that needed to be stated in the prospectus while making a public offer, resulting in an overlap between the 2013 Act and the requisite Securities and Exchange Board of India (SEBI) regulations.

The Amendment Act has omitted the provisions that require specific matters to be stated in the prospectus and provides that the company should provide such information as required by the SEBI in consultation with the Central Government.

9. Liability for Misstatement in the Prospectus

While section 34 of the 2013 Act prescribed civil liability for directors, promoters and experts for issuing misleading statements in a prospectus, it did not allow directors who relied on the statements made by experts in a prospectus to use such reliance as a defence.

The Amendment Act incorporates a defence against the liability of a director for misleading statements in the prospectus made by an expert, provided the director

can prove that he had reasonable ground to believe that the expert making the statement was competent to make it, that such expert had given consent to issue the prospectus and had not withdrawn such consent before registration of the prospectus.

10. Key Managerial Personnel - Definition

The term 'key managerial personnel' (KMP) was defined under section 2(*51*) of the 2013 Act to mean the chief executive officer, managing director, manager, company secretary, whole time director and chief financial officer.

The Amendment Act expands the definition of KMP by giving the Board of directors the power to designate such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board and such other officer as may be prescribed.

11. Resident Director

Section 149(3) of the 2013 Act required every company to have at least one resident director, *i.e.*, a director who has stayed in India for a total period of not less than 182 days during the previous calendar year.

The Amendment Act has modified the residency requirement, by making it applicable to the current financial year instead of the previous calendar year.

12. Independent Director

Under the 2013 Act, a person appointed as an independent director and his relatives were not permitted to have any pecuniary relationship or transaction with the company in which such a person was appointed as an independent director.

The Amendment of section 149 of the Act permits an independent director to have limited pecuniary relationships with the company without compromising his independence, such as receiving remuneration as an independent director and having transactions with the company not exceeding 10% of his total income.

13. Number of Directorships

Under section 165 of the 2013 Act, a person was not allowed to hold office as a director, including alternate directorship, in more than 20 companies.

The Amendment Act excludes directorship in dormant companies in determining the limit of 20 companies, so that directorships in dormant companies is not discouraged.

14. Disqualifications for Appointment of a Director

Under section 164 of the 2013 Act, a director could not be reappointed as a director in a company which had failed to file financial statements and annual returns for a continuous period of three years or had not repaid deposits or interest or redeemed debentures on the due date, etc. for a year or more.

The Amendment Act provides that a newly appointed director of a company in default should not incur such disqualification for a period of six months from his appointment, which gives him an opportunity to rectify the defect and avoid this disqualification within such period.

Further, if the existing director of such a company in default incurs disqualification, the office of such director would become vacant in all other companies, except the

company which is in default, to ensure that the defaulting company has the requisite number of directors to remedy the default.

15. Register of significant beneficial owners in a company

The substituted section 90 provides that every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than twenty-five per cent or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (*27*) of section 2, over the company (herein referred to as "significant beneficial owner"), shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed.

16. Abridged form of annual return

Section 92 has been amended to provide that the Central Government may prescribe abridged form of annual return for "One Person Company", small company and such other class or classes of companies as may be prescribed.

17. Annual general meeting of an unlisted company

Amended section 96 allows annual general meeting of an unlisted company to be held at any place in India if consent is given in writing or by electronic mode by all the members in advance.

18. Business required to be transacted by means of postal ballot

Section 110 has been amended to provide that any item of business required to be transacted by means of postal ballot may be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108.

19. Consolidated Financial Statements

Section 129(3) 'as amended' provides that where a company has one or more subsidiaries or associate companies, it shall, in addition to financial statements provided under sub-section (2), prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with applicable accounting standards, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement under sub-section (2).

20. Overall Maximum Managerial Remuneration

A company can now pay remuneration to its managerial personnel exceeding 11% of the net profits by passing a resolution in general meeting. Approval of the Central Government, as contemplated under the Act of 2013 shall not be required.

Test your knowledge

1. Discuss briefly the history of company law in India. Do you agree that the company legislation in India has closely followed the English Company Law ?

2 Meaning and Nature of a Company

2.1 What is a company ?

The word 'company' has no strictly technical or legal meaning (*Stanley, Re* [1906] 1 Ch. 131). It may be described to imply an association of persons for some common object or objects. The purposes for which people may associate themselves are multifarious and include economic as well as non-economic objectives. But, in common parlance, the word 'company' is normally reserved for those associated for economic purposes, *i.e.*, to carry on a business for gain.

Used in the aforesaid sense, the word 'company', in simple terms, may be described to mean a voluntary association of persons who have come together for carrying on some business and sharing the profits therefrom.

Indian Law provides two main types of organisations for such associations : 'partnership' and 'company'. Although the word 'company' is colloquially applied to both, the Statute regards companies and company law as distinct from partnerships and partnership law. Partnership Law in India is codified in the Partnership Act, 1932 and Limited Liability Partnership Act, 2008. Both these legislations are based on the law of agency, each partner becoming an agent of the other(s), and it, therefore, affords a suitable framework for an association of a small body of persons having trust and confidence in each other. A more complicated form of association, with a large and fluctuating membership, requires a more elaborate organisation which ideally should confer corporate personality on the association, that is, should recognise that it constitutes a distinct legal person, subject to legal duties and entitled to legal rights separate from those of its members. This can be obtained easily and cheaply by registering an association as a company under the Companies Act, 2013.

It should be noted that the Companies Act, 2013 even allows a company to be formed and registered for the promotion of commerce, art, science, sports, religion or charity, *i.e.*, for non-economic purposes.

In this book, we shall limit our scope of study only to companies registered under the Companies Act, 2013 or under any of the earlier Companies Acts.

2.2 Definition of a company

The Companies Act, 2013 does not define a company in terms of its features. 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 does not clearly point out the meaning of a company. In order to understand the meaning of a company, let us see the definitions as given by some authorities. Some of these definitions are :—

Lord Justice Lindley - "A company is an association of many persons who contribute money or monies worth to a common stock and employed in some trade or business and who share the profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute to it or to whom it pertains are members. The proportion of capital to which each member is entitled is his share. The shares are always transferable although the right to transfer is often more or less restricted."

Chief Justice Marshall - "a corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the Charter of its creation confers upon it, either expressly or as incidental to its very existence."

Prof. Haney - "a company is an artificial person created by law, having separate entity, with a perpetual succession and common seal."

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

In *G.V. Pratap Reddy Through G.P.A. TSR Research (P.) Ltd.* v. *K.V.V.S.N. Associates* [2016] 70 taxmann.com 34 (SC), the Supreme Court of India held that where notice inviting tender (NIT) by State of Telangana required that bidder must be an individual/company, word company in NIT could only mean a company as understood under Companies Act and cannot be read to include a firm and, therefore, bid of respondent which was neither an individual nor a company but a firm was rightly rejected by State.

2.3 Characteristic features of a company

The most important characteristic features of a company are 'separate legal entity' of the company and in most cases 'limited liability' of its members. These and other characteristic features of a company are discussed below:—

2.3-1 Incorporated association

A company must be incorporated or registered under the Companies Act. Minimum number of members required for this purpose is seven in the case of a 'public company' and two in the case of a 'private company' (Section 3). However, section 3 of the Companies Act, 2013 allows formation of 'One Person Company' also.

2.3-2 Legal entity distinct from its members

Unlike partnership*, the company is distinct from the persons who constitute it. Hence, it is capable of enjoying rights and of being subjected to duties which are not the same as those enjoyed or borne by its members. As Lord Macnaughten puts it, "the company is at law a different person altogether from the subscribers.....; and though it may be that after incorporation the business is precisely the same as it was before and the same persons are managers and the same hands receive the proceeds, the company is not in law, the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by the Act." [Solomon's case]

The first case on the subject (even before the famous *Solomon's* case) was that of *Kondoli Tea Co. Ltd., Re* ILR [1886]. In this case certain persons transferred a tea estate to a company and claimed exemption from *ad valorem* duty on the ground that they themselves were the shareholders in the company and, therefore, it was nothing but a transfer from them in one to themselves under another name.

Rejecting this, the Calcutta High Court observed - "The company was a separate person, a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons."

If the total shareholding of a company is purchased by one person, or a group of persons acting in concert, the legal consequence is not that the company ceases to exist or undergoes a cataclysmic metamorphosis leading to its complete disappearance - *Memtec Ltd.* v. *Lunarmech* [2001] 30 SCL 55 (Delhi).

Again, by changing members of Board of directors or by changing shareholding pattern, a company does not become different legal entity - *Amit Products (India) Ltd.* v. *Chief Engineer, (O and M) Circle* [2005] 127 Comp. Cas. 443 (SC).

Limited company is a separate legal entity distinct from its shareholder. Merely because there is only one shareholder, the entities which are otherwise distinct, one is a natural person and the other is an artificial juristic person, it cannot be contended that the said entities merge and one can act for and on behalf of other - *Floating Services Ltd.* v. *MV San Fransceco Dipalola* [2004] 52 SCL 762 (Guj.).

Unlike a partnership firm, a company is a different entity and need of company in which landlord is a director cannot be said to be need of landlord for his 'own' occupation and therefore, landlord cannot file a petition under section 11(3) of the Kerala Buildings (Lease and Rent Control) Act, 1965 for the occupation of building owned personally by him for functioning of company merely because he is a director of company - *K.M. Basheer* v. *Lona Chackola* [2003] 115 Comp. Cas. 127 (Ker.); [2004] 50 SCL 19 (Ker.).

A shareholder is an investor and he will be entitled to participate in the profits of the company in which he holds shares as and when the company declares, subject to articles of association that the profits or portion thereof should be distributed by way of dividends among the shareholders, and that apart, the shareholder has got a further right to participate in the assets of the company, which would be left over

*Partnership as per the Partnership Act, 1932 and not LLP under the Limited Liability Partnership Act, 2008.

after winding up, but not in the assets as a whole - *K.S. Mothilal* v. *K.S. Kasimaris Ceramique (P.) Ltd.* [2003] 113 Comp. Cas. 562 (Mad.).

A shareholder has a limited restricted right only after an order of winding up is made, liabilities of the company discharged and then if any surplus of assets is left. Where the company is struck off from the register and dissolved as a consequence, there is no question of any particular shareholder, even the sole shareholder, making a claim to the property of the company without showing that all liabilities of the company stood discharged - *Floating Services Ltd.* v. *MV San Fransceco Dipalola* [2004] 52 SCL 762 (Guj.).

The separate legal personality of the company is the bedrock of the Company Law and piercing the 'veil' of the company is permissible only in exceptional circumstances—*S.A.E. (India) Ltd.* v. *E.I.D. Parry (India) Ltd.* [1998] 18 SCL 481 (Mad.).

Thus, a company can own property and deal with it the way it pleases. 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 - *B.F. Guzdar* v. *CIT* [1955] 25 Comp. Cas. 1 (SC).

A company's right to sue arises when some loss is caused to the company, *i.e.*, to the property of the personality of the company, as distinct from a loss occasioned to the directors of the company. The rights of the company and the rights of its shareholders are not co-extensive. Incorporation brings into existence a legal person which develops into its own separate existence as a business or enterprise. A company, as a person separates from its members, may even sue one of its own members for libel. The publication of any statement which disparages the business of the company, defames the company at the same time. Hence, the company is entitled to sue in damages for libel or slander as the case may be - *Floating Services Ltd.* v. *M.V. San Fransceco Dipalola* [2004] 52 SCL 762 (Guj.). But, if on date of filing suit the company's name has been struck from Register of Companies and as a consequence dissolved, then it cannot initiate any legal proceedings so as to be valid in law - *Floating Services Ltd.* v. *M.V. San Fransceco Dipalola* [2004] 52 SCL 762 (Guj.).

In *Rajendra Nath Dutta* v. *Shibendra Nath Mukherjee* [1982] 52 Comp. Cas. 293 (Cal.) it was held that for any wrong done, the company must sue or be sued in its own name. It was observed that as the company is a distinct legal personality, distinct from its shareholders and/or directors, the company, if aggrieved by some wrong done to it, must sue or contrarily be sued in the name of the company. In this case, a lease deed was executed by the director of the company without the seal of the company. Later, a suit was filed by the directors and not the company to avoid lease on the ground that a new term had been fraudulently and surreptitiously included in the lease deed by the defendants. It was held that a director of the Board of directors or a managing director could not file a suit, unless it was by the company, in order to avoid any deed which admittedly was executed by one of the directors and admittedly also the company received the rent. The case as made out in the plaint was not made by the company but some of the directors of the company and the company was not even a plaintiff. If the company was aggrieved, it was the company which was to file the suit and not the directors. Therefore, the suit was held to be not maintainable.

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 *Solomon* v. *Solomon & Co. Ltd.* [1895-99] All. ER 33 (HL), Solomon was a prosperous leather merchant. He converted his business into a Limited Company—Solomon & Co. Ltd. The company so formed consisted of Solomon, his wife and five of his children as members. The company purchased the business of Solomon for £39,000, the purchase consideration was paid in terms of £10,000 debentures conferring a charge over the company's assets, £20,000 in fully paid £1 share each and the balance in cash. The company in less than one year ran into difficulties and liquidation proceedings commenced. The assets of the company were not even sufficient to discharge the debentures (held entirely by Solomon himself). And nothing was left for the unsecured creditors. The House of Lords unanimously held that the company had been validly constituted, since the Act only required seven members holding at least one share each. It said nothing about their being independent, or that there should be anything like a balance of power in the constitution of the company. Hence, the business belonged to the company and not to Solomon. Solomon was its agent. The company was not the agent of Solomon.

Likewise, in the case of *Lee* v. *Lee's Air Farming Ltd.* [1960] 3 All. ER 420 (PC), 'L' formed a company with a share capital of three thousand pounds, of which 2999 pounds were held by 'L'. He was also the sole governing director. In his capacity as the controlling shareholder, 'L' exercised full and unrestricted control over the affairs of the company. 'L' was a qualified pilot also and was appointed as the chief pilot of the company under the articles and drew a salary for the same. While piloting the company's plane he was killed in an accident. As the workers of the company were insured, workers were entitled for compensation on death or injury. The question was while holding the position of sole governing director, could 'L' also be an employee/worker of the company. *Held that* the mere fact that someone was the director of the company was no impediment to his entering into a contract to serve the company. If the company was a legal entity, there was no reason to change the validity of any contractual obligations which were created between the company and the deceased. The contract could not be avoided merely because 'L' was the agent of the company in its negotiations. Accordingly, 'L' was an employee of the company and, therefore, entitled to compensation claim.

So much so that even if a shareholder acquires all shares of a company, business of the company does not become his business unless the company is treated as his agent - *Gramophone & Typewriters Ltd.* v. *Stanley* [1908-10] All. ER 833 (CA).

The High Court of Delhi in *Memtac Ltd.* v. *Lunarmech* [2001] 30 SCL 55 has held that the corporate legal entity does not mutate or transfer itself or undergo a transfer with each change in its shareholders. Even if the total shareholding of a company is purchased by one person, or a group of persons in concert, the legal consequence is not that the company ceases to exist or undergoes a cataclysmic metamorphosis leading to its complete disappearance. The Court also said that, though this case was not an amalgamation, yet even in case of amalgamation, pending suits are not closed.

It is interesting to note that a company even enjoys fundamental rights similar to the natural persons. Consequently, if a fundamental right of a company is infringed, it is the company and not shareholders which can challenge infringement -

Chiranjilal Chaudhari v. *Union of India* [1951] 21 Comp. Cas. 33 (SC). In this case, the Supreme Court held that a company has a fundamental right to own property and in the event of any infringement of such a right it is the company itself which can bring an action and not the shareholders. It was observed that it is settled law that in order to redress a wrong done to the company, the action should *prima facie* be brought by the company itself. Although a shareholder may, in a sense, be interested to see that the company of which he is a shareholder is not deprived of its property, he cannot be heard as complainant in his own name and on his own behalf for the infringement of the fundamental right to property of the company, for, in law, his own right to property has not been infringed as he is not the owner of the company's property.

Even where a decree has been issued by the Court in respect of sums due against a company, the same cannot be enforced against its managing director. In *H.S. Sidana* v. *Rajesh Enterprises* [1993] 77 Comp. Cas. 251 (P & H), it was held that the liability to discharge the decretal amount was that of the company and not of its managing director. The executing court could proceed against the managing director only if it came to the conclusion that the managing director was personally liable to discharge the decretal amount.

Again, in *Bacha F. Guzdar* v. *The Commissioner of Income-tax, Bombay (supra),* Mrs. Guzdar received certain amounts as dividend in respect of shares held by her in a tea company. Under the Income-tax Act, agricultural income is exempt from payment of income-tax. As income of a tea company is partly agricultural, only 40% of the company's income is treated as income from manufacture and sale and, therefore, liable to tax. Mrs. Guzdar claimed that the dividend income in her hands should be treated as agricultural income up to 60%, as in the case of a tea company, on the ground that the dividends received by shareholders represented the income of the company.

The Supreme Court held that though the income in the hands of the company was partly agricultural yet the same income when received by Mrs. Guzdar as dividend could not be regarded as agricultural income.

In *Chamundeeswari* v. *CTO, Vellore Rural* [2007] 78 SCL 151 (Mad.), it was held that a company being a legal entity by itself, any dues from company have to be recovered only from company and not from its directors.

2.3-3 Artificial person

The company, though a juristic person, does not possess the body of a natural being. It exists only in contemplation of law. Being an artificial person, it has to depend upon natural persons, namely, the directors, officers, shareholders, etc., for getting its various works done. However, these individuals only represent the company and accordingly whatever they do within the scope of the authority conferred upon them and in the name and on behalf of the company, they bind the company and not themselves.

2.3-4 Limited liability

One of the principal advantages of trading through the medium of a limited company is that the members of the company are only liable to contribute towards payment of its debts to a limited extent. *If the company is limited by shares,* the

shareholder's liability to contribute is measured by the nominal value of the shares he holds, so that once he or someone who held the shares previously has paid that nominal value *plus* any premium agreed on when the shares were issued, he is no longer liable to contribute anything further. However, companies may be formed with unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of their shares and the premium, if any, unpaid thereon. In the case of unlimited liability companies, members shall continue to be liable till each paisa has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, *i.e.*, he shall be liable to contribute up to the amount guaranteed by him. If the guarantee company also has share capital, the liability of each member shall be determined in terms of not only the amount guaranteed but also the amount remaining unpaid on the shares held by a member.

If a company is unable to pay its debts, its creditors may petition the Court to wind it up. If a winding-up order is made, a liquidator is appointed to administer its affairs, and if he realises insufficient amount to pay its debts by selling its assets, he calls upon its shareholders to make good the deficiency, but, of course, their liability to do so is limited to the balance of capital unpaid on their shares *plus* unpaid premiums. It may be that some of the shareholders as at the date the winding-up commences are themselves insolvent and unable to contribute the balance of unpaid capital in respect of their shares. In that case, the liquidator can recover the unpaid capital from any person who held the shares in question within a year before the winding-up began.

2.3-4a UNLIMITED LIABILITY OF A MEMBER OF A LIMITED LIABILITY COMPANY - Section 3A, inserted by the Companies (Amendment) Act, 2017, provides that if at any time the number of members of a company is reduced, in the case of a public company, below seven, in the case of a private company, below two, and the company carries on business for more than six months while the number of members is so reduced, every person who is a member of the company during the time that it so carries on business after those six months and is aware of the fact that it is carrying on business with less than seven members or two members, as the case may be, shall be severally liable for the payment of the whole debt.

2.3-4b CAN A LIMITED LIABILITY COMPANY BECOME A PARTNER OF A PARTNERSHIP FIRM ? - A company being a juristic person is capable of contracting in its own name. Since partnership, as per section 4 of the Partnership Act, 1932, is a contractual relationship between persons, there should be no objection to a partnership being created with or by a company. The only doubt that may arise in the minds of the readers is that the liability of a partner being unlimited, can a limited liability company become a partner ? To this the simple reply shall be that it is the liability of the members of a limited company which is limited and not that of the company itself. Thus, there should be no objection to a limited liability company becoming a partner of a partnership firm. However, the Department of Company Affairs[1], in this regard has opined that the objects clause must contain a facilitating provision in this regard. Thus, in the opinion of the Department of Company Affairs[1], a

1. Now Ministry of Corporate Affairs.

company may become a partner only if the Memorandum of Association thereof specifically allows it.

2.3-5 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. *CIT* [1955] AIR 740. The Supreme Court held that a shareholder is not the part owner of the company or its property, he is only given certain rights by law, for example, to vote or attend meetings, or to receive dividends.

In *Macaura* v. *Northern Assurance Company Ltd.* [1925] AC 619, 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 had also advanced substantial amount to the company. He insured the company's timber in his own name. On timber being destroyed by fire, his claim was rejected for want of insurable interest. The court observed : "No shareholder has any right to any item of property owned by the company for he has no legal or equitable interest therein". ". . . the property of the company is not the property of the shareholders; it is the property of the company" - *Gramophone & Typewriter Ltd.* v. *Stanley* (*supra*).

2.3-6 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 Act in section 44 echoes this feature by declaring "the shares, debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company". 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.

The Companies Act, 2013 even upholds shareholders' agreements providing for 'Right of first offer' and 'Right of first refusal' as valid even in case of a public company. What it means is that Articles of a company, whether private or public, may contain a clause that in case a member wishes to sell his shares, he will have to first offer the same to existing members. Only if they refuse to buy within the stipulated period, they can be sold to outsiders. Such a clause under the Act of 1956 could be contained only in the Articles of a private company. The facility under the Act of 2013 stands extended to public companies also.

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.

2.3-7 Perpetual succession

Company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. Being distinct from the members, the death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go for ever. 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 [*K/9 Meat Suppliers (Guildford) Ltd., Re* [1966] 1 W.L.R. 1112]. "King is dead, long live the King" very aptly applies to the company form of organisation. [Here, the first 'King' is used to refer to the individual monarch and the second 'King' refers to the office of king, *i.e.*, the institution of monarchy.] In the above circumstance, the legal heirs of the deceased shareholders will become the members.

2.3-8 Common seal*

A company being an artificial person is not bestowed with a body of a natural being. Therefore, it does not have a mind or limbs of human being. It has to work through the agency of human beings, namely, the directors and other officers and employees of the company.

In *SICAL - CWT Distriparks Ltd.* v. *Besser Concrete Systems Ltd.* [2003] 46 SCL 196 (Mad.), it was held that it is not necessary that agreement executed on behalf of company should bear seal of Company but question whether agreement is valid or not would depend upon facts of each case.

MEANING OF 'COMMON SEAL'

The common seal is a seal used by a corporation as the symbol of its incorporation - *Wharton's Law Lexicon,* 14th edition, p. 223 [cited in *Venkataramaiya's Law Lexicon].*

As per section 22, as amended by the Companies (Amendment) Act, 2015, a company may, under its common seal, if any, 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.

In case a company does not have a common seal, the authorisation under this subsection 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 otherwise expressly provided in this Act, a document or proceeding requiring authentication by a company may be signed by any key managerial personnel or an officer or employee** of the company duly authorized by the Board in this behalf, and need not be under its common seal [Section 21].

SAFE CUSTODY OF THE SEAL

As per Regulation 79(1) of Table F, the Board shall provide for the safe custody of the seal.

MANNER OF AFFIXING THE SEAL

Companies which have adopted Table F

Regulation 79(2) of Table F provides that 'the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or of a committee of the Board authorised by it in that behalf, and except in the presence of at least two directors and of the secretary or such other person as the Board may

*Use of common seal has been made optional under the Companies (Amendment) Act, 2015 [Effective from 29.5.2015]. Thus, a company may not have a common seal.

** *Vide* Companies (Amendment) Act, 2017.

appoint for the purpose; and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence'.

Companies which have not adopted Table F but made provision in the articles

The articles will provide the manner in which the seal is to be affixed.

Where the articles require the seal on a particular document, everyone dealing with the company is bound to take notice of it.

2.4 Lifting the corporate veil

The chief advantage of incorporation from which all others follow is, of course, the separate legal entity of the company. In reality, however, the business of the artificial person is always carried on by, and for the benefit of, some individuals. In the ultimate analysis, some human beings are the real beneficiaries of the corporate advantages, "for while, by fiction of law, a corporation is a distinct entity yet in reality, it is an association of persons who are in fact the beneficiaries of the corporate property" - *Gallaghar* v. *Germania Brewing Company* [1893] 53 MINN. 214. It may, therefore, happen that the corporate personality of the company is used to commit frauds or improper or illegal acts. Since an artificial person is not capable of doing anything illegal or fraudulent, the facade of corporate personality might have to be removed to identify the persons who are really guilty. This is known as 'lifting the corporate veil'. Although, in general, the courts do not interfere and essentially go by the principle of separate entity as laid down in the *Solomon's* case and endorsed in many others, it may be in the interest of the members in general or in public interest to identify and punish the persons who misuse the medium of corporate personality.

In *Cotton Corporation of India Ltd.* v. *G.C. Odusumathd* [1999] 22 SCL 228 (Kar.), the Karnataka High Court has held that the 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 needed to be prevented or trading with enemy company is sought to be defeated.

As to when the corporate veil shall be lifted, the observations of the Supreme Court in *Life Insurance Corporation of India* v. *Escorts Ltd.* [1986] 59 Comp. Cas. 548 is worth noting. "While it is firmly established ever since in *Solomon* v. *Solomon & Co. Ltd.* [1897] AC 22 that a company is an independent and legal personality distinct from the individuals who are its members, it has since been held that the corporate veil may be lifted, the corporate personality may be ignored and the individual members recognised for who they are in certain exceptional circumstances. Generally, and broadly speaking the corporate veil may be lifted where the statute itself contemplates lifting the veil or fraud or improper conduct is intended to be prevented, or a taxing statute or a beneficent statute is sought to be evaded or where associated companies are inextricably connected as to be, in reality, part of one concern.

It is neither necessary nor desirable to enumerate the classes of cases where lifting the veil is permissible, since that must necessarily depend on the relevant statutory

or other provisions, the object sought to be achieved, the impugned conduct, the involvement of the element of public interest, the effect on parties who may be affected, etc."

Again, in *State of U.P.* v. *Renusagar Power Co.* [1991] 70 Comp. Cas. 127, the Supreme Court observed:

The concept of lifting the corporate veil is a changing concept. The veil of corporate personality, even though not lifted sometimes, is becoming more and more transparent in modern jurisprudence. It is high time to reiterate that, in the expanding horizon of modern jurisprudence, lifting of the corporate veil is permissible, its frontiers are unlimited. But it must depend primarily on the realities of the situation.

Delhi High Court in *Prem Lata Bhatia* v. *UOI* [2006] 71 SCL 142 has in a case involving renting of government controlled premise to an individual held that use of that premise by an individual using corporate form with her spouse as the only co-shareholder did not amount to violation of renting terms on piercing the corporate veil [Also *see, Saurav Exports* v. *Blaze Finlease and Credits (P.) Ltd.* [2006] 72 SCL 321 (Delhi), it is a case of private company formed and assisted by family members taking deposits from others and not repaying the same].

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

(A) Under statutory provisions.

(B) Under judicial interpretations.

A. *UNDER STATUTORY PROVISIONS* - The veil of corporate personality may be lifted in certain cases or pierced as per express provisions of the Act. In other words, the advantage of 'distinct entity' and 'limited liability' may not be allowed to be enjoyed in certain circumstances. Such cases are :

The Companies Act, 2013 itself provides for certain cases 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 cases are as follows:

2.4-1a 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.

2.4-1b FAILURE TO RETURN APPLICATION MONEY [SEC. 39] - In case of issue of shares 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.

2.4-1c MISDESCRIPTION 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) New Delhi LR 637]. 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.

2.4-1d PUNISHMENT FOR CONTRAVENTION OF SECTION 73 OR SECTION 76 [SECTION 76A][2]- Where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest due thereon within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under section 73,besides the company that shall be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees; every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both. Moreover, if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall also be liable for action under section 447.

2.4-1e 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 section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, to investigate also the affairs of—

(*a*) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

2. Section 76A has been inserted vide the Companies (Amendment) Act, 2015.

(*b*) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;

(*c*) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or

(*d*) any person who is or has at any relevant time been the company's managing director or manager or employee,

he shall, subject to the prior approval of the Central Government, investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

2.4-1f FOR INVESTIGATION OF OWNERSHIP OF COMPANY [SEC. 216] - Under section 216, the Central Government may appoint one or more inspectors to investigate and report on the membership of any company for the purpose of determining the true persons who are financially interested in the company and who control its policy or materially influence it.

2.4-1g FRAUDULENT CONDUCT [SEC. 339] - Where in the case of winding-up of a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, those who are knowingly parties to such conduct of business may, if the Tribunal thinks it proper so to do, be made personally liable without any limitation as to liability for all or any debts or other liabilities of the company. Liability under this section[3] may be imposed only if it is proved that the business of the company has been carried on with a view to defraud the creditors - *Re. Augustus Barnett & Sons Ltd.* [1986] B CLC 170 Ch. D.

2.4-1h 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* the company.

The directors of a railway company which had fully exhausted its borrowing powers advertised for money to be lent on the security of debentures, 'W' lent £500 upon the faith of advertisement and received a debenture. *Held,* the debenture was void but 'W' could sue the directors for breach of warranty of authority (since they had by advertisement warranted that they had the power to borrow which in fact they did not have) - *Weeks* v. *Propert* [1873] L.R. 8 C.P. 427.

2.4-1i LIABILITY UNDER OTHER STATUTES - Besides the Act, directors and other officers of the company may be held personally 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.

3. The corresponding section under the Companies Act, 1956 was section 542.

B. *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 corporate entity identified and penalised, if necessary.

1. *Protection of revenue* - In *Sir Dinshaw Maneckjee Petit, Re* AIR 1927 Bom. 371, 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.

Similarly in *CIT* v. *Sri Meenakshi Mills Ltd.* AIR 1967 SC 819, where the veil had been used for evasion of taxes and duties, the court upheld the piercing of the veil to look at the real transaction.

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] 1 CH 935, 'Horne' had been employed by the company under an agreement that he shall not 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] 1 All. ER 442, 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. Initially the company was formed by third parties, and the vendor purchased the whole of its shares from them, had the shares registered in the name of himself and a nominee, and had himself and the nominee appointed directors. It was held that specific performance of the contract cannot be resisted by the vendor by conveyancing 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] 2 AC 307, 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.

4. *Formation of subsidiaries to act as an agent* - In *Merchandise Transport Limited* v. *British Transport Commission* [1982] 2 QB 173, 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 an Advance Ruling issued by the Authority for Advance Rulings, it has been stated that when a U.S. based company allows stock option to the employees of its wholly owned Indian subsidiary at a predetermined price lower than the market price of the concerned security, it amounts to be monetary benefit given by the subsidiary, hence taxable as salary. Here though the offer is from the U.S. based holding company, by piercing the corporate veil of that entity, it is the Indian subsidiary which stands out as the businesses of both the entities are to be seen as only one [*Advance Rulings Petition No. 15 of 1998, In re* [1999] 102 Taxman 74 (AAR)].

Similarly, in the *State of U.P.* v. *Renusagar Power Co.* [1991] 70 Comp. Cas. 127 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.

Again, where small scale industries were given certain exemptions and the company owning an industry was not controlled by any group of persons or companies, it was held that it was permissible to lift the veil of the company to see whether it was the subsidiary of another company and, therefore, not entitled to the proposed exemptions - *Inalsa Ltd.* v. *Union of India* [1996] 87 Comp. Cas. 599 (Delhi).

In *Smith, Stone and Knight* v. *Birmingham Corpn.* [1939] 4 All ER 116 (KB), the following criteria were laid down for determining whether the business of the subsidiary company is the business of the parent company :

(*i*) Were the profits treated as the profits of the parent company ?

(*ii*) Were the persons conducting the business appointed by the parent company ?

(*iii*) Was the parent company the head and brain of the trading venture ?

(*iv*) Did the parent company govern the adventure, decide what should be done and what capital should be embarked on the venture ?

(*v*) Did the parent company make the profits by its skill and direction ?

(*vi*) Was the parent company in effectual and constant control ?

The mere fact that the holding company has a subsidiary company does not imply that whenever claims are made against the subsidiary company, the corporate veil

is to be pierced in order to make the holding company liable for the debts incurred by the subsidiary company. The normal rule is that independent legal personality of the company is to be respected and preserved. Holding company shall, however, be liable if it offers guarantee for repayment of the debts borrowed by its subsidiary. But, the liability in such a case arises because of 'guarantee' and not the 'holding - subsidiary' relationship - *S.A.E. (India) Ltd.* v. *E.I.D. Parry (India) Ltd.* [1998] 18 SCL 481 (Mad.).

In *J.B. Exports Ltd.* v. *BSES Rajdhani Power Ltd.* [2007] 73 SCL 133 (Delhi), 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 shareholders* - In *Smith, Stone and Knight* v. *Birmingham Corpn.* [1939] 4 All ER 116 (KB), it was observed, that it is well settled that the mere fact that a man holds all the shares in a company does not make the business carried on by that company his business, nor does it make the company his agent for the carrying on of the business. This proposition is just as true if the shareholder is itself a limited company. It is also well settled that there may be such an arrangement between the shareholders and a company as will constitute the company the shareholders' agent for the purpose of carrying on the business and make the business, the business of the shareholders. Thus, where an arrangement, as aforesaid, prevails, the individual shareholders may be identified for fixing their liability.

6. *In case of economic offences* - In *Santanu Ray* v. *Union of India* [1989] 65 Comp. Cas. 196 (Delhi), 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 and 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 wilful mis-statement 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] 59 Comp. Cas. 134. The facts of the referred case are quite interesting and may be noted with advantage. 'A limited' had purchased shares of 'B limited' by investing a sum of Rs. 4,50,000. It was getting annual dividends in respect of these shares and the amount so received was shown in the profit and loss account of the company year after year. It was taken into account for the purpose of calculating the bonus payable to workmen of the company. Sometime in the course of the year 1968, the company transferred the shares of 'B limited', held by it to 'C limited', a subsidiary company wholly owned by it. 'C limited' had no other capital except the shares of

'B limited' transferred to it by the 'A limited'. It had no other business or source of income whatsoever except receiving the dividend on the shares of 'B limited'. The dividend income from the shares of 'B limited' was not transferred to the 'A limited' and, therefore, it did not find place in the profit and loss account of the company with the result that available surplus for the purposes of payment of bonus to the workmen of the company got reduced. On an industrial dispute raised by the workmen for including the dividend in the profits of 'A limited', the Industrial Tribunal and later the High Court held that 'A limited' and 'C limited' were two independent companies with separate legal existence and, therefore, the profits made by 'C limited' could not be treated as profits of 'A limited'.

The Supreme Court, however, held that it was true that in law 'A limited' and 'C limited' were distinct legal entities having separate existence, but, that was not an end of the matter. Here the new company was created as wholly owned by the principal company with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company and served no purpose whatsoever except to reduce the gross profits of the principal company. These facts spoke for themselves. There could not be a more direct evidence that the second company was formed as a device to reduce the gross profits of the principal company for whatever purpose. An obvious purpose that was served and which stared one in the face was to reduce the amount to be paid by way of bonus to workmen. The amount of dividend received by 'C limited' was, therefore, to be taken into account in computing profits of 'A Ltd.' available for bonus.

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. In *PNB Finance Limited* v. *Shital Prasad Jain* [1983] 54 Comp. Cas. 66 (Delhi), pursuant to a request made by 'S', the financial advisor of a financing public limited company, granted a loan of Rs. 50 lakhs to 'S' on his representation that he would utilise the said amount for the purchase of immovable property in Delhi and the directors of the plaintiff company sanctioned the loan, *inter alia*, on the condition that the loan would be secured by deposit of the title deeds of the property. A promissory note with regard to the same was also executed by 'S'. However, 'S' did not pay anything either towards the principal amount or towards interest. Instead, he diverted the amount of the loan to three public limited companies floated by him and his son. These companies, in turn, applied the amount of loans so diverted in purchasing immovable properties at New Delhi. The question that arose was whether the defendants ('S' his son and the three public limited companies) could be restrained from alienating the properties purchased.

The court granted relief to the plaintiff by restraining the defendants from any alienation, transfer, disposal or encumbering of the properties in question.

9. *To punish for contempt of Court* - In *Jyoti Limited* v. *Kanwaljit Kaur Bhasin* [1987] 62 Comp. Cas. 626 (Delhi), a firm of two partners agreed to sell two floors to parties but cancelled the agreement. Litigation followed and the High Court restrained the firm from selling the property. In the meantime, a private company was floated by the two partners who being the only two shareholders became the Chairman and the Managing Director respectively and the property was transferred to the company. In spite of the High Court's restraint order the company sold off the two

floors. In answering to the contempt proceedings, the partners of the firm took the plea that the sale had been made by the company and therefore the firm had not disobeyed the court's order.

Held that, once the corporate veil is lifted, it is crystal clear that the orders of the court were disobeyed by the respondents. The company was admittedly promoted by the respondents alone. They only were its shareholders and directors. One of the respondents was its Chairman and the other respondent, Managing Director. The entire interest in the company was of the respondents. Thus, in reality the order of the court was disobeyed by the respondent.

10. *For determination of technical competence of the company* - The Supreme Court in one of its recent decisions has delivered an interesting and very significant judgment with regard to lifting of corporate veil. The case in reference is that of *New Horizons Ltd.* v. *Union of India*[4] [1995] 1 Comp. LJ 100 (SC); [1997] 27 CLA 56 (SC).

The facts of the case are as follows :

The Department of Telecommunications, Telecom District, Hyderabad invited sealed tenders of printing, binding and supply of telephone directories; the stipulation being tenderer should have had experience in supplying such directories to telephone systems with capacity to more than 50,000 lines. The appellant New Horizons Ltd. (NHL), a joint-venture company, and the Respondent No. 4 and others submitted their tenders, which were considered by the Tender Evaluation Committee. The offer of Respondent No. 4 was accepted. NHL challenged the decision in the High Court stating that its offer could not be rejected on the hyper-technical plea that NHL itself had no experience. NHL pleaded that its both Indian and the foreign collaborators had experience in the related field. The High Court dismissed NHL's plea on the ground that NHL itself had no experience. The question before the Supreme Court was whether on facts, the telephone authorities were justified in not considering the tender submitted by NHL on the ground that they did not fulfil the conditions about eligibility for the award of the contract. The Supreme Court held that lifting of the corporate veil was necessary and for the purpose of considering whether NHL had the requisite experience as contemplated in the tender document, the experience of the constituents of the NHL had also to be taken into consideration. The said experience of NHL had been ignored by the Tender Evaluation Committee on an erroneous view. Piercing through the veil covering NHL the Court revealed that both the groups of joint venture had contributed towards the resources of the venture in the form of machines, equipment and expertise. Thus, in respect of such a joint venture company, the experience of the company would include the experience of the constituents of the joint venture as well.

The Supreme Court held that the Tender Evaluation Committee's refusal to consider the tender of NHL and the consequent acceptance of the tender of Respondent No. 4 suffered from the vice of arbitrariness and irrationality.

11. *Where company is a mere sham or cloak* - In *Delhi Development Authority* v. *Skipper Construction Company (P.) Ltd.* [1996] 4 SCALE 202, the Supreme Court held that the fact that the director and members of his family had created several

4. Also see, *Progressive Aluminium Ltd.* v. *ROC* [1997] 26 CLA 277 (AP).

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.

Case Law: *State of Rajasthan and others* v. *Gotan Lime Stone Khanji Udyog Pvt. Ltd.* and another AIR 2016 SUPREME COURT 510

Facts of the Case

In the instant case the lessee was a partnership firm and wished to transfer the mining lease to a private limited company which was mere change of form of its own business by converting itself from a partnership firm into a private limited company. The partners of the firm and Directors of the company were the same and on transfer, no benefit, price or premium was taken from the transferee. The lease was 40 years old and there was no impediment in the transfer. The transferee will comply with the rules and regulations. The transfer was allowed on that basis. After seeking the said permission, the newly formed private limited company instead of operating the mining lease itself sold its entire shareholding to another company allegedly for Rs.160 crores which is alleged to be the sale price of mining lease. Held, while discerning true nature of the entire transaction, Court has not to merely see the form of the transaction which is of sale of shares but also the substance, which is the private sale of mining rights avoiding legal bar against transfer of sale rights circumventing the mandatory consent of the competent authority. Consent of competent authority is not a formality and transfer without consent is void. The minerals vest in the State and mining lease can be operated strictly within the statutory framework.

Decision

The Supreme Court held that the doctrine of lifting the veil can be invoked if the public interest so requires or if there is allegation of violation of law by using the device of a corporate entity. In the instant case, the corporate entity has been used to conceal the real transaction of transfer of mining lease to a third party for consideration without statutory consent by terming it as two separate transactions - the first of transforming a partnership into a company and the second of sale of entire shareholding to another company. The real transaction is sale of mining lease which is not legally permitted. Thus, the doctrine of lifting the veil has to be applied to give effect to law which is sought to be circumvented.

12. *Fraudulent scheme of arrangement or compromise* - Corporate veil may be pierced while considering a scheme of arrangement or compromise under section 391 of the Act if the Court is satisfied that the Scheme proposed is fraudulent and has a different purpose than the one professed - *In re, Bedrock Ltd.* [1998] 17 SCL 385 (Bom.).

13. *Conversion of sole proprietorship into a company* - If an individual takes a premises on rent and converts his sole proprietorship concern into a private limited company in which he has controlling interest, he cannot be evicted from the premises on ground that he has handed over possession of property to anyone else, as the same person remains in possession though technically the company now runs the business - *Prem Lata Bhatia* v. *Union of India* [2006] 71 SCL 142 (Delhi).

2.5 Advantages of incorporation

As compared to other types of associations, an incorporated company has the following advantages :—

1. *Independent legal entity* - Unlike a partnership firm which has no existence apart from its members, a company is a distinct legal or juristic person independent of its members. Section 9 of the Companies Act, 2013 provides that from the date of incorporation, the subscribers to the memorandum and other members shall be a body corporate by the name contained in the memorandum, capable of performing all the functions of an incorporated company and having perpetual succession and a common seal.

The advantage derived from the separate legal entity is that a company remains free from the hazards of all personal misfortunes of its members.

2. *Limited liability* - A company can be formed with the liability of its members limited. In the case of limited companies, no member is bound to contribute anything more than the nominal value of the shares held by him or/and the amount guaranteed by him. This advantage of limiting the liability is one of the principal advantages of forming a company and enables the enterprising business people to embark upon business projects uninhibited by the thought of involving his entire present and future wealth.

3. *Perpetual succession - An incorporated company has perpetual succession [Sec. 9].* Notwithstanding any change in its members, the company will be the same entity with the same privileges and immunities, estate and possessions. "Members may come and members may go but the company can go on for ever". The death or insolvency of individual members does not in any way, affect the existence or continuity of the company. It can continue to exist indefinitely till it is wound up in accordance with the provisions of the Companies Act. This is a distinct advantage over and above, a partnership where the death, insolvency, insanity or separation of members, *i.e.,* partners will not only have a bearing on its business but may even result in dissolution of the firm.

4. *Transferability of shares* - Section 44 of the Act provides that the shares, debentures or other interests of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. The facility of free transferability of shares as enshrined under section 44 encourages investment of funds in shares of joint stock companies. Raising of funds for projects requiring heavy investments is, therefore, facilitated through the medium of company form of organisation.

5. *Infinite membership* - Another advantage of incorporation is that there is no limit to the maximum number of members in a public company. Thereby very large number of people including juristic ones can combine and contribute to the formation and functioning of the company. An off shoot of this is the easy access for people not in the business background or possessing great economic resources to be a co-shareholder in the business of the company.

6. *Mobilisation of huge resources* - Because of the participation of unlimited number of people in the form of business venture, huge amounts can be collected from them

to undertake all sorts of business ventures including ones requiring huge investment that no individual or a small collection of people can provide.

7. *Separate property* - The property of the company is not the property of the shareholders; it is the property of the company - *Gramophone & Typewriter Co.* v. *Stanley* [1906] K.B. 856. The Madras High Court in *R.T. Perumal* v. *H. John Deavin* AIR 1960 Mad. 43, observed that "no member can claim himself to be the owner of the company's property during its existence or in its winding-up". Thus, no member or director can use the properties of the company to his own personal advantage. In the eyes of law, even a member holding majority shares or a managing director of a company is held liable for criminal misappropriation of the funds or property of the company, if he unauthorisedly takes it away and uses it for his personal purposes.

8. *Ease in control and management* - The company law provides for the management of companies through the elected representatives of the members known as directors and, therefore, no shareholder is to worry about the management of the company. The directors may include professionals thereby enabling the company to be managed professionally and more efficiently.

2.6 Disadvantages of incorporation

There are, however, certain disadvantages and inconveniences with incorporated bodies. Some of these disadvantages are :—

(*i*) *Formality and expense* - Incorporation of a company involves a number of legal formalities and the consequent expenses that go with it. The affairs and working of a company have to be conducted strictly in accordance with the applicable legal provisions, non-compliance of which entails penal consequence. Various returns and documents are required to be filed with the Registrar of Companies. Certain books and registers are compulsorily required to be maintained. Approvals and sanctions of the Company Law Board, the Central Government, the Court, the Registrar of Companies or other appropriate authority, as the case may be, are required to be obtained for certain corporate activities. Meetings of the directors or shareholders are to be held and conducted in accordance with the provisions of the Act.

Other forms of business organisations are comparatively free from these legal compulsions and formalities.

(*ii*) *Loss of privacy* - Another disadvantage of incorporation is loss of privacy. Various returns, resolutions and documents are required to be filed with the Registrar of Companies. The office of the Registrar of Companies is a public office. Any member of the public can, on payment of prescribed fees, inspect any of the documents filed by a public company with the Registrar of Companies. Even in the case of private companies the same exposure is there but in a restricted scale.

(*iii*) *Divorce of control from ownership* - Members of a company cannot have as effective and intimate control over its working as in partnership or proprietary business. This is particularly so where the membership of the company is too large. The company functions through the representatives of the

shareholders - the directors. Members, therefore, do not have any active and complete control over the company's working, as the partners may have over the firm's affairs or a sole proprietor may have in his business.

(*iv*) *Detailed winding-up procedure* - The Companies Act provides elaborate and detailed procedure of winding-up of companies which is more expensive and time consuming than what is applicable to other forms of business organisation.

(*v*) *Control by few* - Few people with business background or with enterprising character can effectively control the entire business and too huge corporate economic resources with a disproportionately low percentage of financial stake in the company. *For example,* even with a holding of not more than 5% of the share capital of a company such people can use the cent per cent resources of the company with immeasurable financial benefit. It also has a snowballing effect of such people spreading their economic and control net to build huge business empires for them and their family members.

(*vi*) *Greater public accountability* - Any company and in particular a public company has much greater public accountability inasmuch as, it cannot act against public interest. As and when public interest will come in conflict with the corporate working, intervention by regulatory authorities will come.

(*vii*) *Possibility of frauds* - Since the control of economic resources is in few hands and in spite of public accountability, it is possible for those few to defraud unsuspecting other people who have contributed funds to the company either as shareholder or debenture-holder or creditor or lender by diverting funds of the company to their private channels leaving the company high and dry. There are ample examples of this. By the time the regulatory authorities or other common stockholders come to realise the matter, the damage is already done and cleverness of the manipulator often makes it difficult to fix responsibilities and bring to book the wrong doers.

2.7 Company vis-a-vis 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. Sub-section (11) of section 2 of the Act defines the expression 'body corporate' as follows :

> "'Body corporate' or 'corporation' includes a company incorporated outside India but does not include—
>
> (*a*) a co-operative society registered under any law relating to co-operative societies;
>
> (*b*) any other body corporate not being a company which the Central Government may, by notification in the Official Gazette, specify in this behalf."

It will further include all public financial institutions mentioned in section 2(*72*) as well as the nationalised banks incorporated under section 3, sub-section (4) of the Banking Companies (Acquisition & Transfer of Undertakings) Act.

It may be noted that under clause (*b*) of sub-section (11) of section 2, the Central Government has reserved the right to declare any association of persons as a body

corporate. Accordingly, Oil & Natural Gas Commission (ONGC), like many others, has been declared as a body corporate.

Thus, the expression 'body corporate' is not equivalent to the words 'incorporated company'. An incorporated company is a body corporate but many bodies corporate are not incorporated companies - *Madras Central Urban Bank Ltd.* v. *Corporation of Madras* [1932] 2 Comp. Cas. 328 (Mad.).

The expression 'corporation' or 'body corporate' is, thus, wider than the word company.

2.7-1 Is a society registered under the Societies Registration Act, a body corporate?

A society registered under the Societies Registration Act has been held by the Supreme Court in *Board of Trustees Ayurvedic & Unani Tibia College, Delhi* v. *State of Delhi* AIR 1962 SC 458 not to come within the term 'body corporate' under this Act, though such a society is a legal person capable of holding property and becoming a member of a company.

Similar view has been held by the Department of Company Law administration* in its communication No. 8/26/2(7)/63/PR dated 13th June, 1962 addressed to Federation of Indian Chambers of Commerce. The Department observed as follows:

Generally speaking, this Department would consider that a body which has been or is incorporated under some statute and which has a perpetual succession and a common seal and is a legal entity apart from the members constituting it, will come within the definition of the term 'body corporate'. The term will not, however, include a society registered under the Societies Registration Act, 1860, or any of the bodies which have been specifically excluded by clauses (*a*), (*b*) and (*c*) of section 2, sub-section (7).

2.7-2 Corporation sole

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.

2.8 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] 39 Comp. Cas. 905 (SC). The Supreme Court of India in *State Trading Corporation of India Ltd.* v. *CTO* [1963] 33 Comp. Cas. 1057 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.

*Now Ministry of Corporate affairs.

In *Narasaraopeta Electric Corpn. Ltd.* v. *State of Madras* [1951] 21 Comp. Cas. 297 (Mad.), 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.

Similar view was upheld by the Supreme Court in the case of *State Trading Corporation of India Ltd.* v. *CTO* [1963] 33 Comp. Cas. 1057. The Supreme Court, in this case, observed that the rights of citizenship and the rights flowing from the nationality or domicile of a Corporation are not co-terminus. It would thus appear that the makers of the Constitution had altogether left out the consideration of juristic persons when they enacted Part II of the Constitution relating to citizens and made a clear distinction between 'persons' and 'citizen' in Part III of the Constitution. Part III, which proclaims fundamental rights was very accurately drafted, delimiting those rights like freedom of speech and expression, the right to assemble peacefully, the right to practice a profession, etc., as belonging to citizens only and those more general rights like the right to equality before the law, as belonging to all persons. Corporation may have nationality in accordance with the country of their incorporation; but that does not necessarily confer citizenship on them. There is also no doubt that Part II of the Constitution when dealing with citizenship refers to natural persons only. This is further made absolutely clear by the Citizenship Act which confines citizenship to natural persons only.

A company is also not allowed to lay claim to fundamental rights on the basis of its being an aggregation of citizens. Once a company or a corporation is formed, the business of the company or 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 - *Telco Ltd.* v. *State of Bihar* [1964] 34 Comp. Cas. 458 (SC).

It should, however, be noted that certain fundamental rights enshrined in the Constitution are for protection of any person, *for example,* right to equality, etc. (Article 14) are available to a company. In *Chiranjilal Chaudhari* v. *Union of India* [1951] 21 Comp. Cas. 33, the Supreme Court held that the fundamental rights guaranteed by the Constitution are available not merely to individual citizens but to corporate bodies as well except where the language of the provision or the nature of the right compels the inference that they are applicable only to natural persons.

Similarly in *Bennet Coleman Co.* v. *Union of India* [1972] S.C.C. 788, 806, the Supreme Court extended the rule by stating "it is now clear that the fundamental rights of shareholders as citizens are not lost when they associate to form the company. When their fundamental rights as shareholders are impaired by State action, their rights as shareholders are protected. The reason is that the shareholders' rights are equally and necessarily affected if the rights of the company are affected.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/PE-II/IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Explain the meaning of 'company'.

2. Enumerate the advantages that a business organisation enjoys through incorporation under the Companies Act, 2013.

3. "The fundamental attribute of corporate personality is that company is a legal entity distinct from the members". Elucidate the statement.

4. "The term body corporate connotes a wider meaning than the term company". Explain.

5. State the facts of the case of *Solomon* v. *Solomon & Co. Ltd.* and explain the principles laid down therein.

6. "A limited liability company is not capable of becoming a partner in a firm". Examine this statement.

6A. Common seal of a company will have to be affixed on all the letters and documents of the company. Comment.

7. "The 'company' under the Companies Act, 2013 is an artificial person in the eyes of law but not a citizen of the country." Comment.

8. Explain the concept of 'corporate veil' and state the circumstances when it can be lifted. Refer to relevant decided cases and provisions of the Companies Act, 2013 in this regard.

9. Examine the following statement :

"The liability of members in a limited company may be unlimited".

10. The term 'body corporate' connotes a wider meaning than the term 'company'.

11. (*i*) State the minimum and maximum number of members that a company may have.

(*ii*) What will be the consequences if such number of members fall below the statutory minimum limit ?

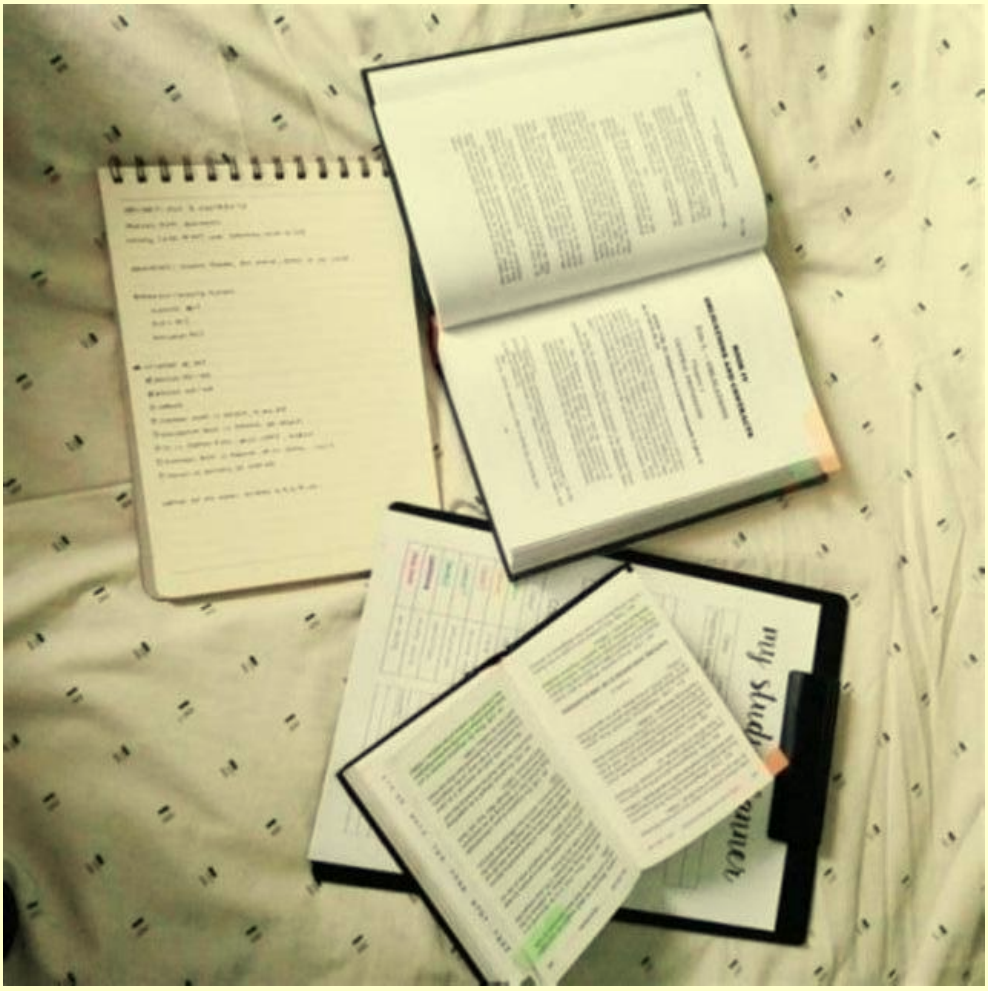
12. As a corporate body, the company is entitled to own and hold property in its own name. Comment.

13. The situation of the Registered office of a company determines its domicile.

PRACTICAL PROBLEM

1. Directors of a public limited company accepted a bill of exchange on behalf of a company. But the word 'limited' was omitted from the name of the company at the time of acceptance. Who can be held liable for the payment of the bill ?

Hints : Directors may be held personally liable, if the company refuses to pay. Liability of directors is in the nature of surety's liability.



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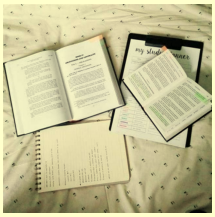

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3 Kinds of Companies

3.0 Introduction

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
  (*i*) One person company
  (*ii*) Small company
(*b*) Public companies

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

Limited liability companies may be :—

(*i*) Companies limited by shares; (*ii*) Companies limited by guarantee; (*iii*) Companies limited by guarantee as well as shares.

Companies may also be classified as :—

(*a*) Statutory Companies; (*b*) Registered Companies; (*c*) Existing Companies; (*d*) Associations not for profit; (*e*) Government Companies; (*f*) Foreign Companies; (*g*) Holding and Subsidiary Companies.

3.1 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:

(*a*) restricts the right to transfer its shares, if any;
(*b*) limits the number of its members to 200, not including :—
  (*i*) persons who are in the employment of the company, and

*Minimum paid up share capital requirement of Rs. 1 lakh has been omitted vide the Companies (Amendment) Act, 2015, w.e.f. 29-5-2015.

(*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; and

where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of membership, be treated as a single member.

(*c*) prohibits invitation to the public to subscribe for any securities of the company.

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

3.1-1 Restrictions on transferability of shares

Consistent with the objective of promoting the company as a closely knit family or friendly affair, a private company has to contain the specific restrictions so as to prevent anybody or everybody acquiring shares of the company by transfer and thereby defeating the very objective of promotion of the company as a private company. This restriction should uniformally apply to all the shareholders of the private company and accordingly the articles usually provide that directors may in their absolute discretion and without assigning any reason therefor decline to register a transfer of any share whether fully paid or partly paid. *However, this restriction should not be construed as a ban on any transfer of shares.* Transfer in circumstances not covered by specific restriction(s) is possible. *It is important to note that this restriction is relevant only in case of a private company having share capital and, therefore, is inapplicable to a private company incorporated as a pure guarantee company.*

Courts generally have held that a restriction by way of pre-emption is permissible. In other words, the articles may provide that a shareholder shall have to offer the shares; he intends to transfer, to a specified group, *e.g.,* any of the existing shareholders. A concomitant to this also is often seen in the articles, *i.e.,* determination of the price at which the shares are to be transferred, say at a fair value to be determined either by a formula given in the articles or as determined by the auditor of the company. If the shareholder fails to get acceptance of his offer to transfer shares in terms of the provisions of the articles, he would then be free to offer the shares to any other person and the directors ordinarily will be obliged to affect the transfer. It may be noted that even after making the offer to sell, the offer may be withdrawn before acceptance unless as per articles the offer is irrevocable. If an entire lot of shares is offered, a partial acceptance by one who enjoys the right of pre-emption will entitle the offerer to withdraw the offer.

Only restrictions contained in articles are valid - The only permissible restrictions on transferability are those contained in the company's articles of association. An additional restriction not contained in the articles but in a private agreement between two shareholders which places further obstacles in the way of transferability is not binding either on the company or on the shareholders - *V.B. Nagaraj* v. *V.B. Gopalakrishnan* [1991] CLA 211 (SC).

3.1-2 Limitation on number of members

A private company is required compulsorily to limit through its articles, the number of members to 200, taking joint holders as single member and also not counting present or past employees who are members.

However, with reference to former employees, for the benefit of the exemption being available to the company, such employees must have been members while they were in employment and continue as members after ceasing to be in employment of the company. Thus, the exemption cannot be claimed by first being enrolled as the member and then inducted as employee.

It has been observed that directors are not considered to be employees of the company. Thus, if they are members of the company, they shall be counted. However, if a director is also employed by the company in another capacity, *for example,* as Works Manager, Sales Manager or as the Company Secretary, he may be treated as employee of the company notwithstanding his directorship. He will not then be counted towards the maximum number of members.

3.1-2a NUMBER OF DEBENTURE HOLDERS MAY EXCEED 200 - It may be noted that it is only the number of members that is limited to 200. 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.

3.1-3 Restriction on inviting public to subscribe for securities

The articles of a private company must prohibit an invitation to the public to subscribe for any shares , debentures , or any securities of the company. In practical terms, this requirement shall mean that a private company must not make public issue or publish any advertisement inviting investments or resort to any other method of inviting public investment in its shares, debentures, or any other security. A private company can only collect its capital through a 'private approach'. 'Private approach' shall mean giving opportunity of investment to the persons approached and not to others.

3.1-4 Other requirements relating to a private company :

1. There should be at least two persons to form a private company. As per section 3, for forming a private company, two or more persons are required to subscribe their names to a Memorandum of Association. The subscribers to the Memorandum may, however, be nominees of a single person and subscribing their names may be merely a formality.

   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.

   A minor cannot be a signatory to the Memorandum since he is not competent to contract. The guardian of a minor who subscribes to a memorandum on behalf of the minor will be deemed to have subscribed in his personal capacity.

   Again, a Joint Hindu Family, being not a person, cannot be a subscriber. A 'Karta' or manager of the Joint Hindu Family may however sign on its behalf.

In the case of an illiterate subscriber, the thumb impression or mark duly attested by the *person writing* for him may be given.

2. 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.

Can a private company be incorporated with two members, one being a preference shareholder? - A preference shareholder is indeed a member of the company but with a restricted membership rights. While two persons subscribing to the memorandum of association can form a private company, the presumption of the law appears to be that such members should be equity shareholders. A member with restricted voting right *i.e.* a preference shareholder cannot constitute the quorum for a general meeting. The Act has not stated this in so many words in section 103 but erstwhile the Department of Company Affairs had clarified (*vide* Company News and Notes dated 16-6-1964) that unless the agenda of a general meeting contains any matter involving the rights of preference shareholders, the presence of any preference shareholder shall have to be disregarded for the purpose of quorum. In *Bradford Investments Pvt. Ltd.* (1990) BCC 740 (an English case), it has been said that it is not sufficient in a general meeting to be entitled to be present if the member does not have voting rights therein. *Prima facie*, in the context of a general meeting a member would mean a member with voting rights. Section 9 of the Act specifies that on incorporation, a company must be eligible to start all the functions of an incorporated company. Even at the time of holding the first AGM, the preference shareholders would not, in the normal course, be eligible to vote as there would not arise a situation contemplated by section 87 (now section 47) to endow the preference shareholder with full voting rights when preference dividend falls in arrear. Taking an overall view of the provisions of the section, it seems a private company cannot be incorporated with two persons of which one would be a preference shareholder - (*vide* opinion of Shri L.V.V. Iyer on Pages 41-44 of SEBI and Corporate Laws, January 21, 2008).

3.1A Special privileges and exemptions available to private 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 following privileges and exemptions are available to a private company:

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].

*Ministry of Corporate Affairs vide its notification dated 5-6-2015 has exempted private companies from a few more provisions of the Companies Act, 2013. These have been discussed at the appropriate places.

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]. However, it does not mean that they cannot be removed throughout their life or life of the company or before the expiry of the period for which they were appointed.
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 [Section 149].
10. **Audit Committee –** A private company is not required to constitute audit committee of the Board [Section 177].
11. **Voting rights and kinds of share capital -** 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. **Further issue of shares -** 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*

Additional Privileges and Exemptions[1]

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. **Loans to directors:** A private company may give a loan or provide guarantee or offer a security in connection with a loan taken by a director provided:
    (*a*) No other body corporate should have invested any money in the lending/guaranteeing company;
    (*b*) Borrowing from banks, financial institutions or bodies corporate should be less than double of its net worth or Rs. 50 crore, whichever is lower;
    (*c*) The lending company should not have defaulted in repayment of borrowings.
17. **Relaxation of ceiling on company audits:** The ceiling of 20 audits under section 141 will not include private companies having a paid-up share capital of less than Rs. 100 crore.
18. **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.
19. **Provisions relating to directors:** Provisions of sections 160, 162 and 180 relating to appointment and restrictions on the powers of directors shall not apply to private companies.
20. **General body meetings:** Provisions of sections 101 to 107 and section 109 relating to general body meetings shall not apply to a private company if Articles of the company provide otherwise.
21. **Deposits from Members:** Private companies have been allowed to accept deposits from members under section 73 up to 100% of it's paid up capital and free reserves provided they inform ROC in the prescribed manner.
22. **Acceptance of deposits from members:** With respect to acceptance of deposits from the members of a company under section 72 of the Act, the conditions applicable to a public company as contained in clauses (*a*) to (*e*) of section 73(2) shall not be applicable to a private company:
    (A) which accepts from its members monies not exceeding one hundred per cent of aggregate of the paid up share capital, free reserves and securities premium account; or

1. Vide MCA Notification No. F.No. 2/11/2014-CL-V dated 5.6.2015 as amended *vide* its Notification dated 13.6.2017.

(B) which is a start-up, for five years from the date of its incorporation; or

(C) which fulfils all of the following conditions, namely:—

(*a*) which is not an associate or a subsidiary company of any other company;

(*b*) if the borrowings of such a company from banks or financial institutions or any body- corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and

(*c*) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section,

However, the company referred to in clause (A), (B) or (C) shall file the details of monies accepted to the Registrar in such manner as may be specified.

23. **Signing of Annual return:** In case of a private company which is a start-up, annual return shall be signed by the director of the company in case the company does not have a company secretary.

24. **Meetings of the Board:** A private company which is a start-up may hold only one meeting of the Board in each half of the calendar year provided the gap between the two meetings is not less than ninety days.

25. **Interested director**: An interested director shall be counted towards the quorum for a Board meeting.

It may be noted that the exemptions listed under 22 to 25 above shall be applicable to a private company which has not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar.

3.1B One Person Company

The Companies Act, 2013 has, for the first time, allowed formation of a limited liability company by just one person. Such a company is described under section 3(1)(*c*) as a private company. **'**One Person Company' is a one shareholder corporate entity, where legal and financial liability is limited to the company only. In India, the J.J. Irani Expert Committee recommended the formation of one-person company (OPC).

The provisions relating to OPC are strewn all across the Companies Act, 2013. 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 OPC 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 dividends and other rights and liabilities to which such sole promoter member of the company was entitled or liable.

Again, the member of One Person Company may at any time change the name of such other person by giving notice in such manner as may be prescribed. He must, however, intimate the company the change, if any, in the name of the other person nominated by him by indicating in the memorandum or otherwise within such time and in such manner as may be prescribed, and the company 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 OPCs

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). The Central Government may prescribe an abridged annual return for OPC.
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).

Can a body corporate form an OPC?

As per Singapore law, a Company can be the one person in a One Person Company. So, *for example*, if you have an existing Company where you are a director, you can form a One Person Company *with your Company as the sole director.*

For instance, you have a company called Sudeep Textiles Pvt. Ltd. with you and your friend Nitin as directors. Now you also want to import textiles from Italy for sale in India and want to have a separate entity to do that (for accounting and taxation purposes).

As per Singapore law, you are entitled to form a One Person Company *with Sudeep Textiles Pvt. Ltd. as the sole person in the company.*

However, in India, only a natural person can form 'one person company'.

As per the Rules framed by the Central Government:

- *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 1 financial year* ***(Rule No. 3.1****).*
- A natural person shall not be member of more than a One Person Company at any point of time and the said person shall not be a nominee of more than a One Person Company *(****Rule 3.2, as amended vide Notification No. G.S.R. 743 dated 27.7.2016****)*

  A person can be member in only one OPC.

  Where a natural person, being member in One Person Company becomes a member in another OPC by virtue of his being a nominee in that OPC, then such person shall meet the eligibility criteria of being a member in only one OPC within a period of one hundred and eighty days, i.e., he/she shall withdraw his membership from either of the OPCs within one hundred and eighty days.
- No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest *(****Rule No. 3.4****).*
- 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****).*
- *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)****.*
- **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****).*
- **Conversion of a private company into a One Person Company:** A private company other than a company registered under Section 8 of the Act (i.e.

†Word 'or' has been substituted by the word 'and' - Vide the Companies (Incorporation) Amendment Rules, 2015 dated 1-5-2015.

non-profit association) having paid up share capital of Rs. 50 lakhs or less and average annual turnover during the relevant period is Rs. 2 crore or less may convert itself into a One Person Company by passing a special resolution in the general meeting (Rule 8, as amended by the Companies (Incorporation) Amendment Rules, 2015).

- **Penalty:** If a One Person Company or any officer of such company contravenes any of the provisions of these rules, the One Person Company or any officer of such company shall be punishable with fine which may extend to Rs. 5,000 and with a further fine which may extend to Rs. 500 for every day after the first offence during which such contravention continues [2](Rule No. 7A).

3.1C 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) Act, 2017, "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 profit and loss account for the immediately preceding financial year does not exceed two 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.

You should note that 'one person company' or 'small company' cannot be formed for non-economic objectives, *i.e.*, as a non-profit association.

3.2 Public company [Section 2(71)]

Section 2(*71*) of the Companies Act, 2013, as amended by the Companies (Amendment) Act, 2015 defines a *public company* to mean a company which is not a private company and has a minimum paid-up 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 public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

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2. Penalty provision has been introduced vide the Companies (Incorporation) Amendment Rules, 2015 dated 1.5.2015.

*[or such higher amount as may be prescribed which shall not be more than ten crore rupees.]

**Word 'or' has been substituted by the word 'and' - *vide* S.O. 504(E) dated 13-2-2015 issued by MCA.

***or such higher amount as may be prescribed which shall not be more than one hundred crore rupees. "Turnover" means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year - Inserted by the Companies (Amendment) Act, 2017.

†Minimum paid-up share capital requirement of Rs. 5 lakh has been omitted *vide* the Companies (Amendment) Act, 2015, w.e.f. 29-5-2015.

3.3 Distinction between private and 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*** **[Section 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 number, 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 section 76). A private company cannot accept deposits from the public.

3.4 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. **Filing 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.
5. **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].

3.5 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.

As per the Companies (Incorporation) Fourth Amendment Rules, 2018, effective from 18.12.2018, an application for the conversion of a public company into a private company, shall, within sixty days from the date of passing of special resolution, be filed with Regional Director in e-Form No. RD-1 along with the prescribed fee and shall be accompanied by the following documents, namely:-

(*a*) a draft copy of Memorandum of Association and Articles of Association, with proposed alterations;

(*b*) a copy of the minutes of the general meeting at which the special resolution authorising such alteration was passed together with details of votes cast in favour and or against with names of dissenters;

(*c*) a copy of Board resolution or Power of Attorney dated not earlier than thirty days, as the case may be, authorising to file application for such conversion;

(*d*) declaration by a key managerial personnel that pursuant to the provisions of sub-section (68) of section 2, the company limits the number of its members to two hundred and also stating that no deposit has been accepted by the company in violation of the Act and rules made thereunder;

(*e*) declaration by a key managerial personnel that there has been no non-compliance of sections 73 to 76A, 177, 178, 185,186 and 188 of the Act and rules made thereunder;

(*f*) declaration by a key managerial personnel that no resolution is pending to be filed in terms of sub-section (3) of section 179 and also stating that the company was never listed in any of the Regional Stock Exchanges and if was so listed, all necessary procedures were complied with in full for complete delisting of the shares in accordance with the applicable rules and regulations laid down by Securities and Exchange Board of India:

Provided that in case of such companies where no key managerial personnel is required to be appointed, the aforesaid declarations shall be filed by any of the director.

(*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

*Power was earlier vested in the Tribunal.

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.

Where conversion of a public company into private company with a view to comply efficiently with provisions of Companies Act was not prejudicial either to its members or to creditors and provisions of section 14, read with rule 68 of NCLT Rules were complied with, said conversion was to be allowed - *Diana Buildwell Ltd., In re* [2017] 79 taxmann.com 300 (NCLT - Mum.)

Again, in *Greensignal Bio Pharma Ltd., In re* [2018] 89 taxmann.com 174 (NCLT - Chennai), Board of directors of a petitioner-company, which was a public company had passed a resolution approving its conversion to private limited company. Members of company had also approved said conversion by passing special resolution in its Extraordinary General Meeting.

Held that since petitioner-company had complied with all statutory provision of section 14 and conversion from public to private was in interest of a company which was being made with a view to streamline its corporate compliances and to increase efficiency in its functioning, causing no prejudice either to its members or to creditors, conversion was to be allowed.

In *Hetro Spinners Ltd.* v. *Registrar of Companies, Petitioner* company was incorporated as Public Limited Company. In Extraordinary General Meeting, shareholders holding 80.53 per cent shares voted in favour of resolution proposing for conversion of company from public to a private company. Petitioner-company stated that by proposed conversion, company would not change its liabilities and obligations towards anybody - ROC had submitted that company was up to date in filing its returns and proposed conversion was found to be in interest of petitioner-company and stakeholders and no one would be prejudiced. Held, instant petition for approving conversion of company was to be admitted.

Case Law: *Manorama Industrial & Technical Services Ltd., In re* [2018] 99 taxmann.com 141 (NCLT - Kolkata)[3]

Facts of the Case:

Petitioner-company, through Extraordinary General Meeting passed special resolution for conversion of its status of 'Public Limited Company' into 'Private Limited Company.' Special resolution was passed with unanimous approval of shareholders and Board of Directors of company. E-Form MGT-14 relating to conversion was filed and neither RoC nor any other member or creditor of company objected to proposed conversion.

Decision:

Held that, since all requisite statutory compliance had been fulfilled, conversion of status of company was to be approved.

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*Power was earlier vested in the Tribunal.

3. Also see, TITEC Ltd., *In re* [2018] 98 taxmann.com 300 (NCLT - Kolkata); Enlightened Projects Ltd., *In re* [2018] 98 taxmann.com 423 (NCLT - Kolkata)

Again, in AKF invest Ltd., *In re* [2019] 104 taxmann.com 24 (NCLT - Kolkata)

Petitioner was an unlisted public company engaged in providing financial and other related services and was registered with RBI as a non-banking financial company. With an aim to carry on business more economically, efficiently, conveniently, Board of Directors of the petitioner-company passed a resolution approving its conversion to private limited company. Members of petitioner-company had also approved said conversion by passing special resolution in its Extraordinary General Meeting - Petitioner thereupon filed the petition under section 14(1) seeking approval of Tribunal for conversion of its status from public to a private limited company. It was noted from records that petitioner-company did not receive any objection either from its members creditors or from any persons with regard to proposed change in status of company. Moreover, RoC and RBI had also accorded their no objection to change of conversion of company from public limited to private limited. Further, petitioner-company had complied with all statutory provision of section 14 and said conversion would not cause any prejudice either to its members or to creditors.

The Kolkata Bench of NCLT held that since, no objection was received from its members, creditors, RBI or any other person with regard to proposed change, instant petition was to be allowed.

Further, in **Enlightened Projects Ltd., *In re* [2018] 98 taxmann.com 423 (NCLT - Kolkata),** Board of Directors of a petitioner-company, which was a public company had passed a resolution approving its conversion to private limited company. Members of petitioner-company had also approved said conversion by passing special resolution in its Extraordinary General Meeting. It was found that neither there was any investor complaint against company nor any prosecution proceedings was pending against company and its directors. Also, no technical scrutiny/ inspection had been initiated against company. Further, proposed conversion would help company to eliminate and streamline its corporate compliances and increase efficiency in functioning and Proposed conversion would not prejudice rights or interest of any member, creditors and would not affect any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of petitioner company. Held that instant petition for proposed conversion of company should be allowed.

(*iv*) **Filing with the Registrar:** Every alteration of the articles and a copy of the order of the Tribunal 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 from the date of the receipt of the order from the Tribunal in the prescribed manner and the Registrar shall register the same [Section 14(2)]**.

3.6 Statutory company

Bodies with special types of objects which it has been thought desirable to encourage may be formed under general public Acts such as the Friendly Societies,

**Section 14(2) has been made effective from 1-6-2016.

the Industrial and Provident Societies and the Building Societies Acts in the United Kingdom. In our country also, similar legislations exist like the Life Insurance Corporation Act, Reserve Bank of India Act, Insurance Act. These bodies or bodies covered by these Acts do not necessarily require to have a memorandum of association.

Each statutory company is governed by the provisions of its special Act. However, the provisions of the Companies Act, 2013 apply to them, insofar as the same are not inconsistent with the special Acts under which these companies are formed [Sec. 1(4)].

3.7 Registered companies

A company registered under the Companies Act is known as a registered company. Registered companies can be incorporated as limited liability companies or as unlimited liability companies. Further, they may be incorporated as public companies or as private companies.

Having already discussed in detail about the 'private' companies in the foregoing paragraphs, we shall now discuss about the limited liability companies and the unlimited liability companies.

3.8 Limited liability companies

The discussion on limited liability companies may be divided under the following three heads :—

(*i*) Companies limited by shares;

(*ii*) Companies limited by guarantee;

(*iii*) Companies limited by guarantee having share capital.

3.8-1 Companies 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 4(1)(*d*)(*i*)]. 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, except where the articles otherwise provide, 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-up of the company.

3.8-2 Companies 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 to contribute:

(*A*) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and

(*B*) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves [Section 4(1)(*d*)(*ii*)].

3.8-3 Companies limited by guarantee having share capital

The liability of a member of a guarantee company having share capital is not merely limited to the amount as stated above in respect of guarantee companies not having share capital; he may be called upon to also contribute to the extent of any sums remaining unpaid on the shares held by him [Sec. 285].

3.8-4 Conversion of a company limited by guarantee into a company limited by shares

Rule 39, added by the Companies (Incorporation) Fourth Amendment Rules, 2016, has detailed the procedure for conversion of a company limited by guarantee into a company limited by shares as follows:—

(1) A company other than a company registered under section 25 of the Companies Act, 1956 or section 8 of the Companies Act, 2013 may convert itself into a company limited by shares.

(2) The company seeking conversion shall have a share capital equivalent to the guarantee amount.

(3) A special resolution is passed by its members authorising such a conversion omitting the guarantee clause in its Memorandum of Association and altering the Articles of Association to provide for the articles as are applicable for a company limited by shares.

(4) A copy of the special resolution shall be filed with the Registrar of Companies in Form No. MGT-14 within thirty days from the date of passing of the same along with fee as prescribed in the Companies (Registration Offices and Fees) Rules, 2014.

(5) An application in Form No. INC-27 shall be filed with the Registrar of Companies within thirty days from date of the passing of the special resolution enclosing the altered Memorandum of Association and altered Articles of Association and a list of members with the number of shares held aggregating to a minimum paid up capital which is equivalent to the amount of guarantee hither to provided by its members.

(6) The Registrar of Companies shall take a decision on the application filed under these rules within thirty days from the date of receipt of application complete in all respects and upon approval of Form No. INC-27.

The company shall be issued with a certificate of incorporation in Form No. INC-11B.

3.9 Unlimited liability company

A company having no limit on the liability of its members is an unlimited company. Section 3(2) of the Companies Act, 2013 allows a company to be formed as an unlimited company. 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.

An unlimited company is not subjected to any restrictions regarding purchase of its own shares [Sec. 67]. Accordingly, such a company may purchase its own shares or advance monies to any person to purchase its shares.

Conversion of unlimited liability company into limited liability company.

Under section 18, a company registered as an unlimited company may subsequently convert itself into a limited liability company, subject to the provision that any debt, liabilities, applications or contracts in regard to or entered into, by or on behalf of the unlimited liability company before such conversion are not affected by such conversion.

Further, section 65 of the Companies Act, 2013 provides that an unlimited company having a share capital may, by a resolution for registration as a limited company under this Act, do either or both of the following things, namely—

(*a*) increase the nominal amount of its share capital by increasing the nominal amount of each of its shares, subject to the condition that no part of the increased capital shall be capable of being called up except in the event and for the purposes of the company being wound up;

(*b*) provide that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purposes of the company being wound up.

You may note here that whereas, the concept of 'Reserve Capital' has been done away with regarding limited liability companies; it still finds a place with respect to unlimited companies.

Procedure for conversion of unlimited liability company into a limited liability company by shares or guarantee (Rule 37 of the Companies (Incorporation) Rules, 2014 inserted by the Companies (Incorporation) Third Amendment Rules, 2016, dated 27.7.2014:

1. After passing the special resolution in a general meeting, file an application in Form No. INC-27 in the prescribed manner.
2. Within seven days from the date of passing of the special resolution in a general meeting, publish a notice, in Form No. INC-27A of such proposed conversion in two newspapers (one in English and one in vernacular

language) in the district in which the registered office of the company is situate.

3. Also place the notice on the website of the Company, if any, indicating clearly the proposal of conversion of the company into a company limited by shares or guarantee, and seeking objections if any, from the persons interested in its affairs to such conversion.
4. Cause a copy of such notice to be dispatched to its creditors and debentures holders by registered post or by speed post or through courier with proof of dispatch. The notice shall also state that the objections, if any, may be intimated to the Registrar and to the company within twenty-one days of the date of publication of the notice, duly indicating nature of interest and grounds of opposition.
5. Within forty five days of passing of the special resolution file an application as prescribed in sub-rule (1) for its conversion into a company limited by shares or guarantee along with the fees as provided in the Companies (Registration Offices and Fees) Rules, 2014, by attaching the prescribed documents.
6. File a Declaration signed by not less than two Directors including Managing Director, where there is one, that no complaints are pending against the company from the members or investors and no inquiry, inspection or investigation is pending against the company or its Directors or officers.
7. The Registrar shall, after considering the application and objections if any, received by the Registrar and after ensuring that the company has satisfactorily addressed the objections received by the company, suitably decide whether the approval for conversion should or should not be granted.
8. The certificate of incorporation consequent to conversion of unlimited liability company to into a company limited by shares or guarantee shall be issued to the company upon grant of approval for conversion.

Conditions to be complied with, subsequent to conversion

(1) Company shall not change its name for a period of one year from the date of such conversion.

(2) The company shall not declare or distribute any dividend without satisfying past debts, liabilities, obligations or contracts incurred or entered into before conversion.

Explanation: For the purpose of this clause, past debts, liabilities, obligations or contracts does not include secured debts due to banks and financial institutions.

An Unlimited Liability Company shall not be eligible for conversion into a company limited by shares or guarantee in case-

(*a*) its net worth is negative, or

(*b*) an application is pending under the provisions of the Companies Act, 1956 or the Companies Act, 2013 for striking off its name, or

(*c*) the company is in default of any of its Annual Returns or financial statements under the provisions of the Companies Act, 1956 or the Companies Act, 2013, or

(*d*) a petition for winding up is pending against the company, or

(*e*) the company has not received amount due on calls in arrears, from its directors, for a period of not less than six months from the due date, or

(*f*) an inquiry, inspection or investigation is pending against the company.

The Registrar of Companies shall take a decision on the application filed under these rules within thirty days from the date of receipt of application complete in all respects.

3.10 Associations not for profit [Section 8]

An "Association not for profit" 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.

As per section 8, the Central Government may grant such a licence if it is proved to the satisfaction of the Central Government that a person[4] 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".

The licence may be granted by the Central Government on such conditions and subject to such regulations, as it thinks fit and such conditions and regulations shall be binding on the company to which licence is granted. *Examples of companies registered under section 25 (now section 8) include* Mohan Bagan Club, Gymkhana Club, Delhi District Cricket Association (D.D.C.A.) etc.

Consequences for contravention of requirements of section 8/Licence

The Central Government may revoke the licence granted to a company registered under section 8:

- If the company contravenes any of the requirements of section 8 or any of the conditions subject to which the licence was issued; or
- the affairs of the company are conducted fraudulently or in a manner violative of the objects of the company or prejudicial to public interest.

4. 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. However, **Rule 3(5) of the Companies (Incorporation) Rules, 2014** categorically provides that One Person Company cannot be incorporated or converted into a company under section 8 of the Act. Likewise, as per section 2(85), a small company cannot be incorporated or converted into a section 8 company.

Further, the Central Government may direct the company to convert its status and change its name to add the word "Limited" or the words "Private Limited", as the case may be, to its name.

A copy of the order of the Central Government, as above, must be given to the Registrar.

Consequences that follow on revocation of licence under section 8

Where a licence is revoked, as above, the Central Government after giving a reasonable opportunity of being heard, may, if it is satisfied that it is essential in the public interest, direct that the company be wound up or amalgamated with another company registered under section 8 and having similar objects.

If on the winding up or dissolution of such a company, there remains, after the satisfaction of its debts and liabilities, any assets, they may be transferred to another company registered under section 8 and having similar objects, subject to such conditions as the Tribunal may impose, or may be sold and proceeds thereof credited to the Rehabilitation and Insolvency Fund formed under section 269.

If a company makes any default in complying with any of the requirements laid down in section 8, the company shall be punishable with fine which shall not be less than ten lakh rupees but which may extend to one crore rupees and the directors and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees, or with both:

Further, where it is proved that the affairs of the company were conducted fraudulently, every officer in default shall be liable for action under section 447[5].

3.10-1 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.

In *N.C. Bakshi* v. *Union of India* [2013] 117 SCL 476 (Delhi), an association had been given a licence under section 25 (now section 8) by the Central Government and as per licence condition, no alteration could be made in Articles of Association unless alteration had been approved by Central Government. Alteration made to Articles of Association of respondent had been approved but according to petitioner-members their representation was not considered. Petitioner sought for quashing of approval and mandamus to grant fair hearing to petitioner. Delhi High Court held that since petitioner's representation was not considered while granting impugned approval, competent authority was to be directed to provide a post decisional hearing to petitioners on representation and to pass a speaking order while returning a positive finding as to whether alterations in Articles of Association impugned were in contravention of provisions of Act.

5. As per section 447 any person who is found to be guilty of fraud, shall be punishable 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. However, where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

3.10-2 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)].

3.10-3 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].*

However, an OPC cannot be incorporated or converted into a company under section 8 of the Act.

3.10-4 Exemptions

Ministry of Corporate Affairs, *vide* its Notification dated 5-6-2015 has notified, *inter alia*, the following exemptions for section 8 companies:

1. Appointment of a qualified company secretary shall not be mandatory.
2. Such a company may hold its AGM before or after business hours, or on a National holiday or at a place other than its registered office provided that the time, date and place of each AGM are decided before hand by the Board of directors having regard to the directions, if any, given in this regard by the company in its general meeting.
3. A general meeting of a section 8 company may be held by giving 14 days notice instead of 21 days.
4. Provisions of section 118 with respect to recording of minutes shall not apply to section 8 company except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the Articles of association provide for confirmation of minutes.
5. Provisions of section 149 relating to appointment of minimum and maximum number of directors shall not apply to such company.
6. Provisions of sections 149 and 150 relating to appointment of independent directors on the Board shall not apply.
7. Provision relating to consent of the director to act in that capacity required to be filed with RoC within 30 days of the appointment, as required under section 152(5), shall not be applicable.
8. A section 8 company needs to hold at least two meetings of the Board, one in every six months instead of four meetings.
9. Quorum for Board meetings shall be either 8 members or 25% of its total strength, whichever is less provided it is not less than 2 as against 1/3rd of the total strength or two directors, whichever is higher.
10. The power of the Board of directors to borrow monies or to invest the funds of the company or to grant loan or give guarantee or provide security in respect of loans may be exercised by the Board by circulation instead of at a meeting.

11. The maximum limit of 20 directorships shall not apply to section 8 companies.

3.11 Government companies

Section 2(*45*) defines a Government company to mean any company 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.

As per the definition of section 2(*45*) a Government company denotes 'any company' and the term 'company' in the Act, means a company as defined in section 2(*20*) of the Act, according to which a company is the one formed and registered under the *Companies Act, 2013* or under any previous company law. A statutory corporation formed under a statute of the Legislature, like Life Insurance Corporation, is not a 'company' under the *Companies Act, 2013 or* under any previous company law and as such is not a Government company. These are corporations as distinguished from Government companies and are incorporated under separate Acts of the Parliament.

Legal status of a Government company - There has been a catena of cases right from *Salomon* v. *A Salomon & Co. Ltd.* [1897] AC 22, which has established that a company brought into being under the Companies Act has a separate existence and the law recognises a company as *a juristic person separate and distinct from its members*. This personification emerges from the moment of its incorporation, and from that date, the persons subscribing to its memorandum of association and others joining it as members are regarded as a body incorporated or a corporate aggregate and the new person begins to function as an entity. The rights and obligations of a company are distinct from those of its shareholders. Therefore, *the legal status of a Government company is not affected just because the share capital of the company is contributed by the Central Government and all its shares are held by the President of India or the Governor of a State and certain nominated officers of the Government.* [*Heavy Engineering Mazdoor Union* v. *State of Bihar* [1969] 39 Comp. Cas. 905 (SC)]. The observations reproduced below of Justice P.L. Mukherjee *In re, River Steam Navigation Co. Ltd.* [1967] 2 Comp. LJ 106, bring out clearly the legal position of a Government company:

> "Government today is a competitor with public/private companies and corporations, and doing trade or business or commerce. In doing so the Government is not doing it *qua* Government. It joins the field of competition in these diverse spheres and fields as Government companies, as State trading corporations and in many other forms under particular statutes."

The consensus seems to be that when the Government engages itself in trading ventures, particularly as Government companies under the company law, it does not do so as a political State or political Government, but it does so in the garb and essence as a company. A Government company is not a department of the

Government. In *Andhra Pradesh State Road Transport Corporation* v. *ITO* AIR 1964 SC 1486, the Andhra Pradesh Road Transport Corporation claimed exemption from taxation by invoking Article 289 of the Constitution of India according to which the property and income of the State are exempted from the Union taxation. The Supreme Court, while rejecting the Corporation's claim, held that though it was wholly controlled by the State Government, it had a separate entity and its income was not the income of the State Government. Similarly, in *Western Coalfields Limited* v. *Special Area Development Authority* AIR 1982 SC 696, the Supreme Court did not uphold the contention of the Western Coalfields Ltd. and Bharat Aluminium Company Ltd. (the petitioners) that they were wholly owned by the Government of India and so the companies could not be subjected to property tax. The Chief Justice of India, Shri Chandrachud, observed as follows :

> "Even though the entire share capital of the appellant companies has been subscribed by the Government of India, it cannot be predicated that the companies themselves are owned by the Government of India. The companies which are incorporated under the Companies Act have a corporate personality of their own, distinct from that of the Government of India. The land and buildings are vested in and owned by the companies; the Government of India only owns the share capital."

On the rationale of the aforesaid judgments, in *Hindustan Steel Works Construction Co. Ltd.* v. *State of Kerala* [1998] 2 CLJ 383, it was held that notwithstanding all the pervasive control of the Government, company is neither a Government department nor a Government establishment. It is just an instrumentality or agency of the Government, and hence not exempt from the purview of Kerala Construction Workers Welfare Fund Act. However, where more than 97 per cent of the share capital of the company has been contributed by the State Government and the financial institutions controlled and belonging to the Government of India on the security and undertaking of the State Government, that the memorandum of association entrusted the company with important public duties, that out of 12 directors 5 were Government and departmental persons, besides other elected directors also were to be with the concurrence and nomination of the Government, it was clear that the State Government had deep and pervasive control of the company and its day-to-day administration, and the company was nothing but an instrumentality and agency of the State Government and the physical form of company was merely a cloak or cover for the Government - *Mysore Paper Mills Ltd.* v. *Mysore Paper Mills Officer's Association* [2002] 37 SCL 742 (SC).

Again, the exemption enjoyed by the Central Government property from State taxation was not allowed to a Government Company - *Electronics Corporation of India Ltd.* v. *Govt. of Andhra Pradesh* [1999] 97 Comp. Cas. 470 (SC).

A Government company can even sue the Government in its own name as a litigant. But, since protracted litigation between a Government company on the one hand and a Government department on the other, results in waste of public money and other resources including time, such disputes are resolved, as far as possible, outside the juridical process.

The employees of a Government company are not the employees of the Central or State Government. Since employees of Government companies are not Government servants they have no legal right to claim that the Government should pay their salary or that the additional expenditure incurred on account of revision of their pay scales should be met by the Government. A Government company may,

in fact, be wound up like any other company registered under the Companies Act. It may become insolvent or be unable to pay its debts. That should not mean that the shareholding Government, *viz.,* Central or State, as the case may be, has become bankrupt.

Government company is State itself - However, the Supreme Court in *Ajay Hasia* v. *Khalid Majit* AIR 1981 SC 496 held that a Government company may symbolize State. Justice Bhagwati observed as follows :

> "It is immaterial for the purpose whether the corporation is created by a statute or under a statute. The test is whether it is an instrumentality or agency of the Government and not as to how it is created. The enquiry has to be not as to how the juristic person is born but why it has been brought into existence. The corporation may be a statutory corporation created by a statute or it may be a Government company formed under the *Companies Act,* or it may be a society registered under the *Societies Registration Act, 1860* or any other similar statute. Whatever be its genetical origin, it would be an authority within the meaning of Article 12 if it is an instrumentality or agency of the Government and that would have to be decided on a proper assessment of the facts in the light of the relevant factors. The concept of instrumentality or agency of the Government is not limited to a corporation created by a statute but is equally applicable to a company or society and in a given case it would have to be decided on a consideration of the relevant factors whether the company or society is an instrumentality or agency of the Government so as to come within the meaning of the expression 'authority' in Article 12."

If a Government company is an authority, it shall be equivalent to a State and then it must also accept the obligations of the State.

Where more than 97 per cent of the share capital of the company has been contributed by the State Government and the financial institutions, controlled and belonging to the Government of India on the security and undertaking of the State Government, that the memorandum of association entrusted the company with important public duties, that out of 12 directors 5 were Government and departmental persons, besides other elected directors also were to be with the concurrence and nomination of the Government, it was clear that the State Government had deep and pervasive control of the company and its day-to-day administration, and the company was nothing but an instrumentality and agency of the State Government and the physical form of company was merely a cloak or cover for the Government - *Mysore Paper Mills Ltd.* v. *Mysore Paper Mills Officer's Association* [2002] 37 SCL 742 (SC).

Question whether an entity is a State within the meaning of Article 12 has to be decided by taking into consideration the cumulative facts as established and that whether such body or entity is financially, functionally and administratively dominated by or under the control of the Government - *R. V. Dnyansagar* v. *Maharashtra Industrial and Technical Consultancy Organisation Ltd.* [2003] 46 SCL 153 (Bom.).

Where there was nothing on record to indicate that the State Government had deep and pervasive control over the company and it was also not even a Government company within the meaning of section 617 [now section 2(45)], mere fact that the shares of the company prior to 1-6-1995 were held by banks or Industrial Banks/ Infrastructure Corporation by itself would not make it State or agency or instrumentality of State within meaning of Article 12 - *R. V. Dnyansagar* v. *Maharashtra Industrial and Technical Consultancy Organisation Ltd.* [2003] 46 SCL 153 (Bom.).

How should it be determined as to whether a Government company is an instrumentality or agency of the Government or not? Justice Bhagwati felt that it was not possible to evolve a straight formula by which corporations could be classified into those which are instrumentalities of Government and those which are not. However, an attempt to lay down certain tests in this regard was made in *Ramana Dayaram Shetty* v. *International Airports Authority of India* AIR 1979 SC 1628. These are as follows :

- If the entire share capital of the corporation is held by Government, it would go a long way towards indicating that the corporation is an instrumentality or agency of Government;
- Existence of deep and pervasive State control may afford an indication that the corporation is a State agency or instrumentality;
- It may also be a relevant factor … whether the corporation enjoys monopoly status which is State conferred or State protected;
- If the functions of the corporation are of public importance and closely related to Government functions, it would be a relevant factor in classifying the corporation as an instrumentality or agency of Government;
- Specifically if a department of Government is transferred to a corporation it would be a strong factor supporting this inference of the corporation being an instrumentality or agency of Government.

It should be noted, however, that the tests referred to above are not individually decisive: their cumulative effect in each particular case has to be taken into account.

A Government company - Whether a private or public company - Should a Government company be incorporated as a private company or a public company, is a question on which the *Companies Act, 2013* is silent. As a result, a Government company may be incorporated either way. In fact, incorporating a Government company as a private company is more convenient since only two members are needed to constitute it [Ref: Section 3 of the *Companies Act, 2013*]. Consequently, originally almost all Government companies were established as private limited companies and the articles of association of such companies included matters contained in Section 2(*68*) of the *Companies Act, 2013*.

Audit of Government companies - See discussion under Para 19.33-2.

Sale of shares of Government companies - Sale of shares of Government companies, though uninhibited, cannot be to such an extent that substratum of character of these companies is allowed to be lost and converted into an ordinary company without being approved by general body of shareholders - *Centre for Public Interest Litigation* v. *Union of India* [2003] 117 Comp. Cas. 123 (SC).

3.11-1 Exemptions

Ministry of Corporate Affairs vide its Notification dated 5-6-2015 as amended vide its notification dated 13.6.2017 has announced, *inter alia*, the following exemption for Government companies:

1. **Use of word(s) 'Limited' or 'Private Limited'**: A Government Company is not required to use 'Limited' or 'Private Limited' at the end of its name.

2. **Transfer of shares:** In case of transfer of bonds issued by a Government company, duly stamped instrument of transfer executed by the transferor and the transferee shall not be required to be filed provided an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate/letter of allotment relating to the bond.
3. **Beneficial interest in the shares:** Provisions of sections 89 and 90 with respect to declaration of beneficial interest in the shares and investigation thereof, respectively shall not apply to holding of shares in a Government Company.
4. **Place of AGM:** Under section 96, a Government company may hold its AGM at the registered office or such other place within the city, town or village in which the registered office of the company is situate or such other place as the Central Government may approve in this behalf.
5. **Dividends:** Under section 123(4), a Government Company in which entire paid up share capital is held by the Central Government or by any State Government(s) or by the Central Government and State Government(s) or by one or more Government Company need not deposit the dividend in a scheduled bank in a separate account within five days of its declaration.
6. **Board's Report**: The requirement of Board's Report to contain information on company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director, etc. in case of listed and other companies which are required to have Nomination and Remuneration Committee shall not apply to a Government company.
7. **Independent director**: Under section 149(6)(*a*), in case of a Government Company, a person shall be considered as an independent director if in the opinion of the Ministry or Department of the Central Government which is administratively in charge of the company, or as the case may be, the State Government is a person of integrity and possess relevant expertise and experience.
8. **Rotational Directors:** Provisions of section 152(6) and (7) relating to rotation of directors and filling of vacancy arising due to retiring of directors shall not apply to a Government company which is not a listed company.
9. **Managerial remuneration**: The provisions of section 197 relating to managerial remuneration do not apply to a Government Company.
10. **Mergers and Amalgamations:** Under provisions of sections 230-232 relating to compromise and arrangement as well as mergers and amalgamations, the power, instead of NCLT shall vest in the Central Government.
11. **Other Exemptions**: Provisions of many other sections including sections 160, 162, 163, 170, 171, 185 and 186 shall not apply to a Government Company.

3.12 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.

Having a share transfer office or share registration office will constitute a place of business.

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.

In *Tovarishestvo Manufacture Liudvig Rabenek, Re* [1944] Ch. 404 it was held that where representatives of a company incorporated outside the country frequently visited and stayed in a hotel for looking after purchase of machinery and other articles, it was held that the company had a place of business in the hotel.

Mere holding property cannot amount to having a place of business.

But, where the company delivered to the Registrar of Companies at Bombay documents under section 592 (now section 380) and such documents under that section are to be delivered within 30 days of the establishment of the place of business, it was held that by delivering the documents, the defendants had admitted that the company had established a place of business within India [*Framroze Rustomji Paymaster* v. *British Burmah Petroleum Co. Ltd.* [1976] 46 Comp. Cas. 587 (Bom.).

It may be noted that section 2(*42*) defines a foreign company in terms of its place of incorporation. If the company is established outside India and has a place of business in India, then only it will be a foreign company under the section. Accordingly, a company incorporated outside India having shareholders who are all Indian citizens and having its business outside India is not covered. Contrarily, a company incorporated in India but having all foreign shareholders shall be an Indian company and not a foreign company as contemplated under section 2(*42*).

3.12-1 Special provisions relating to foreign companies

A foreign company has to furnish to the Registrar the following documents within 30 days of the establishment of the business in India: (Sec. 380)

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*Rule 2(1)(*h*) of **the Companies (Specification of Definitions Details) Rules, 2014** defines 'electronic mode' as follows:—

"Electronic mode", for the purposes of clause (*42*) of section 2 of the Act, means carrying out electronically based, whether main server is installed in India or not, including, but not limited to-

(*i*) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(*ii*) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India;

(*iii*) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;

(*iv*) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(*v*) all related data communication services,

whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise.

(*a*) A certified copy of the charter, statute 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 English language, a certified translation thereof,

(*b*) The full address of the registered or principal office of the company.

(*c*) A list of directors and secretary of the company containing such particulars, as may be prescribed.

(*d*) The name(s) and address(es) of one or more persons resident in India, authorised to accept, on behalf of the company, service of process and any notices or other documents required to be served on the company shall be deemed to be sufficiently served, if addressed to any person whose name and address have been delivered to the Registrar and left at, or sent by post to, the address which has been so delivered to the Registrar or by electronic mode (Section 383).

(*e*) The full address of the office of the company in India which is to be deemed to be 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.

The aforesaid documents shall be filed along with Form FC-1. The application shall also be supported with an attested copy of approval from the Reserve Bank of India under Foreign Exchange Management Act or Regulations, and also from other Regulators, if any, approval is required by such foreign company to establish a place of business in India or a declaration from the authorized representative of such foreign company that no such approval is required.

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 [Section 380(3)].

Where foreign bank had brought on record factum of change of its name pursuant to merger to ROC by filing the prescribed Form, petition filed to treat all filings of foreign bank as null and void was dismissed by the Delhi High Court - *Klen & Marshalls Manufacturers & Exporters Ltd.* v. *Union of India* [2013] 30 taxmann.com 129 (Delhi)

If the company establishes any branch or branches of its business in India, no further information need be given except that with the annual accounts, the company should deliver a copy of a list in the prescribed form of all places of business established by the company in India as at the date with reference to which the accounts are made out [Sec. 381(3)].

3.12-2 Other obligations of a foreign company (Sec. 382) - A foreign company is further bound by the following obligations:

3.12-2a DISPLAY OF ITS NAME AND COUNTRY OF INCORPORATION - It shall conspicuously exhibit on the outside of every office or place of business, its name and the country of incorporation in English and the vernacular (local) language in general use.

3.12-2b PUBLICATION OF NAME - It shall cause the name of the company and of the country in which the company is incorporated, to be stated in legible English characters in all business letters, letter heads and letter papers and in all notices and other official publications of the company.

3.12-2c LIABILITY OF MEMBERS - If the liability of the members of the company is limited, it shall cause notice of that fact :

(*i*) in every such prospectus issued and in all business letters, letter heads, letter papers, notices, advertisements and other official publications of the company, in legible English characters;

(*ii*) to be conspicuously exhibited on the outside of every office or place where it carries on business in India, in legible English characters and also in legible characters of the languages or one of the languages in general use in the locality in which the office or place is situated.

3.12-2d OBLIGATIONS REGARDING ACCOUNTS (SEC. 381) - Every foreign company 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.

However, the Central Government may, by notification, exempt any foreign company or class of foreign companies from the aforesaid requirements*.

If any above mentioned document is not in the English language, there shall be annexed to it a certified translation thereof in the English language.

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*Ministry of Corporate Affairs *vide* Notification No. S.O. 2463(E) dated the 19th July, 2016 has declared that, in so far as it relates to the foreign company which is an airlines company having share capital, it shall be deemed sufficient compliance of the provisions of clause (*a*) of sub-section (1) of section 381 of the Act, if a company submits to the appropriate Registrar of Companies in India,—

(*i*) documents relating to copies of latest consolidated financial statements of the parent foreign company, as submitted by it to the prescribed authority in the country of its incorporation under the provisions of the law for the time being in force in that country: Provided that where such documents are not in English language, there shall be annexed to it a certified translation thereof in the English language.

(*ii*) in respect of its Indian Business operations, a statement of receipts and payments for the financial year, duly authenticated by a practicing Chartered Accountant in India or a firm or a Limited Liability Partnership of practicing Chartered Accountants in India.

(*iii*) the documents required to be filed with Registrar of Companies under sub-rule (2) of rule 4 of the Companies (Registration of Foreign Companies) Rules, 2014.

Audit of accounts of foreign companies

Every foreign company shall get accounts, pertaining to the Indian business operations prepared in accordance with the requirements of clause (*a*) of sub-section (1) of section 381 and rule 4, audited by a practicing chartered accountant or a firm or limited liability partnership of chartered accountants.

The provisions of the Companies Act, 2013 as contained in Chapter X, *i.e.*, Audit and Auditors and rules made thereunder shall apply, *mutatis mutandis*, to the foreign company – Rule 5 of the Companies (Registration of Foreign Companies) Rules, 2014.

3.12-2e BOOKS OF ACCOUNT AND OTHER RECORDS (SEC. 384) - The provisions of section 128 shall apply to a foreign company to the extent of requiring it to keep at its principal place of business in India, the books of account referred to in that section, with respect to monies received and spent, sales and purchases made, and assets and liabilities, in the course of or in relation to its business in India.

3.12-2f REQUIREMENTS AS TO PROSPECTUS (SECS. 387 TO 389) - A foreign company may, even if it has no place of business in India, issue a prospectus offering shares or debentures for subscription. But, the prospectus shall have to comply with the provisions of sections 387 to 389 of the Act relating to prospectus. *For example,* it shall have to be in the form and contain matters and returns specified in section 26. It must also be registered with the Registrar before it is issued (Sec. 389).

In addition to the general requirements of the Act, section 387 requires the prospectus of a foreign company to contain particulars with respect to the following matters :—

(*a*) The instrument containing or defining the constitution of the company;

(*b*) The provisions of law under which the company was incorporated;

(*c*) An address in India where the above instrument and the enactments or provisions of law may be inspected. If they are not in the English language, the certified English copy should be made available;

(*d*) The date on which and the country in which the company would be or was incorporated.

(*e*) Whether the company has established a place of business in India and if so, the address of its principal office in India.

As per Rule 11 of the Companies (Registration of Foreign Companies) Rules, 2014, the following documents shall be annexed to the prospectus:

(*a*) any consent to the issue of the prospectus required from any person as an expert;

(*b*) A copy of contracts for appointment of managing director or manager and in case of a contract not reduced into writing, a memorandum giving full particulars thereof;

(*c*) A copy of any other material contracts, not entered in the ordinary course of business, but entered within preceding two years;

(*d*) A copy of underwriting agreement;

(*e*) A copy of power of attorney, if prospectus is signed through duly authorized agent of directors.

3.12-2g FOREIGN COMPANIES IN WHICH NOT LESS THAN 50% OF THE PAID-UP SHARE CAPITAL IS IN INDIAN HANDS - Section 379 provides that where not less than 50% of the paid-up share capital (whether equity or preference or partly equity, partly preference) of a company incorporated outside India and having an established place of business in India, is held by one or more citizens of India or/and by one or more bodies corporate incorporated in India whether singly or in the aggregate, such company shall be required to comply with all the provisions of the Act with regard to the business carried on by it in India as if it were a company incorporated in India.

Office where documents to be delivered and fee for registration of documents

As per Rule 8 of the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar at New Delhi.

3.12-2h PENALTY - If a foreign company contravenes any of the aforesaid provisions, it shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and in the case of a continuing offence, with an additional fine which may extend to fifty thousand rupees for every day after the first during which the contravention continues and every officer of the foreign company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty- five thousand rupees but which may extend to five lakh rupees, or with both. [Section 392]

3.12-2i WINDING-UP - Where a foreign company which has been carrying on business in India, ceases to carry on such business in India, it may be wound-up as an unregistered company under section 375.

A foreign company may be a Government company and it may be wound-up or a scheme under section 391 (now section 230) may be sanctioned by the Court in India - *Rivers Steam Navigation Co. Ltd., In re* [1967] 2 Comp. LJ 106.

A foreign company's business in India can be wound-up even in cases where the company has been dissolved or otherwise ceased to exist under the laws of the country under which it was incorporated (Sec. 376).

Foreign company ceases to have place of business in India

Rule 8(3) of the Companies (Registration of Foreign Companies) Rules, 2014 provides that if any foreign company ceases to have a place of business in India, it shall forthwith give notice of the fact to the Registrar, and as from the date on which notice is so given, the obligation of the company to deliver any document to the Registrar shall cease, provided it has no other place of business in India.

Action for improper use or description as foreign company

Rule 12 of the Companies (Registration of Foreign Companies) Rules, 2014 provides that if any person or persons trade or carry on business in any manner under any name or title or description as a foreign company registered under the Act or the rules made thereunder, that person or each of those persons shall, unless duly registered as foreign company under the Act shall be liable for investigation under section 210 of the Act and action consequent upon that investigation shall be taken against that person.

3.12-2j OFFER OF INDIAN DEPOSITORY RECEIPTS (IDRs) (SEC. 390)[6] - An IDR is an instrument denominated in Indian rupees in the form of a depository receipt created by a domestic depository (custodian of securities registered with the Securities and Exchange Board of India) against the underlying equity of issuing company to enable foreign companies to raise funds from the Indian securities markets.

In an IDR, foreign companies would issue shares, to a domestic (Indian) depository, which would in turn issue depository receipts to investors in India. The actual shares underlying the IDRs would be held by an Overseas Custodian, which shall authorize the Indian depository to issue the IDRs. To that extent, IDRs are derivative instruments because they derive their value from the underlying shares.

Like Indian companies trying to tap funds abroad by issue of Global Depository Receipts (GDRs) or American Depository Receipts (ADRs), companies from outside India are interested to raise funds from India. They are allowed to do so but subject to the provisions of section 390.

Section 390 provides that, notwithstanding anything contained in any other law for the time being in force, the Central Government may make rules applicable for—

(*a*) the offer of Indian Depository Receipts;

(*b*) the requirement of disclosures in prospectus or letter of offer issued in connection with Indian Depository Receipts;

(*c*) the manner in which the Indian Depository Receipts shall be dealt with in a depository mode and by custodian and underwriters; and

(*d*) the manner of sale, transfer or transmission of Indian Depository Receipts, by a company incorporated or to be incorporated outside India, whether the company has or has not established, or will or will not establish, any place of business in India.

Rule 13 of the Companies (Registration of Foreign Companies) Rules, 2014 has, *inter alia*, made the following Rules with respect to Issue of Indian Depository Receipts (IDRs):

(1) For the purposes of section 390, no company incorporated or to be incorporated outside India, whether the company has or has not established, or may or may not establish, any place of business in India (hereinafter in this rule called 'issuing company') shall make an issue of Indian Depository Receipts (IDRs) unless such company complies with the conditions mentioned under this rule, in addition to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and any directions issued by the Reserve Bank of India.

Explanation - For the purposes of this rule, the term "Indian Depository Receipt" (hereinafter referred to as 'IDR') means any instrument in the form of a depository receipt created by a Domestic Depository in India and authorized by a company incorporated outside India making an issue of such depository receipts.

6. Section 390 became operational w.e.f. 1 April, 2014.

(2) The issuing company shall not issue IDRs unless–

(*a*) its pre-issue paid-up capital and free reserves are at least US$ 50 million and it has a minimum average market capitalization (during the last three years) in its parent country of at least US$ 100 million;

(*b*) it has been continuously trading on a stock exchange in its parent or home country (the country of incorporation of such company) for at least three immediately preceding years;

(*c*) it has a track record of distributable profits in terms of section 123 of the Act, for at least three out of immediately preceding five years;

(*d*) it fulfils such other eligibility criteria as may be laid down by the Securities and Exchange Board of India from time to time in this behalf.

(3) The issuing company shall follow the following procedure for making an issue of IDRs:

(*a*) the issuing company shall, where required, obtain the necessary approvals or exemptions from the appropriate authorities from the country of its incorporation under the relevant laws relating to issue of capital and IDRs.

(*b*) issuing company shall obtain prior written approval from the Securities and Exchange Board of India on an application made in this behalf for issue of IDRs along with the issue size.

(*c*) an application under clause (*b*) shall be made to the Securities and Exchange Board of India (along with draft prospectus) at least ninety days prior to the opening date of the IDRs issue, in such the prescribed form and manner.

Besides, the issuing company shall also file with the Securities and Exchange Board of India, through a Merchant Banker, a due diligence report along with the application under clause (*b*) in the form specified by the Securities and Exchange Board of India.

(*d*) the Securities and Exchange Board of India may, within a period of thirty days of receipt of an application under clause (*c*), call for such further information, and explanations, as it may deem necessary, for disposal of such application and shall dispose the application within a period of thirty days of receipt of further information or explanation.

However, if within a period of sixty days from the date of submission of application or draft prospectus, the Securities and Exchange Board of India specifies any changes to be made in the draft prospectus, the prospectus shall not be filed with the Securities and Exchange Board of India or Registrar of Companies unless such changes have been incorporated therein.

(*e*) the issuing company shall on approval being granted by the Securities and Exchange Board of India to an application under clause (*b*), pay to the Securities and Exchange Board of India The prescribed issue.

(*f*) the issuing company shall file a prospectus containing the prescribed particulars and certified by two authorized signatories of the issuing company, one of whom shall be a whole-time director and other the Chief Financial Officer, stating the particulars of the resolution of the Board by which it was approved with the Securities and Exchange Board of India and Registrar of Companies, New Delhi before such issue:

Provided that at the time of filing of said prospectus with the Registrar of Companies, New Delhi, a copy of approval granted by the Securities and Exchange Board of India and the statement of fees paid by the Issuing Company to the Securities and Exchange Board of India shall also be attached.

(*g*) the issuing company shall appoint and deliver the underlying equity shares or cause them to be delivered to an overseas custodian bank who shall authorize the domestic depository to issue IDRs. The issuing company shall also appoint a Domestic Depository and a Merchant Banker for the purpose of issue of IDRs.

(*h*) the issuing company may appoint underwriters registered with the Securities and Exchange Board of India to underwrite the issue of IDRs.

(*i*) the issuing company shall obtain in-principle listing permission from one or more stock exchanges having nationwide trading terminals in India.

(4) The Merchant Banker to the issue of IDRs shall deliver for registration the prescribed documents and information to the Securities and Exchange Board of India and Registrar of Companies at New Delhi. The documents are similar to the documents required to be filed by a foreign company.

(5) (*a*) No application form for the securities of the issuing company shall be issued unless the form is accompanied by a memorandum containing the salient features of prospectus in the specified form.

(*b*) An application form can be issued without the memorandum as specified in clause (a), if it is issued in connection with an invitation to enter into an underwriting agreement with respect to the IDRs.

(*c*) The prospectus for subscription of IDRs of the Issuing company which includes a statement purporting to be made by an expert shall not be circulated, issued or distributed in India or abroad unless a statement that the expert has given his written consent to the issue thereof and has not withdrawn such consent before the delivery of a copy of the prospectus to the Securities and Exchange Board of India and the Registrar of Companies, New Delhi, appears on the prospectus.

(*d*) The provisions of the Act shall apply for all liabilities for mis-statements in prospectus or punishment for fraudulently inducing persons to invest money in IDRs.

(*e*) The person(s) responsible for issue of the prospectus shall not incur any liability by reason of any non-compliance with or contravention of any provision of this rule, if—

(*i*) as regards any matter not disclosed, he proves that he had no knowledge thereof; or

(*ii*) the contravention arose in respect of such matters which in the opinion of the Central Government or the Securities and Exchange Board of India were not material.

(6) (*a*) A holder of IDRs may transfer the IDRs, may ask the Domestic Depository to redeem them or any person may seek reissuance of IDRs by conversion of underlying equity shares, subject to the provisions of the Foreign Exchange Management Act, 1999, the Securities and Exchange Board of India Act, 1992, or the

rules, regulations or guidelines issued under these Acts, or any other law for the time being in force;

(*b*) In case of redemption, Domestic Depository shall request the Overseas Custodian Bank to get the corresponding underlying equity shares released in favour of the holder of IDRs for being sold directly on behalf of holder of IDRs, or being transferred in the books of Issuing company in the name of holder of IDRs and a copy of such request shall be sent to the issuing company for information.

(*c*) A holder of IDRs may, at any time, nominate a person to whom his IDRs shall vest in the event of his death and Form FC-5 may be used for this purpose.

(7) (*a*) The repatriation of the proceeds of issue of IDRs shall be subject to laws for the time being in force relating to export of foreign exchange.

(*b*) The number of underlying equity shares offered in a financial year through IDR offerings shall not exceed twenty five per cent of the post issue number of equity shares of the company.

(*c*) Notwithstanding the denomination of securities of an Issuing company, the IDRs issued by it shall be denominated in Indian Rupees.

(*d*) The IDRs issued under this Rule shall be listed on the recognized Stock Exchange(s) in India as specified in clause (k) of sub-rule (3) and such IDRs may be purchased, possessed and freely transferred by a person resident in India as defined in section 2(v) of the Foreign Exchange Management Act, 1999, subject to the provisions of the said Act:

Provided that the IDRs issued by an Issuing company may be purchased, possessed and transferred by a person other than a person resident in India if such Issuing company obtains specific approval from Reserve Bank of India in this regard or complies with any policy or guidelines that may be issued by Reserve Bank of India on the subject matter;

(*e*) Every issuing company shall comply with such continuous disclosure requirements as may be specified by the Securities and Exchange Board of India in this regard.

(*f*) On the receipt of dividend or other corporate action on the IDRs as specified in the agreements between the Issuing company and the Domestic Depository, the Domestic Depository shall distribute them to the IDR holders in proportion to their holdings of IDRs.

(8) The prospectus or letter of offer shall contain the prescribed particulars.

3.13 Holding and subsidiary companies

'Holding' and 'subsidiary' companies are relative terms. 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(46), "holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies. *Explanation to this clause, added by the Companies (Amendment) Act, 2017 states that f*or the purposes of this clause, the expression "company" shall include any 'body corporate'.

Impact of change

A holding company, in relation to one or more other companies, was defined under the 2013 Act as a '*company*' of which such companies are subsidiary companies. The term '*company*' refers to a company incorporated under the 2013 Act or any previous company law and does not refer to an entity incorporated outside India. Accordingly, while Indian companies qualify as subsidiaries of foreign holding companies as per the definition of subsidiary under the 2013 Act, foreign holding companies were not covered within the ambit of the definition of holding company.

The CLC in its report observed that though this was a minor anomaly, it could lead to uncertainties in ascertaining the status of a foreign holding company and in determining the applicability of the 2013 Act to such a company.

The Amendment Act has therefore introduced an explanation to the definition of holding company to clarify that a holding company includes any body corporate.

Thus, Foreign companies which meet the prescribed test under the 2013 Act will consequently qualify as holding companies.

Accordingly, provisions of the 2013 Act which refer to holding companies, such as issuance of ESOPs of a holding company to employees of the Indian subsidiary, the restriction on auditors and audit firms providing certain non-audit services wherein they are engaged directly or indirectly by the holding company (or any of the holding company's associates or subsidiaries), the restriction on an Indian company giving loans to a director of its holding company, etc. will apply to a foreign holding company as well.

Subsidiary Company

According to Section 2(*87*), as amended by the (Amendment) Act of 2017, "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 voting power either at its own or together with one or more of its subsidiary companies:

However, such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

You may note that a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in (*i*) or (*ii*) above is of another subsidiary company of the holding company;

Further, the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company, by exercise of some power exercisable by it at its discretion, can appoint or remove all or a majority of the directors.

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

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

Control over composition of a subsidiary company's Board of directors can arise from provisions in subsidiary's memorandum or articles or from a contract with subsidiary empowering holding company to appoint directors to subsidiary's Board - *Oriental Industrial Investment Corporation Ltd.* v. *Union of India* [1981] 51 Comp. Cas. 487 Delhi.

(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'.

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

You may note that 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. The two enjoy separate legal entities.

The position regarding holding subsidiary relationship was impressively summarised in the case of *M. Velayudhan* v. *Registrar of Companies* [1980] 50 Comp. Cas. 33 (Ker.) as follows :—

Section 4 [now section 2(*87*)] envisages the existence of subsidiary companies in different situations. It may be that by acquiring sufficient share capital of a company, sufficient control may be obtained over that company to enable control in the composition of board of directors. But, it is also possible to obtain such control in regard to the composition of the board of directors without making such an investment in equity capital of the company. Such a control may be by reason of an agreement such as where one company may agree to advance funds to another company and in return may, under the terms of an agreement, gain control over the right to appoint all or a majority of the Board of directors. The first of the cases envisaged in section 4 [now section 2(*87*)] is the case where a control is obtained by a company in the matter of composition of the Board of directors of another company. That would be sufficient to constitute the former as holding company and the other as subsidiary. The second type of cases is where more than half of the nominal value of the equity share capital is held by another company. By virtue of such holding that other company becomes a holding company and the one whose shares are so held becomes a subsidiary company. The third case envisaged is where a subsidiary company of a holding company may be a holding company in relation to another company. That other company is also a subsidiary of the holding company of the subsidiary.

Questions as to whether a company was subsidiary of other company cannot be decided merely on basis of fact that one of directors was common to said companies, but it has to be decided in context of section 4 [now section 2(*87*)] - *Whale Stationery Products Ltd.* v. *UOI* [2007] 75 SCL 351 (Delhi).

3.13A Associate Company [Section 2(6)]

According to section 2(*6*) of the Companies Act, 2013, as amended by the Companies (Amendment) Act, 2017 an 'Associate company', in relation to another company means a company in which that other company has a control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement.

Associate company is not a subsidiary but may be a joint venture. The expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

3.14 Public financial institutions [Sec. 2(72)]

According to Section 2(*72*) of the Companies Act, 2013, as amended by the (Amendment) Act, 2017, the following financial institutions shall be regarded, for the purposes of the Act, as public financial institutions, namely :

(*i*) the Life Insurance Corporation of India ;

(*ii*) the Infrastructure Development Finance Company Limited;

(*iii*) specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002*;

(*iv*) institutions notified by the Central Government under sub-section (*2*) of section 4A of the Companies Act, 1956 ;

(*v*) such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India.

However, no institution shall be so notified unless—

(*A*) it has been established or constituted by or under any Central or State Act, other than this Act or the previous company law; or

(*B*) not less than fifty-one per cent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

The Central Government has, *inter alia*, specified the following institutions to be public financial institutions, namely :—

(1) The Industrial Investment Bank of India (Formerly, IRBI).

(2) The General Insurance Corporation of India (GIC).

(3) The National Insurance Company Limited.

(4) The New India Assurance Company Limited.

(5) The Oriental Fire & General Insurance Company Limited.

(6) The United Fire & General Insurance Company Limited.

(7) The Shipping and Credit & Investment Company of India Ltd. (SCICI).

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*Central Government constituted UTI Trustee company and UTI Asset Management Company as the specified companies – *Press Release dated 15-1-2003, Ministry of Finance and Company Affairs.*

(8) Tourism Finance Corporation of India Ltd. (TFCI).
(9) Risk Capital & Technology Finance Corporation Ltd.
(10) Technology Development & Information Company of India Ltd.
(11) Power Finance Corporation Limited.
(12) National Housing Bank (NHB).
(13) Small Industries Development Bank of India (SIDBI).
(14) Rural Electrification Corporation Limited.
(15) Indian Railways Finance Corporation Limited.
(16) Industrial Finance Corporation of India Limited.
(17) Andhra Pradesh State Financial Corporation.
(18) Assam Financial Corporation.
(19) Bihar State Financial Corporation.
(20) Delhi Financial Corporation.
(21) Gujarat State Financial Corporation.
(22) Haryana Financial Corporation.
(23) Himachal Pradesh Financial Corporation.
(24) Jammu & Kashmir State Financial Corporation.
(25) Karnataka State Financial Corporation.
(26) Kerala Financial Corporation.
(27) Madhya Pradesh Financial Corporation.
(28) Maharashtra State Financial Corporation.
(29) Orissa State Financial Corporation.
(30) Punjab Financial Corporation.
(31) Rajasthan Financial Corporation.
(32) Tamilnadu Industrial Development Corporation Limited.
(33) Uttar Pradesh Financial Corporation.
(34) West Bengal Financial Corporation [Notification No. S.O. 247(E), dated 28-3-1995].
(35) North Eastern Development Finance Corporation Limited (Notification dated 23-7-1996).
(36) Indian Renewable Energy Development Agency Ltd.
(37) Housing and Urban Development Corpn. Ltd.
(38) Export-Import Bank of India.
(39) National Bank for Agriculture and Rural Development (NABARD).
(40) National Co-operative Department Corporation (NCDC) added by Notification No. 581E, dated 9-5-2003.
(41) National Dairy Development Board.
(42) The Pradeshiya Industrial and Investment Corporation of UP Ltd.

(43) Rajasthan State Industrial Development and Investment Corporation Ltd.

(44) State Industrial Development Corporation of Maharashtra Ltd.

(45) West Bengal Industrial Development Corporation Ltd.

(46) Tamil Nadu Industrial Development Corporation Ltd.

(47) The Punjab State Industrial Development Corporation Ltd. [Notification No. S.O. 1531(E) dated 25-10-2006].

(48) EDC Ltd. [Notification dated 9-1-2007].

(49) Tamil Nadu Power Finance and Infrastructure Development Corporation Ltd. [Notification No. S.O. 20(E) dated 9-1-2007].

(50) Tamil Nadu Urban Finance and Infrastructure Development Corporation Ltd.*

(51) Kerala State Power and Infrastructure Finance Corporation Ltd.*

(52) Jammu and Kashmir Development Financial Corporation [Notification No. SO. 298(E), dated 12-2-2008]

(53) Kerala State Industrial Development Corpn. Ltd. [Notification No. S.O. 110(E), dated 9-1-2009].

(54) Indian Infrastructure Finance Co. Ltd. [Notification No. S.O. 143(E), dated 14-1-2009].

(55) Gujarat Industrial Investment Corporation Ltd. [Notification No. S.O. 1355(E), dated 10-6-2011].

(56) Andhra Pradesh Industrial Dev. Corporation Ltd. [Notification No. S.O. 1355(E), dated 10-6-2011].

(57) Karnataka Urban Infrastructure Development and Finance Corporation Ltd. [Notification No. S.O. 1355(E), dated 10-6-2011].

(58) L&T Infrastructure Finance Co. Ltd. [Notification No. S.O. 1355(E), dated 10-6-2011].

(59) Srei Infrastructure Finance Co. Ltd. [Notification No. S.O. 2223(E), dated 26-9-2011].

The Companies (Amendment) Act, 2017 has clarified that a company incorporated under the Companies Act cannot be notified as a Public Financial Institution.

3.15 Producer Companies[7]

Part IX A dealing with Producer Companies has been added to the Companies Act, 1956 by the Companies (Amendment) Act, 2002 and the provisions of this part have become operative w.e.f. 6th February, 2003 [*vide* Notification No. S.O. 135(E) dated 5th February, 2003 issued by the D.C.A.]. Through this Amendment Act a new class of companies has been created in the Act with special provisions in this regard. This part of the Companies Act, 1956 is unique in character - it provides a self-contained set of legal provisions in the matter of Producer Companies and is exclusively devoted to Producer Companies. The necessity to bring in this class of companies under the discipline of the Companies Act, though has not been spelt out in the Part,

7. Ministry of Corporate Affairs has clarified that the producer companies, as of now, shall continue to be governed by the provisions of the Companies Act, 2013.

seems to provide a regulated platform for development of entities engaged in activities that a producer company may engage in sections 581A to 581ZT of the Act spread on twelve chapters comprise this Part.

The pattern and contents of the chapters appear to suggest that this Amendment Act is an Act within an Act and most of the distinctive features of the Companies Act, 1956 are there. It can further be noted that this Amendment Act has principal focus on multi-State co-operative societies.

Recognising inherent limitations of the co-operative form of economic organization and primarily to bring the multi-State co-operative societies in the main-stream economic activity but not giving-up the co-operative principle of mutual assistance, Part IX A has been enacted and included in the Companies Act, 1956. This Part IXA has been so framed as to bring inducement for earning profit by emphasising on active membership, distribution of patronage bonus and other direct benefits to members. Further, the scheme of activity has been devised for bringing discernible corporate culture by creating position for C.E.O. and emphasizing on marketing, research, technical services, training, etc.

3.15-1 Overview of the provisions

Part IXA as introduced enable incorporation of co-operatives as companies and conversion of existing co-operatives into companies, on optional basis. Unique elements of co-operative business are accommodated within a regulatory framework similar to that of companies. The salient features are - (*i*) to offer a statutory and regulatory framework that creates the potential for producer-owned enterprises to compete with other enterprises on a competitive footing, (*ii*) to provide for the formation and registration of producer companies which include the mutual assistance and co-operative principles within the more liberal regulatory framework afforded by the Company Law with suitable adaptations, (*iii*) to provide an opportunity to co-operative institutions to voluntarily transform themselves into the new form of producer companies, (*iv*) conversion of a co-operatives to producer companies is purely voluntary, (*v*) member's equity may not be publicly traded, but may only be transferred, with the approval of the producer company's Board of Directors. Producer companies would not be vulnerable to the takeover by multinationals or other companies, (*vi*) the conversion option by co-operative society to producer company can be exercised only if two-thirds of the members of the concerned society vote in favour of a resolution to that effect, (*vii*) the new form of company is designated as 'producer company' to indicate that only certain categories of persons can participate in the ownership of such companies. The members of the Producer Company have necessarily to be 'primary producers' that is persons engaged in an activity connected with, or relatable to, primary produce, (*viii*) the objects of a producer company have been defined to include, among other things production, processing, manufacture and sale of primary produce as well as allied matters.

3.15-2 Incorporation of Producer Companies

Section 581B to section 581N deal with matters connected with incorporation of producer companies. Section 581B(*i*) specifies the objects with which a producer company can be incorporated under the Act. The nucleus of all the objects stated

in the aforesaid section seems to be 'primary produce' and this expression has been defined in section 581A(j) meaning—

(*i*) produce of farmers arising from agriculture [including animal husbandry, horticulture, floriculture, pisciculture (raising fish), viticulture (growing grapes), forestry, forest products, re-vegetation, bee raising and farming plantation products], or from any other primary activity or service which promoted the interest of farmers or consumers;

(*ii*) produce of persons engaged in handloom, handicraft and other cottage industries;

(*iii*) any product resulting from any of the above activities, including by-products of such products;

(*iv*) any product resulting from an ancillary activity that would assist or promote any of the aforesaid activities or anything ancillary thereto;

(*v*) any activity which is intended to increase the production of anything referred to in (*i*) to (*iv*) above or improve the quality thereof. Broadly, the definition covers activities of and related to agriculture (of various forms) and handloom, handicraft and other cottage industries. Till now these activities had been the concern of co-operative societies. Part IXA has not defined the word 'Produce'. Therefore, this word has to be construed as to its natural meaning.

However, services also come within the definition by virtue of clause (*v*) above.

3.15-3 Objects of a Producer Company

The objects with which a producer company can be incorporated are as under :

(*a*) production, harvesting, procurement, grading, pooling, handling, marketing, selling and export of primary produce of the members or import of goods or services for their benefit; any of these activities can be carried on by the company being incorporated or through other institution on behalf of the company;

(*b*) processing including preserving, drying, distilling, brewing, venting, canning and packaging of produce of its members;

(*c*) manufacture, sale or supply of machinery, equipment or consumables mainly to its members; [in other words, a producer company can as well be a normal manufacturing or trading company provided it produces requirements of the farming sector and handicrafts, handloom and cottage industries, provided further that the company's members are the main buyers and users of these products];

(*d*) providing education on the mutual assistance principles to its members and others; [*i.e.*, it can be an institution imparting education to the members of the company as also others, owning the institution on principles of 'mutual assistance'. The expression 'mutual assistance principle' has been defined in section 581A(*f*) read with section 581B(2) of the Act];

(*e*) rendering technical services, consultancy services, training, research and development and all other activities for the promotion of interests of its members [*i.e.*, it can be a service rendering company acting as a catalyst for

improved quality of production or for development of products by research or allied activities of its members;]

(*f*) generation, transmission and distribution of power, revitalization of land and water resources, their use, conservation and communications relatable to primary produce; *i.e.*, it can be a power generating, transmitting and distributing company or a company developing/improving land and water resources including their conservation, all of which should be relatable to primary produce. Here, a company promoted with this object does not need to have as buyers/users of its output restricted to its members;

(*g*) insurance of producers or their primary produce (*i.e.*, it can be an insurance company insuring producers or their primary produce);

(*h*) promoting techniques of mutuality and mutual assistance;

(*i*) welfare measures or facilities for the benefit of members as may be decided by the Board;

(*j*) any other activity, ancillary or incidental to any of the activities referred in (*a*) to (*i*) above or other activities which may promote the principles of mutuality and mutual assistance amongst the members in any manner;

(*k*) financing of procurement, processing, marketing or other activities specified in clauses (*a*) to (*j*) above.

A producer company can be incorporated with all or any of the above objects.

3.15-4 Formation of Producer Company and its registration [Section 581C]

The following categories of people or entities will be entitled to form a producer company :

(*i*) any ten or more individuals each of whom will be a producer;

(*ii*) any two or more producer institutions;

(*iii*) a combination of ten or more individuals and producer institutions.

A 'producer' has been defined in section 581A(*k*) as "any person engaged in any activity connected with or relatable to any primary produce" and a 'producer company' has been defined by clause (*l*) of section 581A as "a body corporate having objects or activities specified in section 581B and registered as 'producer company' under the Act." A 'producer institution' has been defined in the next clause of section 581A as a producer company or any other institution having only producer or producers or producer company or producer companies as its member 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 or producer companies as provided in its articles. The definitions of 'producer' and 'producer company' do not need much elaboration except that 'a producer' is not necessarily an individual and it can be any entity which in law can be considered as 'person' *e.g.* a company or a co-operative society. In other words, a producer can be an individual, a producer company or a co-operative or other society with only condition that such body must be engaged in any activity connected with or relatable to any primary produce. A 'producer company' can have as its members, co-operative societies or other legal entities apart from individuals. The definition of 'producer institution', however, is a bit complex. The term 'institution' in this context does not bear any

special meaning and as such it can be an organisation or establishment devoted to the promotion of a particular object and in this case the object has to be any or all the objects with which a producer company can be registered, (the objects mentioned in section 581B). A producer institution cannot be an individual; it is to be a collective entity composed of members who may be individual or producer company. It is important to note that a producer institution, not itself being a producer company, has to have as its members only producer(s) and/or producer company(ies). A producer company itself also can be a producer institution. A producer institution, other than a producer company, can be either an incorporated body or a non-incorporated body. The only further condition to be fulfilled is that it has to have object or objects mentioned in section 581B. It seems, therefore, that even a partnership firm, a joint Hindu family, or an Association of persons or a Trust can as well be a producer institution, provided its object(s) is confined to the objects mentioned in section 581B. Also a section 25 company under the Act can be a producer company or a producer institution. If any existing section 25 company has as its objects any or all the objects in section 581B, it will automatically become a producer company or a producer institution and would be governed by the requirements of Part IXA of the Act as well with the exception that it cannot have distribution of profit earned amongst its members.

Ordinarily, the term "institution" is associated with a 'no-profit' motive, but in case of producer institution, that is not the case. No provision of this part bars a producer institution from earning profit and distributing the same to its members. A further issue needs consideration; a producer company can be a producer institution apart from any other body that qualify to be a producer institution. What would then be distinguishing feature of a producer company becoming a producer institution ? It seems that any producer company which has other producer companies as members will only qualify to be called producer institution. However, if such a company has any other body or individual as member(s), it will remain as producer company only.

The promoting individuals/bodies of a producer company must express the desire to form such a company with object(s) specified in section 581B. They will also have to comply with the requirements of Part IXA of the Act and provisions of the Act in respect of registration of companies. Under provisions of sections 581F and 581G, the promoters of a producer company will have to prepare the memorandum of association and articles of association, special to producer companies. The requirements are as under :

3.15-5 Memorandum of association of a producer company shall state—

(*i*) the name of the company with "Producer Company Limited" as last words of the name of such company;

(*ii*) the state in which the registered office of the Producer Company is to situate (in case the objects of the producer company are to extend beyond the state of registration, the State(s) to which the objects will extend will have to be stated);

(*iii*) the main objects of the producer company shall be one or more of the objects specified in section 581B;

(*iv*) the names and addresses of the persons who have subscribed to the memorandum ('Persons' mean individuals and Producers institutions);

(*v*) the amount of share capital with which the producer company is to be registered and division thereof into shares of fixed amounts;

(*vi*) the name, address and occupation of the subscribers being producers, who shall act as the first directors of the producer company [a reference to section 581J(2) has been made in this context which seems to be inappropriate. It should be section 581R(2);]

(*vii*) that the liability of its members is limited;

(*viii*) the number of shares each subscriber takes is mentioned opposite to the name of respective subscriber. No subscriber shall take less than one share.

3.15-6 Directors

It seems that the first directors of the producer company will be only from producers who are individuals and producer institution as such cannot be a director. Where, however, a producer company is being promoted only by producer institutions, the possible recourse would be to have required individuals acting for and on behalf of promoting producer institutions as nominee holders of shares to act as first directors. In case of an incorporated body this is already an accepted procedure but if the promoting producer institution is a non-incorporated body, the process of nomination as subscriber *cum* first director shall have to be determined by reference to its constituting document.

3.15-7 Subscription to the memorandum by non-incorporated body of producer institution

Since a non-incorporated body also can be producer institution, a mechanism needs to be evolved by reference to the constituting document of that body to sign as subscriber to the memorandum.

3.15-8 Status of a Producer Company

As per section 581C(5), a producer company on registration as such, will be treated as a private limited company under this Act, to which Part IXA will apply even though it is not required to add the word "private" in its name or to restrict its membership to the number (*i.e.*, fifty) specified for other Private Limited Companies or to be subjected to the general requirement of a minimum of two members. So far minimum strength of members criterion is concerned, it needs to have at least two producer institutions or ten producers or a total of ten producers and producer institutions as minimum number of members to form a producer company and to carry on its activities. A producer company shall have liability of its members limited by the Memorandum to the amount, if any, unpaid on the shares respectively held by them. It will be a company limited by Shares [Section 581C(3)]. A producer company shall not be a public company under this Act. (Nor shall it be a guarantee company or unlimited company)

A member means a person or producer institution admitted as a member of a Producer company and who retains the qualifications necessary for continuance as such.

3.15-9 Articles of Association [Section 581G]

The distinctive feature of the Articles of Association of a producer company is that the Articles have to contain certain "mutual assistance principles", apart from other relevant regulatory provisions. "Mutual assistance Principles" have been defined in clause (*f*) of section 581A as the principles set out in sub-section (2) of section 581G and they are as under :

(*i*) the membership shall be voluntary and available to all eligible persons who, can participate or avail of the facilities or services of the Producer Company, and are willing to accept the duties of membership;

(*ii*) each member shall, save as otherwise provided in Part IXA of the Act, have a single vote irrespective of the shareholding;

(*iii*) the Producer Company shall be administered by a Board consisting of persons elected or appointed as directors in the manner consistent with the provisions of Part IXA of the Act and the Board shall be accountable to the members;

(*iv*) there shall be limited return (the maximum dividend as may be stated in the Articles) on share capital except for circumstances provided in Part IXA of the Act;

(*v*) the surplus arising out of the operations of the producer company shall be distributed in an equitable manner by—

(*a*) providing for the development of the business of the producer company;

(*b*) providing for common facilities; and

(*c*) distributing amongst the members, as may be admissible, in proportion to their respective participation in the business;

(*vi*) provision for education of members, employees and others, on the principles of mutuality and techniques of mutual assistance shall be made;

(*vii*) the producer company shall actively co-operate with other producer companies (and other organisation following similar principles) at local, national or international level so as to best serve the interests of its members and the communities it purports to serve.

The Articles shall also contain the following provisions in terms of sub-section (3) of section 581G of the Act :

(1) the qualifications for membership, the condition for continuance or cancellation of membership and the terms, conditions and procedure for transfer of shares;

(2) the manner of ascertaining the patronage and voting right based on patronage;

(3) the manner of constitution of the Board, its powers and duties, the minimum and maximum number of directors, manner of election and appointment of directors and retirement by rotation, qualifications for being elected or continuance as such and the terms of office of the said directors, their powers and duties, conditions for election or co-option of directors, method of removal of directors and the filling up of vacancies on the Board, and the manner and the terms of appointment of the Chief Executive (as stipulated

in section 581W). [When an inter-State co-operative society transforms itself as a producer company, all its directors at the time of transformation shall become and continue as directors of the producer company concerned for a period of one year from the date of the transformation. However, their rights, duties, etc. as directors will then be according to the provisions of the Companies Act, 1956];

(4) the election of the chairman, term of office of directors and the chairman, manner of voting at the general or special meetings of members, procedure for voting by directors at meetings of the Board, powers of the chairman and the circumstances under which the chairman may exercise a casting vote;

(5) the circumstances under which and the manner in which, the 'withheld price' is to be determined and distributed ['withheld price' means part of the price due and payable for goods supplied by any member to the producer company and as withheld by the producer company for payment on a subsequent date - Section 581A(*n*)].

Note : Since a producer company can engage in providing service also [*vide* section 581A(j)(*v*)], it seems that no part of service charge can be withheld by a producer company. Right to withhold is confined to 'price of goods supplied';

(6) the manner of disbursement of patronage bonus in cash or by issue of equity shares or both; (A producer company can have only equity share capital - *vide* section 581ZB of the Act);

'Patronage bonus' means payments made by a producer company out of its surplus income to the members in proportion to their respective patronage. The word "patronage", in turn, means the use of services offered by the producer company to its members by participation in its business activities [*vide* clauses (*h*) and (*i*) of section 581A];

(7) the contribution to the shared and related matters [in the event of a producer company not being in a position to transfer requisite sum(s) to the reserves (including the general reserve) as may be specified in the Articles, the shortfall will have to be shared by the members in proportion to their patronage in the business of the producer company of that year. This sharing is the "contribution"];

(8) the matters relating to the issue of bonus shares out of general reserve of the producer company;

(9) the basis and manner of allotment of shares of the producer company in lieu of the whole or part of sale proceeds of produce or products supplied by the members;

(10) the amount of reserves, sources from which funds may be raised, limitation on raising of funds, restriction on the use of such funds and the extent of debt that may be contracted and the conditions thereof;

(11) the credit, loans or advances which may be granted to a member and the conditions for the grant of the same;

(12) the right of any member to obtain information relating to general business of the company;

(13) the basis and manner of distribution and disposal of funds available after meeting liabilities in the event of dissolution or liquidation of the producer company;

(14) the authorization for division, amalgamation, merger, creation of subsidiaries and the entering into joint ventures and other matters connected therewith;

(15) laying of the Memorandum of Association and Articles of Association of the Producer Company before a special general meeting to be held within ninety days of its registration; and

(16) any other provision, which the members may, by special resolution recommend to be included in articles, *e.g.*, members' or others' right of inspection of books, registers and records, etc.

3.15-10 Registration of Producer Company

The registration of a producer company requires compliance not only with those specified in this Part IXA of the Act but also other applicable provisions of the Act not dealt with by this Part of the Act. It is evident from the language used in section 581C of the Act. For example, provisions of sections 15 and 30 of the Act dealing with printing and signature of memorandum and articles of association will require compliance. Similarly, section 33 of the Act requiring registration of memorandum and articles will also apply to a producer company. Section 20 concerns approval of name of a company and producer company is no exception to that section. Upon receipt of the memorandum and the articles along with any other relevant document of the producer company for registration and after examining their contents if the Registrar is satisfied that all the requirements of the Companies Act have been complied with in respect of registration of the producer company, including matters precedent and incidental thereto, he shall, within thirty days of the receipt of the documents lodged for registration, register the memorandum, the articles and other documents, if any, and issue a certificate of incorporation to the producer company. Sections 34(2) and 35 of the Act regarding conferring of the 'body corporate' status and conclusiveness of the Certificate of incorporation will then apply to the producer company. On incorporation, the producer company may reimburse to its promoters all the direct costs associated with promotion and registration of the company. These costs include registration fees, legal fees and the cost of printing of the memorandum and the articles. This reimbursement can be made only with the approval of the first general meeting of the producer company.

3.15-11 Amendment of Memorandum and Articles of Association of a producer company

Sections 581H and 581-I contain requirements to be fulfilled for amending memorandum and articles of the producer company. A producer company may, by special resolution, not inconsistent with section 581B (objects of a producer company), alter its objects specified in the memorandum. A copy of the memorandum as amended, together with a copy of the special resolution duly certified by two directors, shall be filed with the Registrar within thirty days from the date of adoption of the resolution. With a view to alter the Memorandum so as to change the address of the producer company, from the jurisdiction of one Registrar to the jurisdiction of another Registrar, a special resolution will have to be passed and

copies of the special resolution certified by two directors of the producer company shall be filed with both the Registrars, presumably with copies of the altered memorandum within thirty days. Each Registrar will record the same and thereafter it will be the responsibility of the Registrar from whose jurisdiction the address (the place) has been shifted to forthwith forward to the other Registrar all the documents with him relating to the producer company concerned. In case the change involves shifting of the producer company from one state to another, the confirmation of the Company Law Board is necessary.

Unlike the process of amendment of the memorandum, section 581-I requires a proposal by either at least two-third of the elected directors or at least one-third of the members of the producer company to amend any clause of the Articles of the company. The proposal as above has to be approved by a special resolution of the members. A copy of the amended Articles together with the copy of the special resolution, duly certified by two directors, is required to be filed with the Registrar within thirty days from the date of its adoption.

3.15-12 Benefits to Members [Section 581E]

(*i*) Every member shall initially receive only such value for the produce or products supplied and pooled as the Board of the producer company may determine. This determination shall have to be made in accordance with the provision made in the Articles in this behalf. The price not paid then (withheld price) may later be disbursed in cash or in kind or by allotment of equity shares, in proportion to the produce supplied to the producer company during the financial year. The extent of the payment or settlement of the withheld price shall be decided by the Board along with the manner and condition thereof. This provision implies that the Board of the Producer Company may not pay the full withheld price.

(*ii*) On the share capital, the members are entitled to only a limited return as provided in the Articles.

(*iii*) Members may receive bonus shares of the producer company in accordance with the provisions of section 581ZJ. Necessary clause in this regard need to be in the Articles. Section 581ZJ authorises a producer company to issue bonus shares by capitalisation of amounts from general reserve, in proportion to the shares held by the members on the date of the issue. However, the issue of the bonus shares as above should be approved by members in a general meeting, provided the Board has made a recommendation to that effect. The Articles may provide for the type of resolution needed for this purpose. However, if the Articles do not contain any clause on issue of bonus shares, the Articles have to be first amended before passing the appropriate resolution.

(*iv*) Patronage bonus may be paid to the members by the producer company out of any surplus left after making provision for payment of limited return and creation of any reserves mandated by section 581ZI. If the company decides to pay patronage bonus to members, it should be in proportion to their participation in the business of the producer company and may be paid either in cash or by way of allotment of shares, or both as may be decided by the members in the general meeting. Here again, the Articles must have clause enabling the producer company to pay patronage bonus.

3.15-13 Voting rights of members of a producer company

Section 581D specifies that :

(*i*) Where membership consists of individual producers only every member shall have a single vote, irrespective of his shareholding or patronage.

(*ii*) Where membership comprises of only producer institutions, such members shall enjoy voting rights on the basis of their participation in the business of the producer company in the previous year, as may be specified in the Articles. However, when the producer company did not exist in the previous year *i.e.*, in the first year of its operation, the voting rights of these members shall be determined on the basis of their respective shareholding.

(*iii*) Where membership comprises of both individual producers and producer institutions, the voting rights shall be computed on the basis of a single vote for every member irrespective of whether he/it is an individual or institution.

(*iv*) The Articles of the producer company may provide for the conditions, subject to which, a member may continue to retain his/its membership as also the manner in which voting rights shall be exercised by the members.

(*v*) Subject to authorization by the Articles, a producer company may restrict the voting rights to 'active members' only in the general or special meeting of members. An 'active member' has been defined in clause (*a*) of section 581A as "a member who fulfils the quantum and period of patronage of the producer company as may be required by the Articles". This means that if the articles so provide any member whether an individual or an institution can be denied voting rights altogether, if he/it fails to fulfil the criteria of "active member".

Therefore, though perhaps not intended to be the shares with differential rights as to dividend, voting or otherwise as included in section 86 of the Act, it is clear that a Producer Company may render certain shares as non-voting shares through its articles.

3.15-14 Membership and conflicting business interest

No person, who has any business interest which is in conflict with business of the producer company, can become a member of that company. Further, if he acquires any conflicting business interest after becoming member of a producer company, he will cease to continue as such member and be removed from membership in accordance with the Articles of the company.

3.15-15 Inter-State Cooperative Societies can become Producer Company [Sections 581J-581N]

Section 581C provides the basic mechanism for formation of producer company in which ten individual producers or two producer institutions or a combination of them numbering not less than ten can form a producer company. However, provisions of section 581J enable an inter-State cooperative society (hereinafter "society") also to become a producer company. Clause (*e*) of section 581A defines "inter-State cooperative societies" as "a multi-State cooperative society" as defined in clause (*k*) of section 3 of the Multi-State Cooperative Societies Act, 1984 and

includes any cooperative society registered under any other law for the time being in force, which has, subsequent to its formation, extended any of its objects to more than one State by enlisting the participation of persons or by extending any of its activities outside the State, whether directly or indirectly or through an institution of which it is a constituent. Clause (*k*) of section 3 of the Multi-State Cooperative Societies Act, 1984 defines a multi-State cooperative society as under :

> "It means a society registered or deemed to be registered under this Act and includes a national cooperative society."

Any inter-State cooperative society with objects not confined to a single state make an application to the Registrar of Companies (RoC) for registration as a producer company. The application has to accompany the following :

(*a*) a copy of special resolution (at least 2/3rd of the total number of members of the cooperative society voting for it) approving for its incorporation as a producer company under the Companies Act, 1956;

(*b*) statements showing/containing/indicating - (*i*) names and addresses or (should be 'and') the occupation of the directors and Chief Executive Officer, if any, by whatever name called, (*ii*) list of members of the cooperative society concerned, and (*iii*) that the inter-State cooperative society is engaged in any one or more of the objects specified for a producer company in section 581B of the Act; and

(*c*) a declaration by two or more directors of the society concerned certifying that particulars given in (*a*) and (*b*) above are correct.

Pursuant to the General Circular 29/2012 (F. No. 17/63/2012-CLV) dated 10.9.2012, the ROC on receipt of application seeking conversion of a Cooperative Society (society not registered as the Multi State Society) into a Producer Company, will require the applicant society to file written consent from the local Cooperative Department of the concerned State certifying that the Society desirous of being converted into Producer Company, under Part IXA of the Companies Act, 1956, has no dues payable to the State at the time of such conversion and the Cooperative Department has 'no objection' to its being converted into a Producer Company under the Companies Act, 1956. Further, the ROC must satisfy himself fully that the applicant society has indeed extended its activities to other State/(s).

Upon registration as a producer company, the society shall have to have its name with "Producer Company Limited" as last words. It may retain its old name without the words implying cooperative society. It may also evolve any word or expression to precede the words "producer company limited" that would identify itself to its earlier co-operative status. The Registrar, within thirty days of the receipt of application for registration, complete in all respects, and having found it in compliance with the laid down requirements, shall certify under his hand that the applicant inter-State cooperative society has been incorporated as a producer company under Part IXA of the Companies Act, 1956. Apart from an inter-State cooperative society, a cooperative society formed by (*i*) Producers, (*ii*) by Federation or Union of cooperative societies of producers, (*iii*) co-operatives of producers, registered under any law for the time being in force which has extended its objects outside the State, either directly or through a union or Federation of cooperatives of which it is a constituent, or (*iv*) any Federation of Unions of such cooperatives, which has extended its object or activity outside the State, shall be eligible to make

application for registration as a producer company [clause (5) of section 581J]. Therefore, this facility of registration as a producer company, though basically is available to producers or producer institutions, has been extended to (*a*) inter-State cooperative societies and (*b*) cooperative societies formed by producers or cooperative societies formed by union or Federation of cooperative societies of producers or existing cooperative societies of producers or any Federation of Unions of such cooperative society provided they are registered cooperative societies in the cases of cooperative society and have extended their objects and activities beyond the geographical boundary of their state of registration. The key-points to be noted in this regard is that the applicant has to be a registered cooperative society or a Federation of Unions of cooperative societies, its primary constituent or members must be 'producer' as defined in this Part and it must have extended its objects and activities outside the state of its registration/location as such society or Federation. Section 581J as such does not require filing of any memorandum or articles of association by the transforming inter-state cooperative society. However, following section 581ZQ, it would not be incorrect to hold that the basic requirements of section 33 of the Act have not been expressly excluded and, therefore, the general requirements of filing memorandum and articles for registration and 'declaration' by a professional [*vide* section 33(2)] also apply in case of transformation of an inter-state cooperative society into a Producer Company.

3.15-16 Transformation of inter-State cooperative society into producer company

An inter-State cooperative society, upon registration as a producer company shall automatically, by operation of law, become a producer company. As such producer company, it shall be governed by the provisions of this part of the Companies Act, 1956 (Part IXA) in exclusion of the law to which it was earlier subjected. However, anything done or omitted to be done before its registration as a producer company will have to be followed up or done under the earlier law. For example, if a dividend declaration was made as a cooperative society (where it was possible to make the declaration), the same has to be paid in accordance of the provisions of the concerned cooperative law including the bye-laws thereunder. No person shall have any claim against the cooperative so transformed or against the producer company that came into being because of the transformation, based on the fact of the transformation [clause (6) of section 581J]. The Registrar of Companies who registered the inter-State cooperative society as a producer company shall forthwith intimate the concerned Registrar of cooperative societies with whom the erstwhile cooperative society was registered, the fact of the registration of the producer company to enable the latter Registrar make appropriate deletion of the name of the cooperative society from his register [clause (7) of section 581J]. The clauses (6) and (7) as above, specify the inter-State cooperative society as the subject of transformation. The categories of cooperative societies mentioned in clause (5), appear to be covered by this clause as they also become inter-State cooperative societies by virtue of the fact that they also have extended their objects/activities beyond their State of registration. However, when a Federation of Unions of cooperative societies apply for registration of a producer company, whether that Federation ceases to exist after the registration of the related producer company, is not clear.

Under section 581K, every shareholder of the inter-State cooperative society immediately before the date of registration of the producer company (*i.e.*, the transformation date) shall be deemed to be registered shareholder of the producer company to the extent of the face value of the shares held by such shareholder in the cooperative society. It seems that the applicant cooperative society will not be able to admit any new member or effect any transfer of its shares after making the application to become a producer company as such act may bring complications of deeming the initial members of the producer company.

Section 581L deals with further consequences that follow on transformation of an inter-State cooperative society into a producer company. On the transformation date—

(*i*) all properties and assets, movable and immovable, of, or belonging to the transforming cooperative society shall vest in the producer company;

(*ii*) all the rights, debts, liabilities, interests, privileges and obligations of the society shall stand transferred to, and be the corresponding rights, liabilities etc. (as above) of the producer company;

(*iii*) all debts, liabilities and obligations incurred, all contracts entered into and all matters and things engaged to be done by, with or for the society as on the transformation date for or in connection with their purposes, shall be deemed to have been incurred or entered into, or engaged to be done by with or for the producer company;

(*iv*) all sums of money due to the society immediately before the transformation date shall be deemed to be due to the producer company;

(*v*) every organisation which was being managed by the society immediately before the transformation date shall be managed by the producer company, for such period, to such extent and in such manner, as the circumstances may require;

(*vi*) every organisation which was getting financial, managerial or technical assistance from the society immediately before the transformation date, may continue to be given the same assistance by the producer company, for such period, to such extent and in such manner, as the company may deem fit;

(*vii*) the amount representing the capital of the erstwhile society shall form part of the capital of the producer company;

(*viii*) any reference to the inter-State cooperative society (the society) in any law other than the Companies Act, 1956 or in any contract or other instrument, shall be deemed to be reference to the producer company; and

(*ix*) any pending legal suit, arbitration, appeal or other legal proceedings of whatever nature by or against the society, shall not get abated, or discontinued, or anyway prejudicially affected by reason of incorporation of and consequent transformation into producer company, and the same may be continued, prosecuted and enforced by or against the producer company in the same manner and to the same extent as it would have or may have been continued, prosecuted and enforced by or against the society, as if the provisions contained in this Part (Part IXA) of the Companies Act, 1956 had not come into force.

It may be noted that the consequences (*i*) to (*ix*) above, except (*v*) and (*vi*) are absolute in their very nature. Though the responsibilities of the society contained in (*v*) and (*vi*) devolve upon the producer company immediately on transformation, the producer company has been given the flexibility to determine the duration of the responsibility, extent of the responsibility and the manner of discharging the responsibility on such devolution. In other words, the producer company has to take stock of these responsibilities taken by the society keeping in view its own position and limitations. It cannot bind itself indefinitely to the responsibilities. However, determination shall be done on a fair and reasonable basis.

3.15-17 Officers and other employees of the society [Section 581N]

On and from the transformation date all the serving employees and officers of the society shall become employees and officers of the corresponding producer company.

These officers (excluding directors) and other employees shall retain all the rights, privileges, obligations, benefits, tenure etc. as were with them in the society immediately before the transformation date. These include remuneration, other terms and conditions of employment, right to leave and leave travel concession, welfare measures, medical benefit schemes, insurance, provident fund, other funds, retirement, voluntary retirement, gratuity and duties. Any unrevoked contract or agreement with the officers and employees of the society on the date of transformation shall also survive including a situation where certain benefits are to be extended on a future date. Any officer (excluding directors) or employee may opt out from becoming officer or employee of the corresponding producer company and such persons shall be deemed to have resigned. This transformation, notwithstanding anything contained in the Industrial Disputes Act, 1947 or any other law then in force, will not give such officers or employee any right to compensation on their services being transferred to the corresponding producer company. No court of law or tribunal or other Authority shall entertain any such claim. However, employees or officers of the society who had retired from the services of the society before the transformation date will retain their rights, benefits, etc. *e.g.* pension or gratuity, and the corresponding producer company will take the position of the society in discharging these obligations. Similarly, any trust created by the society for provident fund or gratuity or other similar benefit and any other bodies created for welfare of the employees and officers of the society, shall continue to exist and discharge functions assigned to them under the umbrella of the producer company. Any tax exemption enjoyed by the Provident Fund or the Gratuity Fund will also survive under the producer company. Any officer of the society (including any director) entrusted to manage the whole or substantial part of business and affairs of the society under any law or the regulations governing the society will be entitled to any compensation from the society or the corresponding producer company for loss of office or the premature termination of contract of management, if any takes place, as a result of the transformation.

3.15-18 Directors of the society

Under section 581N, discussed above, all the employees and officers including directors of the erstwhile society, on the date of transformation get transferred in the corresponding position in the resulting producer company. So far directors are concerned, this will prevail inspite of the substantive provisions of section 581-O.

Section 581-O provides for floor and ceiling in respect of number of directors in a corresponding producer company. The minimum and maximum numbers are five and fifteen respectively. However, if a society which gets transformed into a producer company, had more than fifteen directors on the transformation date, the corresponding producer company, inspite of the aforesaid requirement, shall have all the directors on its Board (*i.e.*, exceeding the number of 15) for a period of one year from the date of incorporation of the producer company. This is also a beneficial provision and allows the newly incorporated Producer Company time to adjust its position suitably so that on expiry of aforesaid one year, the number of directors can be brought within the limits set by section 581-O. Neither this section nor any other section provides for a situation where the society had less than five directors immediately before transformation. In such a situation, obviously, those who were then directors of the society will become directors of the producer company and to meet the shortfall in number the Board may co-opt one or more expert directors or additional director(s) as may be necessary and for such period as the Board would then determine, subject to the Articles. This right of co-option is available in all situations and is not necessarily restricted to a situation to meet the shortfall. Ordinarily, however, the number of directors co-opted as above cannot exceed one fifth of the pre-co-option strength of the Board. The co-opted directors shall not have any vote in the matter of the election of the Chairman of the Board. Nevertheless, they are eligible to be elected to the office of the chairman if so allowed by the Articles.

3.15-19 Transfer of existing benefits, etc. on transformation

A further favourable consequence of transformation is contained in section 581M which provides for transfer of all the existing benefits, fiscal and other concessions, licences, privileges and exemptions with the society to the corresponding producer company with effect from the transformation date. These benefits, concessions, etc. should relate to the affairs and business of the society and should have been granted under any law, which was then in force.

3.15-20 Appointment of Directors and their tenure (Section 581P)

Except the case of transformation of an inter-State cooperative society into a producer company, the members of the society who sign the Memorandum and Articles of the producer company may designate therein the Board of directors comprised of not less than five members (obviously not exceeding fifteen members) to govern the affairs of the producer company until the directors are elected. The election of directors shall be conducted within a period of ninety days of the registration of the producer company. (In case of transformation of a society into registered company this period is one year *i.e.*, 365 days). Every director so elected shall hold office for a period of not less than one year and not more than five years, as may be specified in the Articles. Every director who retires in accordance with the provisions in the Articles shall be eligible for re-appointment as a director. Except the case of election of directors for the interim period *i.e.*, within ninety days as stated above, the directors of the Board shall be regularly elected or appointed by the members in the annual general meeting.

3.15-21 Vacation of office by directors of a producer company [Section 581Q]

This section is corresponding to section 283 of the Act, which applies to other companies. However, the grounds for vacation of office in the two situations are not

similar. In case of a producer company a director vacates his office if any of the following happens—

(*a*) He is convicted by a Court of any offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months. This ground is same as given in section 283(1)(*e*).

(*b*) The producer company in which he is a director has made a default in repayment of any advances or loans taken from any company or institution or any other person and such default continues for ninety days. This ground appears to be a serious one for the producer company concerned. By virtue of the provision all the directors will vacate the office at a time (and vacation of office is always automatic) and there will not be any Board, on happening of this default; no safeguard seems to have been provided in this respect in Part IXA of the Act (section 283 does not contain a same or similar clause).

(*c*) He has made a default in respect of any advances or loans taken from the producer company in which he is a director [no such provision appears in section 283, although a default in payment of call is a ground for vacation of office under section 283(1)(*f*)].

(*d*) The producer company, in which he is a director has—

(*i*) not filed the annual accounts and annual return for any continuous three financial years commencing on or after the first day of April, 2002, or

(*ii*) failed to, repay its deposit or withheld price or patronage bonus or interest thereon, on due date, or pay dividend and such failure continues for one year or more; (this clause is similar but not same to the disqualification clause for a director in section 274(1)(*g*); also a director who incurs the disqualification arising out of failure of the company concerned does not vacate his office under section 283); like (*b*) above this one also results into all the directors of the producer company vacating their respective offices and thereby making the Board non-existent.

(*e*) Default is made in holding election for the office of director in the producer company concerned, in accordance with the provisions of this Act and the Articles (section 283 does not contain any such ground); same observation as has been made in respect of (*b*) and (*d*) above, will apply in this case also. [It is important to note that the word 'default' as has been used, is not confined to non-holding of election alone but covers even holding the election but not following the requirements of the Companies Act and the Articles.]

(*f*) The annual general meeting or extraordinary general meeting of the producer company concerned, is not called in accordance with the provisions of the Act except due to natural calamity or such other reason (same observation as regards vacation resulting into non-existence of the Board will apply). Here the incidence is with reference to 'non-calling' and not 'non-holding'. Apart from the clear case of non-calling of these meetings, even a defect in calling these meetings may attract this clause).

These grounds are also applicable to the directors of a producer institution which is a member of the producer company concerned. More specifically, defaults of the

company mentioned in (*b*), (*d*), (*e*) and (*f*) above will result in vertical incidence on the directors of the member producer institution, rendering the institution director less. However, sub-section (2) of this section under which directors of the member producer institution get hit contains the words "as far as may be" implying that there will not be unqualified incidence of vacation. But what that will be can be known only from clarification/judicial interpretation.

3.15-22 Powers and functions of the Board [Section 581R]

The general powers of the Board of a producer company are similar to the general powers of the Board of other companies as provisions of section 581R and section 291 of the Act are broadly similar. Section 581R(2) has specified certain powers for exercise by the Board. The Board of a producer company shall exercise all the powers (general and specific) it has for and on behalf of the company only in meetings of the Board.

The specific powers are as under :

(*i*) determination of the dividend payable and quantum of withheld price;

(*ii*) recommendation of patronage bonus for consideration and approval in general meeting;

(*iii*) admission of new members;

(*iv*) formulation and pursuing of the organizational policy and objectives including specific long term and annual objectives;

(*v*) approval of corporate strategies and financial plans;

(*vi*) appointment of a Chief Executive Officer (CEO) and such other officers as may be specified in the Articles;

(*vii*) exercising of superintendence, direction and control over CEO and other officers appointed by it (for the producer company);

(*viii*) causing proper books of account to be maintained, preparation of annual accounts to be placed before the annual general meeting with the auditor's report thereon and the replies to the auditor's qualifications, if any, in the report;

(*ix*) acquisition or disposal of property of the producer company and investment of the funds of the producer company, in the ordinary course of business;

(*x*) sanctioning any loan or advance, in connection with business activities of the producer company, to any member of the producer company, who is not a director of the producer company or his relative (since the word 'relative' has not been defined for the purpose of Part IXA of the Act, the definition of 'relative' as appears in Schedule 1A of the Act will apply); [it seems, making loans and advances for business of the producer company to anybody other than a member of the producer company is not permissible in the normal context. Section 292 of the Companies Act specifically empowers the Board of other companies to make loans. Here such specific empowerment is absent]; and

(*xi*) taking such other measures or to do such other acts as may be required in the discharge of its functions or exercise of its powers.

Persons who are not validly holding the position of directors of a producer company, acting individually or as a group (read Board) cannot exercise any of the powers of the Board.

3.15-23 Committee of Directors [Section 581U]

The Board of a producer company may constitute such number of committees as it may deem fit for the purpose of assisting the Board in the efficient discharge of its functions. However, it cannot delegate any of its powers to any committee it constitutes. Similarly, the Board cannot assign any of powers of the CEO to any of its Committee.

A committee constituted as above, may with the approval of the Board, co-opt such number of persons as it deems fit as members of the committee. It appears that the CEO may be a member of the committee apart from other directors. It is not clear from the provisions of section 581U, whether a co-optee to a committee can be anybody other than the directors or the CEO.

A committee once formed shall function under the general superintendence, direction and control of the Board, for such duration and in such manner as the Board may direct. It seems, therefore, the committees will have tenures as may be decided by the Board and there will be no standing committee. The fee and allowances of the members of the committee shall also be prescribed by the Board. The minutes of the meetings of the committee(s) will have to be placed before the meeting of the Board held next.

3.15-24 Meetings of the Board and Quorum [Section 581V]

At least one Board meeting shall be held in a period of three months and at least four such meetings shall be held in one year.

Notice for the Board meeting shall be given in writing to every director of the producer company including those for the time being in India, at his usual address in India. In other words, if any director is not ordinarily residing in India, he would be given the notice only when he is in India to the knowledge of the producer company.

The responsibility of issuing the notice rests with the CEO. He is to issue the notice at least seven days prior to the date of the meeting. In case of failure to issue the notice, he is punishable with fine which may extend to rupees one thousand. Convening a Board meeting at a notice shorter than seven days may be possible provided the reasons for the same are recorded in writing by the Board. It is possible that in a meeting of the Board, a decision is taken and recorded in the minutes of that meeting for calling the next Board meeting at a shorter notice. Alternatively, even the Board may ratify a Board meeting called at a shorter notice in the meeting itself and record the same in the minutes.

Quorum for a Board meeting, shall be one-third of the total strength of the Board, subject to a minimum of three directors. The directors including the co-opted director, if any, may be paid such fees and allowances for attendance at the Board meetings, as may be decided by the members in the general meeting.

These provisions are similar to the provisions contained in sections 285, 286 and 287 of the Companies Act applicable to other companies with such modifications as are called for a producer company *e.g.* the notice for Board meeting is to be issued by

the CEO (a designated officer in Part IXA of the Act), and the minimum number to form the quorum is three for producer company as against two in cases of other private companies.

3.15-25 Liability of directors [Section 581T]

Any resolution passed or any thing done by the directors in contravention of the provisions of this Act, or any other law for the time being in force or of the Articles, invites liability to such directors who passed the resolutions or who acted in aforesaid manner. These directors will be jointly and severally liable to make good to the producer company any loss or damage suffered by it in consequence of such resolution or action. More specifically the producer company has the right of recovery against its director(s) where he or they have made personal profit as a result of the resolution or action as aforesaid, the amount of the profit. In a situation where the producer company has suffered any loss or damage (irrespective of whether there was personal profit for directors) as a result of the contravention, the amount of the loss or damage is recoverable by the company from its contravening directors. This liability of the directors of a producer company is in addition to and not in derogation of the liability imposed on a director under the Companies Act or any other law for the time being in force.

3.15-26 Chief Executive Officer (CEO) and his functions [Section 581W]

Every producer company is required to have one full time executive officer to manage and carry on the activities of the company. While the designation Executive officer has been stipulated by the Act, he may have any designation provided his responsibilities and functions are those which are provided in the Act. He, who will have to be a non-member, would be appointed by the Board of the producer company concerned. The CEO shall be ex-officio director of the producer company and will not retire by rotation.* The articles of the producer company may specify the qualifications, experience and the terms and conditions of the service of the CEO. In the absence of any such provision in the Articles, the Board of the producer company shall fix these specifications. The CEO shall be entrusted by the Board with substantial power of management, as may be determined by it. Within the ambit of this, the CEO may exercise the powers and discharge the functions as are provided by section 581W(5). They are as under :

(*a*) administrative acts of a routine nature including management of day-to-day affairs of the company;

(*b*) operation of bank accounts or entrusting this job to any other person (obviously in employment of the company), subject to the general or special approval of the Board;

(*c*) arrangement for safe custody of cash and other assets of the producer company;

(*d*) signing such documents as may be authorized by the Board, for and on behalf of the company;

(*e*) maintaining proper books of account and preparation of annual accounts of the company and getting these audited;

(*f*) placing the audited annual accounts before the Board and the members in general meeting;

(It is not expected that the CEO will do the auditing as there is an inherent conflict of interest situation. Unfortunately the language used in the law does not bring out the possible intention);

(*g*) furnishing the members with periodic information to apprise them of the operation and functions of the company;

(*h*) making appointments of officers and employees for the company in accordance with powers delegated by the Board;

(*i*) assisting the Board in the formulation of goals, objectives, strategies, plans and policies;

(*j*) advising the Board with respect to legal and regulatory matters relating to proposed and on-going activities of the company and taking necessary action thereon;

(*k*) exercising the powers as may be necessary in the normal course of business;

(*l*) discharging such other functions and exercising such other powers, as may be delegated by the Board.

The CEO shall manage the affairs of the producer company under the general superintendence, direction and control of the Board and shall be accountable for the performance of the producer company.

3.15-27 Secretary of Producer Company [Section 581X]

Every producer company having an average annual turnover exceeding rupees five crore in each of the three consecutive financial years shall appoint a whole-time secretary.

The incumbent to the position of the whole-time secretary of a producer company shall have to be a member of the Institute of Company Secretaries of India.

3.15-28 General Meetings [Sections 581ZA, 581S, 581Y and 581Z]

The provisions relating to general meetings of a producer company broadly conform to the corresponding provisions in the Act as regards other companies. However, departures are there where they are needed in the context of a producer company.

Annual General Meeting (AGM) - Conforming to the language used in section 166 of the Act, this new provision (Section 581ZA) has been drafted. Every producer company shall, in each year hold, in addition to any other meetings, a general meeting, as its AGM and shall specify the meeting as such in the notice calling it. Not more than fifteen months shall elapse between the date of one AGM and the next. Registrar (ROC), may, for any special reason, permit extension of this time by a period not exceeding three months except for the first AGM. A producer company shall hold its first AGM within a period of ninety days from the date of its incorporation. It may be noted that other companies are allowed time upto eighteen months instead of three months (90 days). Section 581P(2) in the context of directors, allows a period of ninety days, for the first Board of the producer company and before expiry of ninety days (*i.e.*, first ninety days after incorporation), the regular Board has to be elected (by the members). Section 581P(2) has a three hundred sixty five days time frame for the first Board of a company which was formed by transforming an inter-state cooperative society into a producer com-

pany. It seems that the requirement to hold the first AGM of a producer company within ninety days of its incorporation follows the requirement of section 581P(2). However, no separate mention of the first AGM of a transformed producer company has been mentioned in section 581ZA. As such, though such a company will hold its first AGM within ninety days of its transformation, it will not be required to elect a regular Board in that meeting. It will have to constitute a regular Board within one year of its transformation by a process of election in the next AGM, which has to be held within one year of its transformation. In other words, for a transformed producer company the time gap between the first and the second AGMs will be not more than two hundred and seventy five days.

Sub-section (3) of section 581ZA requires the members to adopt the Articles of the company and appoint the members of the Board in the AGM (presumably refers to first AGM although appointment of directors will thereafter be recurring feature of subsequent AGMs). This requirement about appointment of directors will not apply to a transformed producer company as it has a period of 365 days for the purpose.

Section 581S specifies certain matters to be transacted at a general meeting to give necessary powers to the Board. They are—

(*a*) approval of budget and adoption of annual accounts of the producer company;

(*b*) approval of patronage bonus;

(*c*) issuing of bonus shares;

(*d*) declaration of limited return and distribution of patronage;

(*e*) specifying the condition and limits of loans that may be sanctioned by the Board to any director; and

(*f*) approval of any transaction of the nature as is to be reserved in the Articles for approval of members.

None of these except (*e*) and (*f*) and approval of budget can figure in the agenda of the first AGM.

Notice of the AGM - The notice calling the AGM shall be accompanied by the following documents—

(*i*) agenda of the AGM;

(*ii*) minutes of the previous AGM or the EGM, if any held;

(*iii*) the names of the candidates for election, if any, to the office of the director including a statement of qualifications in respect of each candidate (Part IXA does not specify any qualification except share qualification for the office of the director of a producer company. Therefore, this statement is expected to contain the normal matters like academic qualification, experience, etc.);

(*iv*) the audited balance sheet and profit and loss account of the producer company and its subsidiary, if there be any, together with a report of the Board, with respect to :

(*a*) state of affairs of the producer company;

(*b*) amount proposed to be carried to reserve(s);

(*c*) amount to be paid as limited return on share capital;

(*d*) amount proposed as patronage bonus;

(*e*) material changes and commitments, if any, affecting the financial position of the producer company and its subsidiary, if any, which have occurred between the dates of annual accounts of the producer company and the date of the report of the Board (*i.e.* subsequent event of material nature);

(*f*) any other matter of importance relating to energy conservation, environmental protection, expenditure or earnings in foreign exchange; and

(*g*) any other matter which is required to be, or may be, specified by the Board,

It may be observed that salient features of sections 210, 212 and 217 of the Act applicable to other companies are present here;

(*v*) the text of the draft resolution for appointment of auditors; and

(*vi*) the text of the draft resolution proposing amendment to the Memorandum or Articles to be considered at the general meeting, along with recommendation of the Board.

Every AGM shall be called, for a time during business hours, on a day that is not a public holiday and shall be held at the registered office of the producer company or at some other place within the city, town or village in which the registered office of the company is situated. [This is same as section 166(2) *minus* the proviso].

3.15-29 Period of Notice

Not less than fourteen days notice in writing is required to convene a general meeting including the AGM (contrast this with section 171 of the Act requiring 21 days' notice).

3.15-30 Contents of the Notice and Circulation of the notice

The notice of the general meeting indicating the date, time and place of the meeting shall be sent to every member and auditor of the producer company.

3.15-31 Quorum and Voting Rights

Unless the Articles provide for a larger number, one-fourth of the total number of members, shall be the quorum for the AGM of a producer company as well as of any other general meeting (*vide* section 581Y). Section 581Z states that subject to the provisions of sub-sections (1) and (3) of section 581D, every member shall have one vote and in the case of equality of votes, the chairman or the person presiding shall have a casting vote except in the case of election of the chairman. As regards the voting rights we may note : (1) where individual is a member of the producer company, he has one vote irrespective of the size of his holding, (2) where both individuals and producer institutions are members - single vote for every member, (3) where membership is confined to producer institutions only, in the first year of registration of the company the voting rights shall be based on the size of the shareholdings of the member institutions and in the following years it will be based on participation by the respective institutions in the business of the producer company in the previous year (as may be specified in the Articles), (4) a producer company, may, if authorized by Articles, restrict the voting rights to active members

of the producer company, and (5) casting vote can be cast by the presiding member (chairman) in case of equality of votes on any resolution (except for election of the Chairman).

3.15-32 Filing of documents following AGM with ROC [sub-section (10) of section 581ZA]

The proceedings of every AGM shall be filed by the producer company with the ROC within sixty days of the date of holding the AGM along with—

(1) Director's report,

(2) Audited balance sheet and the profit and loss account, and

(3) The annual return.

Applicable fee for the filing should accompany the documents.

3.15-33 Producer institution as member

A producer institution which is a member of the producer company shall be represented by its chairman or the CEO in the general meeting. However, such a person must be competent to act as such. This means that the concerned institution must have authorized that person in writing so to attend and represent. The producer institution will forfeit this right if the producer company concerned in which the institution is a member has made defaults mentioned in clauses (*d*) to (*f*) of section 581Q(1) discussed earlier. This forfeiture of right appears to be acting in opposite direction. While efforts should be there to strengthen the company so that defaults are cured, it will act to make things more difficult.

3.15-34 Extraordinary General Meeting on Requisition [Section 581ZA(5)]

A producer company has the right to convene general meetings between two AGMs as and when the Board of the company feels necessity for the same. However, the company's Board shall, on the requisition made in writing and duly signed by one-third of members entitled to vote in the general meetings, proceed to call an extra-ordinary general meeting in accordance with provisions of sections 169-186 of the Act (applicable to other companies. The requisitioning members have to set out the matters for consideration at that meeting. In other words, all requirements for holding a general meeting as contained in sections 171 to 186 shall apply for holding the requisitioned general meeting. It seems to be a case of drafting confusion as section 581ZA(7) requires fourteen days notice for holding every general meeting of the producer company, while section 171 provides for twenty one days' notice for every other company. Section 173 requires providing explanatory statement. There is no similar provision specially for producer company. As the law has been drafted, it may be inferred that the intention was to make all the provisions from section 171 to section 186 applicable to any general meeting of the producer company by excluding the provision for notice period or quorum etc. for which specific provisions have been made in Part IXA of the Act. Then again arises the question as regards rules to govern the general meetings of the producer company for which no provision has been made in Part IXA. A simple interpretation, howsoever unworkable it may be, would be that provisions of sections 169-186 will apply only to requisitioned EGM's, except for those provisions which explicitly appear in Part IXA. Important aspects of a general meeting like proxy, poll, etc., and power of CLB to order meeting to be called remain in limbo. This also needs clarifications.

3.15-35 Share capital, special rights, bonus shares, transfer and transmission (Sections 581ZB to 581ZD and 581ZJ)

As has been mentioned earlier, a producer company can issue equity shares only to raise its share capital. Shares shall be issued, as far as practicable, to the members in proportion to their patronage of the producer company concerned. Beside equity shares, a producer company, if allowed by its articles, may issue instruments embodying 'special rights', to its active members. The special rights instrument issued to an active member is transferable to another active member, subject to prior approval of the Board. The expression special rights' means any right relating to supply of additional produce by the active member, or any other right relating to his produce, conferred upon him by the Board. This may take the form of higher consideration for the produce supplied or a right of priority to make the supply to the producer company.

3.15-36 The shares of a producer company has limited transferability

A member may transfer whole or part of his share holding, along with special rights, if any, to only an active member at par value, with prior approval of the Board. No other means of transfer is available to a member of the producer company. However, the nominee of a deceased member, shall become entitled to all the rights in the shares of the deceased and the Board of the producer company shall transfer such shares to the nominee appointed by the member concerned. Every member of a producer company is required to nominate a person to whom his share shall vest in the event of his death. This nomination has to be made within three months of a person becoming member of the producer company, in the manner specified in the Articles. In case the nominee is not a producer, then the Board of the producer company shall direct the nominee to surrender the shares along with special rights, if any, to the company, at par value or such other value as may be determined by the Board. The Board of a producer company can require the surrender of shares along with special rights, if any, from any member of the company, by serving on him a written notice and giving him an opportunity of being heard. The Board can exercise the right where it is satisfied that the concerned member has ceased to be a primary producer or has failed to retain his qualifications for becoming a member, in terms of the Articles of the company.

3.15-37 Issue of bonus share

On the basis of recommendation of the Board and by passing a resolution in the general meeting, a producer company may issue bonus shares by capitalisation of amounts lying in general reserves, in proportion to the respective shareholding of the members on the date of the issue.

3.15-38 Finance, Accounts and Audit (Sections 581ZE to 581ZI)

Every producer company shall keep at its registered office proper books of account with respect to—

(*a*) all sums of money received and expended by the producer company and the matters in respect of which the receipts and expenditure take place;

(*b*) all sales and purchases of goods by the producer company;

(*c*) the instruments of liability executed by or on behalf of the producer company;

(*d*) the assets and liabilities of the producer company; and

(*e*) in case the producer company is engaged in production, processing and manufacturing, the particulars relating to utilization of materials or labour or other items of costs.

The above broadly conforms to the provisions of section 209 in the matter of 'Proper books of account' that any other company is required to keep. So far cost records are concerned, mining activity has not been envisaged for a producer company.

The balance sheet and the profit and loss account shall be prepared by the producer company (based on the books of account maintained), in accordance with the provisions of section 211 of the Companies Act, 1956, as far as practicable. As such, the balance sheet and the profit and loss account should show a true and fair view and the balance sheet should be prepared in the form and with the particulars given in Schedule VI, Part I and the profit and loss account should make the disclosures required by Part II of that Schedule of the Companies Act, 1956. A producer company like any other company is required to comply with applicable accounting standards.

3.15-39 Internal Audit

Every producer company shall get the internal audit of its accounts done, at such interval and in such manner, as may be specified in its Articles. The internal audit shall be carried out by a chartered accountant as defined in section 2(1)(*b*) of the Chartered Accountants Act, 1949. Under the Chartered Accountants Act, 1949, he should also possess the certificate of practice without which he is debarred from public practice.

3.15-40 Duties of Auditor (Section 581ZG specifies duties of the auditor of a producer company and the same should not be mixed up with duties of internal auditors)

The auditor here, undoubtedly refers to the statutory auditor appointed under section 224 or 224A or 619 or 619B of the Act. Section 227 of the Act lays down the reporting duties of the statutory auditor as are generally applicable. The section presently under discussion specifies certain additional duties of reporting by the statutory auditor of a producer company, whose appointments and other related matters shall be as per sections 224 to 233 of the Act.

Additional duties of reporting - Without prejudice to the provisions of section 227 of the Act, the auditor shall also report on the following—

(*i*) The amounts of debts due along with particulars of bad debts, if any;

(*ii*) The verification of cash balance and securities;

(*iii*) The details of assets and liabilities;

(*iv*) All transactions which appear to be contrary to the provisions of Part IXA of the Act relating to producer company;

(*v*) Loans given by the producer company to the directors;

(*vi*) Donations or subscriptions given by the producer company; and

(*vii*) Any other matter considered necessary by the auditor.

3.15-41 Donation or subscription by producer company

A producer company may make donation or subscription to any individual or institution, subject to approval by a special resolution of the company. The purposes for which donation/subscription can be made are - (*i*) promoting the social and economic welfare of producer members or producers amongst general public or (*ii*) promoting the mutual assistance principles. The aggregate amount of all the donation and subscription in any financial year shall not exceed three per cent of the net profits of the producer company in the financial year immediately preceding the financial year in which the donation and subscription is made. By an explicit proviso to section 581ZH, producer companies have been debarred from making any political contribution directly or indirectly. Donation/subscription to political parties or for political purposes to any person is not permissible whether in cash or in kind or by making available services of its officers/employees.

The powers to make donation or subscription or political contribution by a producer company are different from those contained in sections 293(1)(*e*) and 293A of the Act which apply to other companies.

3.15-42 General and Other Reserves

Every producer company is required to maintain a general reserve in every financial year, in addition to any reserve maintained by it in terms of the Articles of the company. The wording used in section 581ZI appears to be somewhat confusing inasmuch as a general reserve created in the past and carried to following financial year/years, unless fully used up, will remain maintained. The appropriate expression should have been 'credited' with further mention of the amount or the manner of determining the amount.

A producer company may also have other reserves, as per the requirement of its articles. Where a producer company does not have sufficient funds in a financial year for credit (transfer) to reserves to be maintained in terms of the articles, the members of the company will have to contribute sums for transfer to the reserves in proportion to their patronage in the business of the company in that year.

The Department of Company Affairs has by Notification No. GSR 641(E), dated August 7, 2003 has prescribed, pursuant to section 581ZL(1), the securities or assets in which a Producer Company registered under section 581C of the Act can make investment of its general reserve. They are (*i*) approved securities, fixed deposits, units and bonds issued by the Central or State Governments or cooperative societies, scheduled banks, (*ii*) in cooperative bank, state cooperative bank, cooperative land development bank or central cooperative bank, (*iii*) with any other scheduled bank, (*iv*) securities specified in section 20 of the Indian Trusts Act, 1882, (*v*) shares/securities of multi-state cooperative societies or any other cooperative society, and (*vi*) the shares/securities or assets of a public financial institution (*vide* section 4A of the Act). Section 581ZL(1) apply to any producer company but the rules under reference apply to a producer company registered under section 581C. It seems section 581J Producer Company has been left out.

3.15-43 Loans to Members and Investments (Sections 581ZK and 581ZZ) - Loans and Advances

The Board of a producer company may, subject to the provisions in its Articles, provide financial assistance to its members by way of : (*a*) credit facility in

connection with the business of the producer company, for a period not exerting six months and/or (*b*) loans and advances against security specified in the Articles, repayable within a period exceeding three months but not exceeding seven years from the date of disbursement of such loan or advances. No loan or advance can be granted to any director of the company concerned or to his relative unless approved by members in general meeting. This restriction on loan or advance to director or his relative will prevail even when he is a member of the company. An inference can be drawn by a reading of the above in conjunction with section 581B that a producer company does not possess an inherent power to extend loan or advance or any other facility of the kind except to its members or directors. However, whether a producer company can grant any loan or advance to its employees will depend upon any specific enabling provision in the Articles. If directors can avail of loan/advance from the company, there is no reason to exclude employees from the facility.

Investments (Section 581ZL) - A producer company can make investments in certain instruments or in other producer company or in any other body corporate. The specific legal requirements follow :

Financial Instruments - Approved securities; fixed deposits; units, and bonds issued by the Government or cooperative bank or scheduled bank or in such other mode as may be prescribed. The investments shall be made in a manner to derive highest returns.

The sourcing for these investments shall be from the general reserves of the producer company. In other words, the aggregate investments made in various instruments as above should correspond but not exceed the aggregate of the general reserves held by the company. It is possible to have investments of a lesser amount than the aggregate of the general reserves depending upon circumstances. It seems that the detailed scope of investment in instruments will be prescribed by the DCA in due course.

Investment in shares [Section 581ZL(2) and (3)] - A producer company may for promoting its objects—

(*i*) invest in shares of another producer company (to achieve scale of operation, market share, synergy, etc. - modes of promoting objectives);

(*ii*) subscribe to the share capital of any other body corporate.

Under (*ii*) above, the investment is open to be made in any other company (not necessarily a producer company) and in any other body corporate. The immediate purpose of this investment may be formation of its subsidiary company or a joint venture or some other arrangement or agreement that entails subscription to the shares of another company or companies or of a body corporate. However, this investment in shares of a non-producer company or a body corporate needs approval by way of a special resolution of the investing producer company.

Apart from the two situations mentioned above of investing in shares of companies and body corporates, a producer company, either by itself or together with its subsidiary(ies) may invest by way of subscription, purchase or otherwise in shares in any other company for an amount not exceeding thirty per cent of the aggregate of its paid up capital and free reserves. If an investment of the category is to go beyond the thirty per cent limit, it requires prior approval of the Central Government besides the special resolution [*vide* section 581K(4)]. In this context, it is

necessary to understand the implication of the reference to 'free reserves' for calculating the investment ceiling for the category. 'Free reserves' certainly include general reserves. Under section 581ZL(1) the entire amount of the general reserves is available for making investment in financial instruments discussed above. When the entire amount of the general reserves has been invested in the financial instruments, can the amount in the general reserves form the basis of making investments in other mode ? It seems, this provision has been drafted in tune with section 372A(1) of the Act, without regard to the earmarked use of the general reserves in financial instruments. Therefore, reference to free reserves here appear to be redundant as it is really not free for making other investments. If it is not free, then it cannot and should not constitute the basis for making other investments. However, since Part IXA has been legislated to form part of the Companies Act, 1956 only recently, clarifications and interpretation that would inevitably follow will help to correctly operate the provisions currently under discussion *i.e.*, investment by a producer company in other companies and body corporates excluding those covered by sub-sections (2) and (3) of section 581ZK.

All the investments of a producer company as discussed above must conform to the objects of the producer company, *e.g.*, if a producer company makes an investment in an 'entertainment company', it would amount to an impermissible investment as the objects of a producer company do not have anything as such to do with an entertainment company.

Investments made in shares of a non-producer company or in a body corporate covered by sub-sections (3) and (4) of section 581K can be disposed of by the Board of the company with prior approval of the members expressed, in a special resolution.

3.15-44 Register of investments [Section 581ZL(7) & (8)]

A producer company which has made investments, shall keep at its registered office, a Register containing specified particulars of investments in shares of companies. This register is open to inspection by the members of the producer company concerned and they are entitled to take extracts from the Register of Investments. This provision again is an instance of loose drafting of a law. Sub-section (7) primarily requires the Register to be maintained for all the investments. 'All the investments' obviously should include investments in financial instruments also. Unfortunately the particulars required to be entered therein refer only to shares in companies. Even shares in other body corporates also have been left out. The particulars of investments in shares of companies including producer companies are as under :

(1) Name of the company(ies) in which share have been acquired;

(2) Number and value of shares (value should mean acquisition price/consideration on the basis of normal accounting);

(3) The date of acquisition; and

(4) The manner and price at which any of the shares have been subsequently disposed of.

It seems the word 'acquired' should include 'subscribed' and accordingly points (2) and (3) above should be read.

3.15-45 Amalgamation, Merger or Division of Producer Company (Section 581ZN)

Various forms of coming together of producer companies have been provided in this section. These are adaptation of the provisions of section 395 read with section 391 of the Act. Under section 581ZN the coming together may take the form of transfer of the assets and liabilities of a producer company to another producer company, either in whole or in part, after approval by way of a resolution in the general meeting of the transferring producer company provided the transferee producer company had agreed to such transfer and had passed a resolution to that effect in its general meeting. The transferee producer company can only agree to the transfer if the same is in conformity with any of the objects for a producer company enumerated in section 581B of the Act. Apart from this mode, any two or more producer companies may, by resolution passed in their respective general meeting or special meeting, decide to (*i*) amalgamate and form a new producer company, or (*ii*) merge one producer company (merging company) with another such company (merged company). Therefore, coming together of producer companies can be by :

(1) transfer of assets and liabilities either in whole or in part,

(2) amalgamation of two or more producer companies, and

(3) merger of two producer companies (merger may even be partial *e.g.*, an undertaking out of several).

The mechanism of transfer does not entail life of any of the producer companies in agreement, unless all the assets and liabilities of the transferring company are transferred. In case of amalgamation, lives of both/all the amalgamating companies come to an end and in their place a new producer company is formed. In complete merger, the life of the merging company comes to an end and the merged company continues. Whatever may be mode or mechanism, all the producer companies involved in these arrangements have to get prior approval of their members in their respective meetings (general meeting in case of transfer and general or special meeting for the other two modes). The resolutions are to be approved by at least two-third majority of total number of members having the voting right, present and voting. It seems that sub-section (3) of this section has inadvertently omitted to mention special meeting of members mentioned in sub-section (2) for amalgamation or merger (special meeting has been mentioned as an alternative to general meeting). The resolution concerned shall contain all particulars of the transfer of assets and liabilities or of amalgamation or merger as the case may be.

Prior notice in writing has to be given to the members and creditors of respective companies by the company concerned. The notice has to accompany a copy of the proposed resolution. The objective for giving the notice is to seek consent of the members and creditors to the proposal [sub-section (4)]. It may be observed that no period of notice has been specified for the purpose and as such provision of section 581ZA(8) requiring fourteen days' notice will apply for general meeting and the same period will apply for special meeting, if any, unless the articles have provided for a notice of a longer duration. The members, in any case, has the right to attend the meeting and vote thereat reflecting their consent or otherwise. It seems that the creditors have the only recourse to give their consent or disapproval in writing to

the company. So far members are concerned, it seems that they are not debarred from giving consent or disapproval in writing. If such a thing has happened and all or some of such members also attend the meeting and exercise their voting rights, then the written communication sent by the members will get nullified, if identity of members voting for or against the resolution is established. Clarification by appropriate Authority is needed to strengthen this situation regarding members. It may be that written communication of members not present in the meeting may be accepted while the same from members present will get nullified.

A member or creditor not consenting to the resolution has the right to the following options, to be exercised within one month of the date of service of the notice on him :

(*i*) non-consenting members can transfer their shares in the producer company to any active member of the company, with the approval of the Board. These may even be purchased by the producer company itself [*vide sub-section 8(6)*]

(*ii*) non-consenting creditors would be entitled to withdraw their deposit/loan/advance, as the case may be, from the company. This right of exercising option by members and creditors is unfettered by anything to the contrary contained in the Articles or in any contract with the company [sub-section (5)]. Any member or creditor who does not exercise this right within the period of one month mentioned above, shall be deemed to have consented to the resolution [sub-section (6)]. A resolution being discussed in the context of coming together of producer companies, shall not take effect until the expiry of one month (from the date of its passing) or the assent thereto of all the members and creditors has been obtained, whichever is earlier. As a practical understanding, it seems expiry of one month will be earlier in most cases as obtaining consent from all the creditors and members, if possible, would be a time-consuming process.

Division of a producer company [Section 581XN(1)(b)*]* - A producer company by passing resolution in its general meeting may divide itself into two or more new producer companies. All the procedures discussed above regarding giving of written notice, seeking consent to the proposal (resolution), option to members and creditors, consequence of non-exercising of the option and the period of non-implementation of the resolution shall apply to division of the producer company. Upon division of a producer company resulting into two or more producer companies, the erstwhile producer company shall cease to exist as its registration will be cancelled forthwith [*vide* sub-section (13)] and the resulting producer companies shall be registered.

Contents of the resolution [sub-section (8)] - The resolution referred to above for transfer, division, amalgamation or merger shall provide for :

(*a*) the regulation of conduct of the producer company's affairs in future;

(*b*) the purchase of shares or interest of any members of the producer company by other members or by the producer company itself;

(*c*) in the case of purchase of shares of one producer company by another producer company, the consequent reduction of its share capital ;

(*d*) terminating, setting aside or modification of any agreement, howsoever, arrived between the company on the one hand and the directors, secretary and manager on the other hand, apart from such terms and conditions as may, in the opinion of majority of shareholders, be just and equitable in the circumstances of the case;

(*e*) terminating, setting aside or modification of any agreement between the company and any other person, not being the director, secretary or manager referred above, by giving due notice to the person concerned (modification can be made only after getting consent of the party concerned);

(*f*) setting aside of any transfer, delivery of goods, payment, execution or other act relating to property, made or done by or against the producer company within three months before the date of passing of the resolution, which would if made or done against any individual, be deemed in his insolvency, to be a fraudulent preference (these involve third parties and can these be done without recourse to court ?);

(*g*) transfer to the merged company of the whole or any part of the undertaking, property and liability of the producer company;

(*h*) allotment or appropriation by the merged company of any shares, debentures, policies and other similar interests in the merged company;

(*i*) continuation by or against the merged company of any legal proceedings pending by or against any producer company;

(*j*) the dissolution without winding up of a producer company;

(*k*) provision for any member/creditor who dissents;

(*l*) taxes, if any, to be paid by the producer company; and

(*m*) such incidental, consequential and supplemental matters as are necessary to secure that the division, amalgamation or merger shall be fully and effectively carried out.

On passing of the resolution and its taking effect, the resolution shall be sufficient conveyance to vest the assets and liabilities in the transferee [sub-section (9)].

The producer company shall [*see* (*k*) above] make arrangements for meeting in full or otherwise satisfying non-consenting member/creditor [sub-section (10)].

As indicated earlier, where whole of the assets and liabilities of a producer company are transferred to another producer company, pursuant to the resolution passed (*vide* sub-section (9) also), or where there is merger, the registration of the first mentioned company or the merging company, as the case may be, shall stand cancelled and the company shall be deemed to have been dissolved forthwith and shall cease to exist as a body corporate [sub-section (11)]. This provision applies only when there is a case of transfer of assets and liabilities, in entirety. A partial transfer or a partial merger will not result into dissolution of the transferring or merging producer company. As stated earlier, in case of an amalgamation, each of the amalgamating companies cease to exist after getting dissolved forthwith with cancellation of their registration. The amalgamated company that is formed shall be registered by the ROC as a producer company [sub-section (12)].

Pre-existing rights, obligations and legal proceedings [sub-section (14)] - the amalgamation, merger or division of companies (transfer of entire assets and liabilities

should be presumed to be included) shall not in any manner affect any rights/obligations/legal proceedings that related to the erstwhile producer company and the same may be continued or commenced by, or against, the resulting company(ies).

It is the responsibility of the ROC to strike off the names of every producer company deemed to have been dissolved under sub-sections (11) to (13). [The sub-section wrongly mentions (14) in place of (13).]

Appeal to the High Court - Under sub-section (16), any member or creditor or employee aggrieved by the transfer of assets, division, amalgamation or merger may, within thirty days of passing of the resolution, prefer an appeal to the High Court. The High Court, after giving a reasonable opportunity to the person concerned, pass such orders as it may deem fit. While the appeal has been filed, the transfer of assets, division, amalgamation or merger of the producer company shall be subject to the decision of the High Court.

3.15-46 Penalties (Section 581ZM)

If any person, other than a producer company registered under Part IXA of the Act, carries on business under any name which contains the word, "Producer Company Limited", he or it shall be punishable with fine which may extend to rupees ten thousand for every day during which such name has been used.

A director of a producer company who wilfully fails to furnish any information relating to the affairs of the producer company sought/required by a member or a person duly authorized for this purpose, shall be liable to imprisonment for a term that may extend to six months and with fine equivalent to five per cent of the turnover of that company during preceding financial year. Director or officer of a producer company making a default in handing over the custody of the books and other documents or property in his custody to the producer company concerned or failing to convene AGM or any other general meeting, shall be punishable with fine which may extend to rupees one lakh. In case of continuing default for the offence, an additional fine not exceeding rupees ten thousand per day of the default is leviable.

The offence for directors for not furnishing information to members etc. as above, is not compoundable under section 621A of the Act. However, other offences discussed above are compoundable.

3.15-47 Dispute Resolution (Section 581ZO)

Presumably taking into account the fact that in a producer company general members have more intimate interest in the affairs of the company than perhaps in other companies, possibility of internal disputes amongst and among the members and directors etc. is far greater. Here members are by and large producers and they supply their products to the company of which they are the members. Accordingly this section provides that where any dispute on formation, management or business of a producer company arises—

(*a*) amongst members, former members or persons claiming to be members or nominees of deceased members; or

(*b*) between a member, former member or a person claiming to be a member or nominee of a deceased member and the producer company, its Board,

office bearers (the provision of this part has not indicated what would constitute "office bearers"), or liquidator, past or present; or

(*c*) between the producer company or its Board, and any director, office bearer or any former director, or the nominee, heir or legal representative of any deceased director of the producer company, such dispute shall be settled by conciliation or by arbitration as provided under the Arbitration and Conciliation Act, 1996. The aforesaid parties to dispute shall be deemed to have consented in writing for determination of such disputes by conciliation or arbitration under the aforesaid Act. A dispute referred to above shall include :

(*i*) a claim or any debt or other amount due;

(*ii*) a claim by surety against the principal debtor, where the producer company has recovered from the surety amount in respect of any debtor or other amount due to it from the principal debtor as a result of the default of the principal debtor whether such debt or amount due be admitted or not;

(*iii*) a claim by a producer company against its member for failure to supply produce as required of him;

(*iv*) a claim by a member against the producer company for not taking goods supplied by him.

On the primary issue (contention), if any of determining whether a dispute pertains to formation, management or business of the producer company, such matter shall be referred to the Arbitrator, whose decision shall be final.

It may be noted that any dispute involving the producer company with others *i.e.*, third parties will, however, has to be referred to appropriate judicial forum.

3.15-48 Allied Provision

Section 581ZP deals with certain matters that may impact the producer company as a class of companies. They are (*i*) striking off name of producer company (*ii*) impact of the provisions of Part IXA of the Act on other laws, and (*iii*) application of the provisions of the Act regarding private companies on producer companies.

3.15-49 Striking off the name of producer company

When the ROC is satisfied after serving show-cause notice on the producer company and its directors and after giving them reasonable opportunity to represent their cases that the producer company (*i*) has failed to commence business within one year of its registration, or (*ii*) has ceased to transact business with its members (the very foundation of the producer company concept) or (*iii*) is no longer carrying on any of its objects with which it was incorporated or operating pursuant to section 581B of the Act, the name of the producer company can be struck off the Register maintained by the ROC. In regard to (*iii*) above the ROC at the primary stage must have made due enquiry about non-functioning status of the producer company before issuing the show-cause notice and giving opportunity to the company and its directors to make representation against the allegation in the show-cause notice.

Where, however, the ROC has reasonable cause to believe that a producer company is not adhering to any of the mutual assistance principles specified in this part (another basic foundation of a producer company), he shall strike its name off the register in accordance with provisions of section 560 of the Act, relating to defunct companies. As such in regard to (*i*), (*ii*) and (*iii*) above the procedure laid down is simple before the ROC can exercise the power to strike off the name of the producer company from the register maintained by him as they all relate to matters of fact. But in case of the issue of striking off names for non-adherence with mutual assistance principles, the procedure is somewhat elaborate as laid down in section 560 of the Act. In such a case, it seems sub-section (6) of section 560 will remain open for restoring the name of the company in the register.

Any member of a producer company where the producer company's name has been struck off by the ROC on (*i*) or (*ii*) or (*iii*) above, who is aggrieved by the order of the ROC to strike off the name of the company, may appeal to the CLB within sixty days of the order. In that event the ROC's order will remain in abeyance until the appeal is disposed of. It implies that the ROC will not give effect to his order of striking off till the period for making appeal to his order is over and if appeal has been filed in due time, he will not act on his order until the appeal is disposed of. If as a result of the appeal, the order of the ROC is nullified then, there will not arise the case of striking off the name of the company from the register of the ROC.

3.15-50 Reconversion of a Producer Company to inter-State Co-operative Society (Sections 581ZS and 581ZT)

An inter-State cooperative society which transformed itself to a producer company under section 581J in Part IXA of the Act can make an application to the High Court for returning to its earlier status on the basis of (*i*) a resolution passed by its members in a general meeting, where at least two-third of its members present voted for re-conversion or (*ii*) on request of its creditors representing at least three fourth in value of its total creditors. Upon receipt of the application, the High Court shall direct holding of meeting of its members or creditors, as the case may be, in the manner as may be specified in the direction. If in the members' meeting a three-fourth majority of the members in number, present in person and voting or if at least three-fourth majority in value of the creditors present in person and voting in the creditors' meeting, as the case may be, vote for reconversion, then such resolution shall be considered by the High Court. If the High Court sanctions the re-conversion, the sanction shall be binding on all the members' and creditors and the company concerned. As a pre-condition for court's consideration for sanction of re-conversion, the company or any other person. [Section 581ZS(1) does not recognize anybody else other than the company as competent to make application which or who made the application to the Court must disclose by affidavit or otherwise to the Court, all material facts relating to the company latest financial position of the company, the latest auditor's report on the accounts of the company, the pendency of any investigation proceedings against the company under sections 235-251 of the Act or the like]. This is similar to proviso to section 391(2) of the Act.

A certified copy of the Court's order shall be filed with the ROC and only then the order will take effect. Upon the order getting effect as above, the same shall be annexed to every copy of the memorandum of the company or in the absence of memorandum to every copy of the instrument constituting the company.

After an application for re-conversion has been received by the High Court from the company concerned or any other person competent to make the application, the Court may stay the commencement or continuation of any suit or proceeding against the company on such terms as the court thinks fit, until the application is finally disposed of. If the court does not sanction re-conversion, naturally the stay will get vacated and presumably, the Court's final order will include this. But the provision is silent on what would happen to the stay order if reconversion is sanctioned. It seems that the original suit/proceeding will survive for the reconverted inter-state cooperative society, to the extent the same will not be inconsistent with the new status of the erstwhile company.

Every producer company allowed to re-convert into an inter-state cooperative society shall make an application under the Multi-state Co-operative Societies Act, 1984 or any other law for the time being in force for its registration as multi-state cooperative society or as cooperative society, as the case may be, within six months of the sanction by the High Court. A report thereof has to be filed with the High Court, the concerned ROC and the concerned Registrar of Cooperative Society.

3.15-51 Power of the Central Government to modify the provisions of the Companies Act, 1956 in their application to Producer Company (Section 581ZT)

The Central Government may, by notification in the Official Gazette, direct that any of the provisions of the Companies Act, 1956 [other than those appearing in Part IXA] specified in the said notification - (*a*) shall not apply to producer companies generally or any class or category thereof (*e.g.*, Artisans's Producer Company or Silk Worm Producers' Company), or (*b*) shall apply to the Producer Companies generally or to any class or category thereof with such exception or adaptation as may be specified. A copy of every Notification proposed for the above purpose shall be laid in draft before each House of Parliament, while it is in session, for a total period of thirty days comprised of one or more successive sessions. If both the Houses agree in disapproving the issue of the Notification or if both the Houses agree in making any modification on the draft Notification, the Notification shall not be issued in the former case or shall be issued only in such modified form as have been agreed by both the Houses. It is, however, not clear how to deal with the situation of varying views of the Houses.

3.16 Illegal Association [Sec. 464]

Section 464(1) 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 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.

In order to attract the prohibition contained in section 464[8], four conditions must be fulfilled: (*i*) it must be a company, association or partnership consisting of more

8. The corresponding section under the Companies Act, 1956 was section 11.

than the specified number of members; (*ii*) it must not have been registered as a company under the Companies Act nor must it have been formed in pursuance of some other Indian Law; (*iii*) that it must have been formed for the purpose of carrying on any business; and (*iv*) that the business must have for its object the acquisition of gain by the company, association or partnership or by the individual members thereof - *V.V. Ruia* v. *S. Dalmia* [1968] 115 Comp. Cas. 572 (Bom.).

Word 'business' in section 464(1) should be construed in a wide manner and a company formed with object of acting as a trustee can also be treated as business activity and that 'business' does not necessarily mean or is limited only to, commercial activity; word 'business' is not confined only to commercial activity for profit in case of trust companies - *B. Ramachandra Adityan* v. *Educational Trustee Co. (P.) Ltd.* [2003] 41 SCL 385 (Mad.).

3.16-1 Exceptions

However, section 464(1) does not apply in the following cases:

3.16-1a STOCK EXCHANGE - In *V.V. Ruia* v. *Dalmia,* it was decided that a stock exchange is not covered by section 11 (now section 464) because it is not formed for the purpose of carrying on any business.

3.16-1b ASSOCIATIONS 'NOT FOR PROFIT-MAKING' - All charitable, religious, scientific, literary, social and other associations including clubs not having as their object the acquisition of gain are excluded from the purview of the section.

3.16-1c JOINT HINDU FAMILY - Section 464 does not apply to one joint family, 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.

3.16-2 Effects of an illegal association

Following are the effects on an association being illegal :

1. Every member is personally liable for all liabilities incurred in the business.
2. Members are punishable with fine which may extend up to Rs. 1,00,000.
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* AIR 1926 All. 591. 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*).

3.17 Unregistered Companies [Section 375]

Section 375 of the Companies Act, 2013 defines an unregistered company to include any partnership firm, limited liability partnership or society or cooperative society, association or company consisting of more than seven members*. The expression shall, however, not include :

(*i*) A railway company incorporated by any Act of Parliament or other Indian Law or any Act of Parliament of the United Kingdom;

(*ii*) A company registered under the Companies Act, 2013; or

(*iii*) A company registered under any previous Companies Laws and not being a company the Registered Office whereof was in Burma, Aden or Pakistan immediately before the separation of that company from India.

3.18 Dormant Company [Section 455]

'Dormant company' means a company which has been formed and registered under the Companies Act, 2013

(*i*) for a future project or to hold an asset or intellectual property,

(*ii*) has no significant accounting transaction, and

(*iii*) has not filed financial statements or annual returns for two financial years consecutively.

3.19 Inactive Company [Section 455]

"Inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

*As per section 464 read along with Rule 10 of Companies (Miscellaneous) Rules, 2014, it cannot have more than 50 members.

Test your knowledge

[Questions have been selected from past examinations of C.A. (Inter)/PE-II/PCC/Final, C.S. (Inter)/Final, ICWA (Inter)]

1. Define a 'private company'. State the special privileges and exemptions enjoyed by a private company. Also state the circumstances under which a private company is deemed to be a public company.
2. Outline the procedure for converting a public limited company into a private limited company under the provisions of Companies Act, 1956, and the rules thereunder.
3. Write an explanatory note on 'Holding and Subsidiary Companies'.
4. Write a short note on 'Government Company'.
5. Write a short note on 'Foreign Company'.
6. Write a short note on 'Section 25 Companies'.
7. "A company may be formed without using the word(s) 'Limited' or 'Private Limited' at the end of its name".
8. Write a short note on 'Illegal Association'.
9. (*a*) An existing public limited company has decided to convert itself into a private limited company. Discuss in detail the procedure to be adopted for the purpose.

   (*b*) What are the requisites for getting a licence from the Central Government for registering a company under section 8 of the Companies Act, 2013 and what are the exemptions enjoyed by such a company?

   (*c*) State the criteria under which a company shall become a subsidiary of another company.
10. Write a short note on 'Guarantee Company'.
11. Define a Government Company. Summarise the provisions of the Companies Act, 2013 relating to Government companies. State a few exemptions granted to such companies.
12. "Foreign companies having a place of business in India are also governed by the Companies Act, 2013". Comment.
13. "The place from which a representative of a foreign company in India conducts meetings of shareholders or even directors, and procures orders from customers is a 'place of business' of the foreign company". Comment.
14. State with reasons and relevant provisions/case laws, wherever applicable, whether the following statement is correct or incorrect:

    "Foreign company has opened an office for operating bank accounts in India. Hence, it is supposed to carry on business in India."
15. A company incorporated outside India decides to establish a place of business in India. State the documents that are required to be filed by such foreign companies under the Companies Act soon after establishment of a place of business in India.
16. What are the books of account to be maintained under the Companies Act, 2013 by a foreign company having established a place of business within India ?
17. An existing society seeks your advice as to its eligibility to be registered as a 'Producer Company' under the Companies Act and the procedure to be followed for such registration. Advise explaining the relevant provisions of the Companies Act.
18. (*i*) An Inter-State Cooperative Society has been incorporated on 1st May, 2014 as a Producer Company under the provisions of the Companies Act. Give your comments on its proposal to have 18 directors on its Board after incorporation as a Producer Company.

(*ii*) A producer company wants to issue bonus shares. You are required to state the relevant provisions of the Companies Act in this regard.

(*iii*) What are the modes of investment, from and out of its general reserves, available to a producer company formed and registered under the Companies Act?

19. (*i*) As per provisions of the Companies Act, 2013 what is the status of XYZ Ltd., a company incorporated in London, UK, which has a Share Transfer Office at Mumbai?

(*ii*) ABC Ltd., a foreign company having its Indian principal place of business at Kolkata, West Bengal is required to deliver various documents to Registrar of Companies under the provisions of the Companies Act, 2013. You are required to state, where the said company should deliver such documents.

(*iii*) In case, a foreign company, does not deliver its documents to the Registrar of Companies as required under section 380 of the Companies Act, 2013, state the penalty prescribed under the said Act, which can be levied.

PRACTICAL PROBLEMS

1. In a private limited company it is discovered that there are, in fact, 204 members. On an enquiry, it is ascertained that 6 of such members have been employees of the company in the recent past and that they acquired their shares while they were still employees of the company. Is it necessary to convert the company into a public limited company?

Hints - As per section 2(*68*), a company to be registered as a private company must restrict its membership to 200 only. However, in counting this number of 200 members, employee members and ex-employee members (*i.e.*, those who become members while in the employment of the company but now having ceased to be in the employment still continue to retain membership) are to be excluded. Thus, in the given case, the company shall continue to be a private company. There is no need for conversion.

2. The paid-up share capital of XYZ (Private) Company Ltd. is Rs. 20 lakhs consisting of 2,00,000 equity shares of Rs. 10 each fully paid-up. ABC (Private) Ltd. and its subsidiary DEF (Private) Ltd. are holding 60,000 and 50,000 shares respectively in XYZ (Private) Co. Ltd.

Examine with reference to the provisions of the Companies Act, 2013. Whether XYZ (Pvt.) Co. Ltd. is a subsidiary of ABC (Pvt.) Ltd. Would your answer be different if DEF (P.) Ltd. is holding 1,10,000 shares in XYZ (Pvt.) Co. Ltd. and no shares are held by ABC (Pvt.) Ltd. in XYZ (Pvt.) Co. Ltd. ?

[**Hints -** Section 2(*87*) of the Companies Act, 2013, *inter alia*, provides that a company shall be deemed to be the holding of another where it either at its own or together with one or more of its subsidiary companies holds more than half of the total share capital of the other. Further, shares held or power exercisable by a subsidiary shall be treated as held or exercisable by the said company. Thus, the shares held or power exercisable by a subsidiary shall be treated as 'held' or 'exercisable' by the holding company. Thus, in the given case XYZ (Pvt.) Ltd. shall be deemed to be the subsidiary of ABC (Pvt.) Ltd.

The second situation is rather simpler inasmuch as under *Explanation (a)* to section 2 (*87*), a company which is a subsidiary of a subsidiary shall also be deemed to be the subsidiary of the holding company. Accordingly, XYZ (Pvt.) Ltd. shall be, on the basis of majority shareholding criterion, the subsidiary of DEF (Pvt.) Ltd. and DEF (Pvt.) Ltd. being subsidiary of ABC (Pvt.) Ltd.; XYZ (Pvt.) Ltd. shall also be subsidiary of ABC (Pvt.) Ltd.].

3. Fortune Traders Ltd. was registered as a public company. There are 215 members in the company as noted below :

(*i*)	Directors and their relatives	35
(*ii*)	Employees	100
(*iii*)	Ex-employees (shares were allotted when they were employees)	20
(*iv*)	15 couples holding shares jointly in the names of husband and wife $(15 \times 2) =$	30
(*v*)	Others	30
	Total number of members	215

The Board of Directors of the company propose to convert it into a private company. Advise the Board of directors about the steps to be taken for conversion into a private company including reduction in the number of members, if necessary.

Hints : A private company as per section 2(*68*) cannot have more than 200 members. But for counting these 200 members, employee members and ex-employee members (provided they acquired the shares while in employment) are to be excluded. Besides, joint members are to be counted as single member. Accordingly, total number of members are actually $35 + 15 + 30 = 80$ only. No reduction in membership is therefore called for. *For procedure to convert a public company into private company, refer Para 3.6.*

4. A group of promoters propose to establish a company for charitable purposes without the addition of the word 'Limited' as part of its name. Discuss briefly the procedure to be followed in addition to the normal procedure for incorporation of a company.

Hints : *Refer Para 3.12-4*

5. Radiant Pvt. Ltd. had 5,00,000 equity shares of Rs.10 each fully paid as on 31st March, 2014. Two shareholders holding 1,50,000 equity shares each sold their shares to Srilakshmi Ltd. at Rs. 15 per share and the Board of directors approved the same on 20th April, 2014. Discuss the implication of the said share transfer.

Hints: With the acquiring of 3,00,000 equity shares by Srilakshmi Ltd., Radiant Private Ltd. becomes public company under section 2(*71*) of the Companies Act, 2013.

As per section 2(*71*), a public company includes a company which is a private company, which is a subsidiary of a company which is not a private company. Radiant Pvt. Ltd. by virtue of the said share transfer has become the subsidiary of Srilakshmi Ltd. Therefore, Radiant Pvt. Ltd. shall have to take steps for converting itself into a public company.

6. (*i*) An inter-state cooperative society has been incorporated on 1st May, 2008 as a Producer Company under the provisions of the Companies Act. Give your comments on its proposal to have 18 directors on its Board after incorporation as a Producer Company.

(*ii*) Mr. Zameen, a member of a Producer Company, wants to transfer his shares. You are required to state as to how he can transfer his shares under the provisions of the Companies Act, 1956.

Hints : (*i*) As per provisions of section 581-O of the Companies Act, 1956[9], any Producer Company cannot have more than fifteen directors. However, by way of a proviso, the said section further provides that an inter-state cooperative society which is incorporated as a Producer Company, may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

9. MCA has clarified that Producer companies shall continue to be governed by the Companies Act, 1956.

In view of the above provisions of the Companies Act, 1956, the proposal to have 18 directors by the Producer Company after its incorporation as such, is a valid proposition, but since it is incorporated on 1st May, 2008, it can have more than 15 directors for one year only from the date of its incorporation.

(*ii*) According to the provisions of section 581ZD(1) and (2) of the Companies Act, 1956, the shares of a member of a Producer Company may, after obtaining the previous approval of the Board, transfer the whole or part of his shares along with any special rights, to an active member at par value.

Based on the above provisions relating to the transfer of shares of a member in a Producer Company, Mr. Zameen has to obtain prior approval of the Board and then transfer his shares to an active member of the Producer Company at par value.

4 Formation and Incorporation of a Company

The whole process of formation of a company may be divided into four stages, namely :

(*i*) Promotion

(*ii*) Registration

(*iii*) Floatation

(*iv*) Commencement of business.

4.1 Promotion

Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company. The persons who assume the task of promotion are called promoters. A promoter may be an individual, syndicate, association, partner or company.

4.1-1 Who is a promoter

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 aforesaid description of promoter does not bring out the nature of activities that a promoter is usually associated with. It may serve a good purpose for fixation of liabilities for wrong doings by the company.

To know about the nature of activities that the promoters usually do, study of some of the definitions advanced by the learned judges will be pertinent. Cockburn CJ., in *Twycross* v. *Grant* 1877 2 C.P.D. 469, page 541 C.A. 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". Another attempt was made by Bowen, L.J., in *Whaley Bridge Printing Co.* v. *Green* [1880] 5 B.D. 109 at page 111. He observed that the term promoter is "a term not of law but of business", usefully summing up, in a single word— promotion, "a number of business operations familiar to the commercial world by which a company is brought into existence".

In USA, the Securities Exchange Commission Rule 405(*a*) defines a promoter as a person who, acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organising the business enterprise.

To be a promoter one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter.[1]

However, the persons assisting the promoters by acting in a professional capacity do not thereby become promoters themselves. 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. In Palmer's view, anyone who assists in the promotion, for example, by obtaining the services of a director, or agreeing to place shares or negotiating an agreement or merely by bringing a vendor in touch with persons who may form a company to exploit or purchase his goods may find himself as a promoter of a company which is consequently formed.

In conclusion, it may be said that word "promoter" is used in common parlance to denote any individual, syndicate, association, partnership or a company which takes all the necessary steps to create and mould a company and set it going. The promoter originates the scheme for the formation of the company; gets together the subscribers to the memorandum; gets memorandum and articles prepared, executed and registered; finds the bankers, brokers and legal advisors; locates the first directors, settles the terms of preliminary contracts with vendors and agreement with underwriters and makes arrangements for preparation, advertisement and circulation of the prospectus and placement of the capital. In India, the promoter or promoters or the principal of them are usually persons who, in forming the company, secure for themselves the management of the company being formed or are persons who convert their own private business into a limited company, public or private and secure for themselves more or less a controlling interest into the company's management[2].

1. *Lagunas Nitrate Co.* v. *Lagunas Syndicate* [1899] 2 Ch. 392.
2. A. Ramaiya, Guide to Companies Act, 12th edn., p. 351.

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* [1938] 8 Comp. Cas. 7].

4.1-2 When promotion begins and ends

The relationship between promoter and the company that he has floated must be deemed to be fiduciary relationship from the day the work of floating the company starts[3] and continues up to the time that the directors take into their hands what remains to be done in the way of forming the company [*Twycross* v. *Grant* (*supra*)].

The date upon which the person becomes a promoter can be a matter of great importance to him and the company. A number of sections impose civil as well as criminal liabilities on promoters for misrepresentations in a prospectus or a statement in lieu of prospectus, for misappropriation or misapplication of the monies collected.

The status of a promoter is generally terminated when the Board of Directors has been formed and they start governing the company. Chronologically, the first persons who control or influence the company's affairs are its promoters. It is they who conceive the idea of forming the company, and it is they who take the necessary steps to incorporate it, to provide it with share and loan capital and acquire the business or property which it is to manage. When these things have been done, they hand over the control of the company to its directors, who are often themselves under a different name.

On handing over the control of the company to the directors, the promoter's fiduciary and common law duties cease, and he is thereafter subject to no more extensive duties in dealing with the company than a third person who is unconnected with it[4]. Thus, where a promoter disclosed the profit which he made out of a company's promotion to the persons who provided it with the share capital with which it commenced business, it was held that he was under no further duty to disclose the profit to persons who were invited to subscribe further capital a year later, and so the company could not recover the profit from him for his failure to do so[5]. Nevertheless, a promoter may remain subject to fiduciary and other duties to the company if he becomes a director or agent of it, but the duties are then owed only in that other capacity.

4.1-3 Legal position of a promoter

While the accurate description of a promoter may be difficult, his legal position is quite clear. 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, he 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

3. *CIT* v. *Bijili Cotton Mills Ltd.* [1953] 23 Comp. Cas. 114.
4. Pennington's Company Law, 5th Edn., p. 607.
5. Re, British Seamless Paper Box Co. [1881] 17 Ch. D. 467.

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.* (39 LT 269), "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 begins to act as a trading corporation. Similarly, it was observed in *Lagunas Nitrate Co.* v. *Lagunas Syndicate* (1899 2 Ch. 392), that : "The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become shareholders in it." Lord Justice Lindley in *Lidney & Wigpool Iron Ore Co.* v. *Bird* [1866] 33 Ch. D 85 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."

4.1-4 Duties of promoters

The Companies Act, 2013 contains no provisions regarding the duties of promoters. It merely imposes liability on promoters for untrue statements in prospectus they are parties to (sections 34 & 35), and for fraudulent trading (section 339). The courts, however, have been conscious of the possibility of abuse inherent in the promoters' position and therefore laid down that any one, who can properly be regarded as promoter stands in a fiduciary position towards the company with all the duties of disclosure and accounting. *In particular,* the two fiduciary duties imposed on a promoter are :

(1) not to make any secret profit out of the promotion of the company;

(2) to disclose to the company any interest which he has in a transaction entered into by it.

Duty to disclose secret profits: The commonest way in which professional promoters used to make a secret profit was by purchasing property or business themselves and reselling it to the company at an enhanced price. But the difference between the two prices in such a case shall be a secret profit only if the promoter has begun to promote the company at the time he buys the property or business, so that he owes a duty to the company at that time not to profit on a re-sale to it [*Re Cape Breton Co.* [1885] 29 Ch. D 795]. If the promoter purchases the property or business at a time when he merely has an intention of promoting a company to acquire it, he owes no fiduciary duty to the company [*Erlanger* v. *New Sombrero Phosphate Co.* [1878] 3 App. Cas. 1218]. The duty of disclosing the profits does not even extend to a situation where the contract with the vendor provides that the promoters shall form a company to which the property or business shall be transferred. [*Re Coal Economising Gas Co. Gover's* case [1875] 1 Ch. D 182].

Promoters may obtain secret profits by other methods than reselling property to company. For example, the vendor may agree to pay a share of profit to the promoter.

A promoter is not forbidden to make profit but to make secret profit. He may make a profit out of promotion with the consent of the company, in the same way as an agent may retain a profit obtained through his agency with his principal's consent. In *Gluckstein* v. *Barnes*[6] 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: As noted in the preceding paragraphs, a promoter is allowed to make a profit out of a 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 *Erlanger* v. *New Sombrero Phosphate Co.* (*supra*), it was held that it shall be sufficient if the disclosure is made to an independent and competent Board of directors. Lord Cairns, in this case, observed that 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 defending how, and when, and in what shape, and under what supervision, it shall start into existence and begin to act as a trading corporation . . . . It does not mean that the owner of property may not promote and form a joint stock company and then sell his property to it, but it does mean that if he does, he is bound to take care that he sells it to the company through the medium of a Board of directors who can and do exercise an independent and intelligent judgment on the transaction . . .".

However, at the time when promoters are involved, an entirely independent Board of directors would be impossible in the case of most private and many public companies. In such cases, the disclosure should be made to the whole body of persons who provide the company with its initial capital [*Lagunas Nitrate Co.* v. *Lagunas Syndicate Ltd.* [1899] 2 Ch. 392]. The initial shareholders' consent may either be obtained individually or by way of an ordinary resolution to that effect. Consent to the retention of a promotional profit can only be given by the directors or shareholders (as the case may be) if the promoter makes full disclosure to them of the nature and amount of the profit he has made, and it is insufficient for him to give them information from which they could deduce that he has obtained a profit by making enquiries [*Whaley Bridge Calico Printing Co.* v. *Green* [1880] 5QBD 109].

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.

Duty of disclosure of interest: In addition to his duty for declaration of secret profits, a promoter must disclose to the company any interest he has in a transaction

6. [1900] AC 240.

entered into by it. This is so even where a promoter sells property of his own to the company, but does not have to account for the profit he makes from the sale because he bought the property before the promotion began [*Re Lady Forest - (Murchison) Gold Mine Co. Ltd.* [1901] 1 Ch. 582]. Disclosure must be made in the same way as though the promoter was seeking the company's consent to his retaining a profit for which he is accountable.

Promoter's duties under the Indian Contract Act: Promoter's duties to the company under the Indian Contract Act have not been dealt with by the courts in any detail. They cannot depend on contract, because at the time the promotion begins, the company is not incorporated, and so cannot contract with its promoters. It seems, therefore, that the promoter's duties must be the same as those of a person, who acts on behalf of another without a contract of employment, namely, to shun from deception and to exercise reasonable skill and care. Thus, where a promoter negligently allows the company to purchase property, including his own, for more than its worth, he is liable to the company for the loss it suffers. Similarly, a promoter who is responsible for making misrepresentations in a prospectus may be held guilty of fraud under section 17, of the Indian Contract Act and consequently liable for damages under section 19 of that Act.

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* (*supra*)]. When these things have been done, the promoter's fiduciary and contractual duties cease, and he is thereafter subject to no more extensive duties in dealing with the company than a third person, who is unconnected with it. Thus, where a promoter disclosed the profit which he made out of a company's promotion to the persons who provided it with the share capital with which it commenced business, it was held that he was under no further duty to disclose the profit to persons who were invited to subscribe further capital a year later, and so the company could not recover the profit for his failure to do so - [*Re. British Seamless Paper Box Company* [1981] 17 Ch. D 467]. Nevertheless, a promoter may remain subject to fiduciary and other duties to the company if he becomes a director or agent of it, but the duties are then owed only in that other capacity.

4.1-5 Remedies available to the company against the promoter for breach of his duties

Since the promoter owes a duty of disclosure to the company, the primary remedy in the event of breach is for the company to bring proceedings for rescission of any contract with him or for the recovery of any secret profits which he has made.

Rescission of contract : So far as the right to rescind is concerned, this must be exercised on normal contractual principles, that is to say, the company must have done nothing to show an intention to ratify the agreement after finding breach involving non-disclosure or misrepresentation.

To recover secret profit: If a promoter makes a secret profit or does not disclose any profit made, the company has a remedy against him. This varies according to the circumstances which may be divided into the following two situations :

(1) *Where the promoter was not in a fiduciary position when he acquired the property but only when he sold it to the company.* If the property on which the profit was made was acquired before the promoter became promoter, there can be no claim for the recovery of the profit as such. [*Re Ambrose Lake Tin & Copper Co.* [1880] 14 Ch. D 390]. According to this view, it may be necessary for this purpose to make the determination of the exact moment of time at which the promotion began. The principle on which this view is based has been expressed as follows :—[7]

> "In any question as to the remedies available against a [promoter] who has sold his own property to the company, regard must be had to the relationship in which the [promoter] stood to the company when he acquired the property. If he was under no obligation at that time to acquire the property for the company instead of for himself then his non-disclosure of the fact that the property was his own would entitle the company to repudiate the sale and restore the original position, but would not entitle it to retain the property at a price reduced by a deduction of the [promoter's] profit. When, however, the [promoter's] default extends further than non-disclosure, when a breach of duty attended the original acquisition, the company may, if it chooses, retain the property purchased and also demand a refund of the profits."

Thus, if a person acquires properties or had it before he takes any active steps in the promotion of a company and sells it to the company at a profit, he is entitled to retain that profit. Here the promoter, as in *Solomon's* case must have had the property for a certain length of time. He can hardly be said to be in a fiduciary relation to the company.

(2) *Where the promoter was in a fiduciary position when he acquired the property and when he sold it to the company.* This may happen in any of the following circumstances :—

(*i*) Where the promoter bought property with a view to selling it to the company which he intends to promote.

(*ii*) Where the promoter resells to the company at an increased price, the property which he purchased after he commenced the promotional activities.

(*iii*) Where a person is a promoter for acquiring the property for the company in the capacity of an agent.

In the aforesaid circumstances, the remedies of the company may include :

(*a*) rescission of the contract, and if the promoter has made a profit on some ancillary transaction that may also be recovered; or

(*b*) to retain the property, paying no more than what the promoter has paid for it, thus depriving him of his profit; or

(*c*) where the above remedies would be inappropriate, say, where the property has been altered so as to render rescission impossible and the promoter has

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7. The quotation is from the headnote of *Robinson* v. *Randfontein Estates* [1921] A.D. 168 summarizing the statement of Innes, C.J. at p. 179. 'Promoter' has been substituted for 'director'.

already received the inflated price, the company may sue for misfeasance (breach of duty to disclose). The measure of damages in such a situation will be the difference between the market value of the property and the contract price.

4.1-6 Liability of promoters

A promoter is subject to following liabilities under the various provisions of the Companies Act :

1. 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.
2. 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.
3. 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. They may thus be liable 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.

The Madras High Court in *Probir Kumar Misra* v. *Ramani Ramaswamy* [2010] 104 SCL 174, has held that to fix liability on a promoter, it is not necessary that he should be either a signatory to the Memorandum/Articles of Association or a shareholder or a director of the company. Promoter's civil liability to the company and also to third parties remain in respect of his conduct and contract entered into by him during pre-incorporation stage as agent or trustee of the company (as agent to third party and as trustee to the company).

4.1-7 Remuneration of promoters

A promoter is not entitled to recover any remuneration for his services from the company unless there is a valid contract, enabling him to do so, between him and the company. Indeed, without such a contract, he is not even entitled to recover his preliminary expenses or the registration fees [*Re English & Colonial Produce Company* [1906] 2 Ch. 435 CA]. In practice, however, recovery of preliminary expenses and registration fees does not normally present any difficulty. The Articles generally contain a provision authorising the directors to pay them [*Touche* v. *Metropolitan Railway Warehousing Company* [1871] L.R. 6 Ch. 671]. The provision in the Articles does not impose any legal obligation on the company towards the promoters but as they or their nominees will usually be the first directors of the company, there is little risk of the power being not exercised in their favour. It may well be, however, that the promoters will not be content with merely their expenses; a professional promoter expects to be handsomely remunerated. It cannot be said to be unreasonable either. As Lord Hatherly said: "The services of a promoter are very peculiar; great skill, energy and ingenuity may be employed in constructing a plan and bringing it out to the best advantage". Hence, it is perfectly proper for the promoter to be rewarded, provided, as we have seen, that he fully discloses to the company the profits which he has made. Companies, after registration, may (and usually they do) pay or agree to pay some remuneration to the promoters for the services rendered. In practice, a promoter is remunerated in any of the following ways :

(*a*) 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.

(*b*) He may take commission on the shares sold.

(*c*) He may be paid a lump sum by the company.

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

4.1-8 Pre-incorporation contracts

Sometimes, contracts are made on behalf of a company even before it is duly incorporated. But no contract can bind a company before it becomes capable of contracting by incorporation. "Two consenting parties are necessary to a contract, whereas the company before incorporation is a non-entity" - [*Kelner* v. *Baxter* [1866] 15 LT 213].

The true legal position in respect of pre-incorporation contracts may be discussed under the following two heads :—

(1) Position before 1963 (*i.e.*, before passing of Specific Relief Act, 1963), and

(2) Position since 1963.

Position before 1963 :

(*a*) A pre-incorporation contract never binds a company since a person (legal or juristic cannot contract before his or its existence and a company before incorporation has no legal existence. Another reason is that promoters are

proverbially profuse in their promises and if the corporation were to be bound by them, it would be subject to many unknown, unjust and heavy obligations. [*Parke* v. *Modern Woodman* 181 All 214, 234].

(*b*) Even where there is a request purported to enforce such a contract, the company cannot be bound because ratification is not possible as the ostensible principal did not exist at the time the contract was made - [*Kelner* v. *Baxter* (*supra*)].

In re, English and Colonial Produce Company (*supra*), a solicitor was engaged to prepare the necessary documents and obtain the registration of a company. He paid the registration fee and incurred certain expenses incidental to registration. *Held,* the company was not bound to pay for his services and expenses.

(*c*) The company is also not entitled to sue on a pre-incorporation contract.

In *Natal Land and Colonisation Company* v. *Pauline Colliery Syndicate*[1904] AC 120, N Co. contracted with 'A', the nominee of the syndicate (which was not even incorporated) to grant a lease of certain coal mining rights for three years. After the syndicate was registered, it claimed the contracted lease which the N Company refused. In a suit for specific performance, it was held that the syndicate was not entitled to its claim as it was not in existence when the contract was made and a company cannot obtain the benefit of a pre-incorporation contract.

Position since 1963 (after passing of the Specific Relief Act, 1963): Until the passing of the Specific Relief Act, 1963, in India the promoters found it very difficult to carry out the work of incorporation. Since contracts prior to incorporation were void and also could not be ratified, people hesitated to either supply any goods or service for the cause of incorporation. Promoters also felt shy of accepting personal responsibility. The Specific Relief Act, 1963 came as a relief to the promoters. Section 15(*h*) of the Specific Relief Act, 1963 provides that where the promoters of a public company have made a contract before its incorporation for the purposes of the company, and if the contract is warranted by the terms of its incorporation, the company may enforce it. "Warranted by the terms of incorporation" means within the scope of the company's objects as stated in the memorandum. Thus, where a person, who intended to promote a company, acquired a leasehold interest for it, held it for some time for partnership firm, converted the firm into a company which adopted the lease, the lessor was held bound to the company under the lease. [*Vali Pattabhirama Rao* v. *Sri Ramanuja Ginning and Rice Factory Pvt. Ltd.* [1986] 60 Comp. Cas. 568 (AP)].

Please note that it is not only the company which is allowed, under the Specific Relief Act, to adopt and enforce its pre-incorporation claims against third parties. Section 19 of the Specific Relief Act also allows the other party to enforce the contract against the company if, (*i*) the company had adopted the same after incorporation, and (*ii*) the contract is warranted by the terms of incorporation. Contracts like preparation and printing of the memorandum, and articles, remunerating the professionals, if any, for securing the registration of the company, renting premises, hiring secretarial staff are envisaged under the Act.

Liability of promoters vis-a-vis *pre-incorporation contracts* : An important question that needs to be tackled is what is the position of a promoter *vis-a-vis* preliminary contracts? If the company does not execute a fresh contract after incorporation and the contract is not one warranted for the purposes of incorporation of the company, what will be the legal position of the promoter who brings about such a contract ?

In *Phonogram Limited* v. *Lane* [1982] QB 938, 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] LR 2CP 255].

The persons who make the contract are liable as parties to it, and are not merely liable to pay damages for breach of implied warranty that they had authority to contract on company's behalf.[8] This distinction may be of importance when the contract is specifically enforceable (for example, a contract for the sale of land to the unformed company) for there seems to be no reason why the vendor should not obtain an order for specific performance against the persons who make the contract instead of suing them for damages.

Formerly, these consequences did not ensue when a contract was made in the name of a company before its incorporation by a person who did not purport to contract on its behalf or as its agents, but simply described himself in the offer or acceptance as an officer of the company or as being in some other way connected with it - [*Newborne* v. *Sensolid (Great Britain) Ltd.* [1954] 1QB 45]. Such contracts were declared void both against the company and the person authenticating the same by adding his name.

However, now, besides the judicial decisions on the subject, section 36(4) of the English Companies Act, 1985 specifically provides that such contracts take effect as contracts entered into personally by the persons who make them. Even the knowledge or ignorance of those persons of the fact that the company has not yet been incorporated is immaterial.

4.2 Registration/Incorporation of a company

Section 3 states that, "A company may be formed for any lawful purpose by—

(*a*) seven or more persons, where the company to be formed is to be a public company;

8. Pennington's Company Law, 5th edn., p. 105.

(*b*) two or more persons, where the company to be formed is to be a private company; or

(*c*) one person, where the company to be formed is to be One Person Company that is to say, a private company,

by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

Thus, the promoters will have to get together at least seven persons in the case of a public company and two persons in the case of a private company to subscribe to the memorandum of association.

4.2-1 Procedure for registration/incorporation of a company : Important Steps

Before proceeding, to register a company, the promoters have to, *inter alia,* decide the following aspects :

4.2-1a TYPE OF COMPANY : The first thing the promoters must decide is the type of company proposed to be floated. Under the Act only two types of companies can be registered, *viz.,*

(*i*) Public companies,

(*ii*) Private companies.

4.2-1b APPLICATION FOR AVAILABILITY/RESERVATION OF NAME - The promoters then obtain the approval of the proposed name from the Registrar of Central Registration Centre (CRC)*. Application can now be made online also. As per the prescribed Form INC-1, the promoters are required to give maximum of six proposed names in order of preference, so that there is a possibility that at least one of these will be approved. While selecting a proposed name(s), the promoters must not only look at the provisions contained in the Companies Act, 2013 but also the rules made thereunder.

Section 4 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.

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*Ministry of Corporate Affairs *vide* its Notifications No. S.O. 218(E) and S.O. 1211(E), dated 22nd January, 2016 and 23rd March, 2016, respectively has established a Central Registration Centre (CRC) having territorial jurisdiction all over India, for discharging or carrying out the function of processing and disposal of applications for reservation of names as well as registration of companies under the provisions of the Companies Act.

The CRC shall function under the administrative control of Registrar of Companies, Delhi (ROC Delhi), who shall act as the Registrar of the CRC until a separate Registrar is appointed to the CRC.

The CRC shall process applications for reservation of name *i.e.,* e-Form No. INC-1 filed along with the prescribed fee as provided in the Companies (Registration Offices and Fees) Rules, 2014. He may approve or reject the name, as the case may be.

This notification shall come into force from 26th January, 2016 and 28th January respectively.

Reservation of Name:

Sub-section *(4) of Section 4 of the Companies Act, 2013 read along with the Companies (Incorporation) Rules, 2014,* as amended *vide* Notification dated 23-3-2018, *provides that a* person may make an application, through the web service available at www.mca. gov.in by using form RUN (Reserve Unique Name) and accompanied by such fee, as may be prescribed, to the Registrar, Central Registration Centre for the reservation of a name set out in the application as—

(*a*) the name of the proposed company; or

(*b*) the name to which the company proposes to change its name.

(*i*) Upon receipt of an application under sub-section (4), the Registrar, Central Registration Centre may, on the basis of information and documents furnished along with the application, **reserve the name for a period of twenty days*** from the date of the application.

However, in case of an application for reservation of name or for change of its name by an existing company, the Registrar may reserve the name for a period of sixty days from the date of approval*.

(*ii*) Where after reservation of name under clause (*i*), it is found that name was applied by furnishing wrong or incorrect information, then,—

(*a*) if the company has not been incorporated, the reserved name shall be cancelled and the person making application under sub-section (4) shall be liable to a penalty which may extend to one lakh rupees;

(*b*) if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard—

(*i*) either direct the company to change its name within a period of three months, after passing an ordinary resolution;

(*ii*) take action for striking off the name of the company from the register of companies; or

(*iii*) make a petition for winding up of the company.

You will study in detail about this aspect in Chapter 5 dealing with Memorandum of Association.

4.2-1c PREPARATION OF MEMORANDUM AND ARTICLES 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 as per the applicable State stamp laws.

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.

*Vide Companies (Amendment) Act, 2017.

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.

Section 7 and Rule 13 of the Companies (Incorporation) Rules, 2014 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.

Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.

Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.

4.2-1d PREPARATION OF OTHER DOCUMENTS - The following documents are also required to be prepared by the promoters in connection with the incorporation of a company :

(*i*) *Power of Attorney* - With a view to fulfilling various formalities that are required for incorporation of a company, the promoters may execute a power of attorney in favour of one of them or an advocate or some other professional like the Chartered Accountant, the Company Secretary, the Cost and Works Accountant or an Advocate. The Power of Attorney should be prepared on a non-judicial stamp of the value prescribed by the Stamp Act of the concerned State.

(*ii*) ***Consent of the directors*** - **A list of persons who have agreed to become the first directors of the company along with their consent 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, the particulars of their interest in other firms or bodies corporate 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. The directors are also required to give a written undertaking to take up and pay for their qualification shares, if any, prescribed in the Articles.

(*iii*) *The particulars of Manager, etc.* – Where the company names in its articles the persons who are to act as, manager, secretary, etc., the particulars of such manager, etc., may be filed with the Registrar at the time of registration.

(*iv*) *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 each of the first directors, if any, named 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.

(*v*) *Address for communication and notice of registered address* - Address for communication till the company acquires its registered office shall also be supplied. As per section 12, a company is required to have a registered office within 15 days of incorporation and within 30 days of incorporation, it must submit the verification of the registered office in the prescribed manner. There is no pre-condition for foreign promoters to furnish local address in India for seeking registration and incorporation of a private limited company in India – *Dmitry Rosnin* v. *Registrar of Companies* [2012] 19 taxmann.com 219 (Bom.).

(*vi*) *Statutory declaration* - 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, 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, IRDA, RBI, SEBI, MCA etc.

4.2.1e FILING OF APPLICATION AND DOCUMENTS FOR REGISTRATION - After the aforesaid documents are ready, the next step is filing of an application for incorporation of the company along with these documents with the Registrar of Central Registration Centre (CRC)*.

As per Rule 12 of the Companies (Incorporation) Rules, 2014, as amended vide Notification No. dated 29th May, 2015, an application shall be filed with the Registrar in Form No. INC.2 (for one person company) and Form No. INC.7 (for other companies) along with the prescribed fees.

However, if pursuing of any of the objects of a company requires registration or approval from sectoral regulators such as RBI, SEBI, registration or approval, as the case may be, from such regulator shall be obtained by the company before pursuing

* *Vide* MCA Notifications No. S.O. 218(E) and S.O. 1211(E), dated 22-1-2016 and 23-3-2016.

such objects and a declaration in this behalf shall be submitted at the stage of incorporation of the company.

4.3 Simplified Performa for Incorporating Company Electronically (SPICE)

Rule 38 inserted by the Companies (Incorporation) (Fourth Amendment) Rules, w.e.f. 2.10.2016, provide for simplified integrated process for incorporation of a company in Form No. INC-32 along with e-Memorandum of Association in Form No. INC-33 and E-Articles of Association in Form No. INC-34.

The Rules applicable to the integrated process for formation of companies shall apply, *mutatis mutandis* to incorporation of a company under SPICE except that reference to Forms INC 29, 30 and 31 shall stand substituted with Forms INC 32, 33 and 34.

Application for incorporation of companies under SPICE[9]

An application for registration of a company shall be filed, with the Registrar within whose jurisdiction the registered office of the company is proposed to be situated, in Form No.INC-32 (SPICe) along with the fee as provided under the Companies (Registration Offices and Fees) Rules, 2014.

However, in case pursuing of any of the objects of a company requires registration or approval from sectoral regulators such as the Reserve Bank of India, the Securities and Exchange Board, registration or approval, as the case may be, from such regulator shall be obtained by the proposed company before pursuing such objects and a declaration in this behalf shall be submitted at the stage of incorporation of the company.

Further, in case of incorporation of a company having more than seven subscribers or where any of the subscribers to the MOA/AOA is signing at a place outside India, MOA/AOA shall be filed with INC-32 (SPICe) in the respective formats as specified in Table A to J in Schedule I without filing form INC-33 and INC-34.

Again, in case of companies incorporated, with effect from the 26th day of January, 2018, with a nominal capital of less than or equal to rupees ten lakhs or in respect of companies not having a share capital whose number of members as stated in the articles of association does not exceed twenty, fee on INC-32 (SPICe) shall not be applicable.

4.3A On-line Registration of a Company

MCA 21 Project of the Ministry of Corporate Affairs (MCA) enables on-line registration of a company on the portal of MCA. It involves four major steps for on-line registration of a company:

These four major steps are:

- Acquiring Director Identification Number (DIN)
- Acquiring Digital Signature Certificate (DSC)

9. As per the Companies (Incorporation) Amendment Rules, 2018.

- Filing an e-Form or New user registration
- Incorporating the company.

Step 1: Acquire Director Identification Number (DIN)

This is the first process in registration that each director of the company should obtain their identification number. Acquiring a DIN is compulsory for every director i.e. as such every existing and intending director have to obtain their DIN. To get DIN one need to file an e-Form DIN-1. The DIN-1 form is available on Official site of the Ministry of Corporate Affairs the link is *DIN-1 Form*. The procedure involves:

- Registering on MCA Website first and have a login id. After filling DIN-1 Form, one should upload the filled form by clicking to e-Form upload button on MCA website and should pay applicable fees.
- After getting generated DIN one should intimate their company about DIN. The director can intimate their company about DIN by using DIN-2 Form.
- Then company should intimate the Registrar of Companies (RoC) about all director's DIN through DIN-3 Form.
- If there is any change in DIN or need for any updation like change of address, personal details etc., then director should intimate this change by submitting the e-Form DIN-4 Form.

Step 2: Acquire Digital Signature Certificate (DSC)

In order to ensure the security or authenticity of documents filed electronically the Information Technology Act, 2000 demands a valid digital signature on the documents submitted electronically. This is the only and safest way that one can submit their documents electronically. The digital signature certificate should be acquired from only those agencies which are appointed by the Controller of Certification Agencies (CCA). These are called licenced Certifying Authority (CA). One should not use DSC given by any other agency which is not approved.

If you already have a digital signature then you can use the same, no need to apply for another. But do check for your digital signature validity.

Some of the certified licencing authorities for issuing DSC are: TCS, IDBRT, MTNL, SAFESCRYPT, NIC, nCODE Solutions, etc.

Register DSC: After having acquired DSC, it is important to do the Role Check. At the time of uploading e-form on MCA portal, Role Check verifies whether the Digital Signature affixed on the e-form belongs to the Director, Manager or Secretary and whether the Digital Signature is registered on the MCA portal. Role Check also verifies whether the signatures of the Certifying Agency are duly registered on the MCA portal. In case the Role Check validation fails, the e-form will not be uploaded.

Step 3: Create an account on MCA Portal – New user registration

This is about having a registered user account on MCA Portal for filing an e-Form and for online fee payment. Creating an account is totally free of cost. To register on the MCA portal, click on the register link.

Step 4: Incorporate the company

This is the final major step in a registration of your company which includes registration of company's name, Registering the office address or notice of situation of office and notice for appointment of company directors, manager and secretary and also regarding the take and pay for their qualification shares. The process includes:

- **Filing Form-INC-1:** Application in **Form-INC-1** for availability of name is to be made to Registrar, Central Registration Centre (CRC)[1]. Application can now be made online also. As per the prescribed Form INC-1, the promoters are required to give maximum of six proposed names indicative of the main objects of the company in order of preference, so that there is a possibility that at least one of these will be approved.

While selecting a proposed name(s), the promoters must not only look at the provisions contained in the Companies Act, 2013 but also the rules made thereunder.

Section 4 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 Chapter 5 dealing with Memorandum of Association.

- After the name approval, the applicant can apply for registration of the new company by filing Form INC -7 for incorporation of company other than One Person Company (OPC) and Form INC-2 for incorporation of One Person Company (OPC) within 60 days of name approval.
- Application for incorporation of a company shall be accompanied with the following documents:
  - Memorandum of association as per the relevant prescribed Form[2].
  - Articles of Association[3]
  - 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:

1. Since 23rd March, 2016.
2. Section 4 (6) requires that the memorandum of a company shall be drawn up in such a form as is given in Tables A, B, C, D & E in Schedule I to the Act as may be applicablein the case of the company.
3. As per section 5 of the Companies Act, 2013, the articles of a company shall be inrespective forms specified in Tables F, G, H, I and J in Schedule I as may be applicable to such company.

(*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.

- Affidavit from subscribers and first directors in Form INC-9.
- Verification of signatures of subscribers in Form INC-10 along with proof of residential address.

- Login to the portal and fill the following e- Forms and attach the mandatory documents:
  - Form INC-22: Verification of the registered office shall be filed in Form INC-22.
  - Form DIR- 12: Particulars of appointment of directors and key managerial personnel.
- *Payment of the requisite filing and registration fees*: At the time of filing the application for incorporation in Form INC -7 or INC -2, as the case may be, the MCA 21 portal also facilitates e-payment of all the requisite filing and registration fees.
- Once the application Form has been approved, an e-mail regarding the same will be received and the status of the form will get changed to 'approved'.
- The Registrar will then generate the Certificate of Incorporation containing the Corporate Identity Number (CIN).

4.4 Certificate of incorporation

After scrutinising the documents filed and on being satisfied that they are in order, that the requisite fee has been paid and that all other legal requirements have been duly complied with, the Registrar will enter the name of the company in the Register of Companies and shall certify under his hand that the company is incorporated and, in the case of a limited company that the company is limited.

He would then issue a Certificate in the prescribed Form No. INC-11, under his signature, certifying that the company is incorporated. W.e.f. 30-1-2017, the certificate of incorporation shall also contain PAN of the company where it has been issued by the Income-tax Department. 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 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.

The Ministry of Corporate Affairs has allowed issue of Certificate of Incorporation electronically under digital signature of Registrar.

At the time of incorporation of a company where one of the objects is to carry on the business of Banking, Insurance or to practice the profession of Chartered Accountancy, Cost Accountancy, Company Secretaries or Architecture, then the Registrar shall incorporate the same only on production of in-principle approval/ NOC from the concerned Regulator/Professional Institute.

4.4A Effect of certificate of incorporation

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".*

4.4B Conclusiveness of certificate of incorporation

As per the Companies Act, 2013, certificate of Incorporation is not conclusive proof of everything prior to incorporation being in order.

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 Commencement of Business

Section 10A inserted by the Companies (Amendment) Act, 2019 requires a declaration to be made by the director of a company incorporated post the commencement of Ordinance 2019 within 180 days of its incorporation to the effect that:

(*i*) All the subscribers to the memorandum have paid agreed value of the shares; and

(*ii*) The registered office of the company so incorporated has been verified by filing requisite returns.

The Ministry of Corporate affairs has released INC 20A for such declaration.

As per the Companies (Incorporation) Fourth Amendment Rules, 2018, effective from 18.12.2018, the said form shall be verified by a Company Secretary or a Chartered Accountant or a Cost Accountant, in practice.

In the case of a company pursuing objects requiring registration or approval from any sectoral regulators such as the Reserve Bank of India, Securities and Exchange Board of India, etc., the registration or approval, as the case may be from such regulator shall also be obtained and attached with the declaration.

The company shall not commence its business or exercise borrowing of any kind unless such declaration has been filed by the director of such company.

Penalty

Failure to comply with this section shall qualify as a ground for striking off the name of the company from the register of companies by the Registrar. This is essentially done to ensure that companies having no business of their own, do not function and moreover refrain from engaging in borrowing of any kind before a physical verification of its registered office is conducted and a declaration in respect of the same is filed with the Registrar.

Again, section 12(9), 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 companies. This is an attempt to curb the number of shell companies that are incorporated to facilitate money laundering.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/PE-II/PCC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. "Any person who undertakes to take part in the forming of a company…is *prima facie* a promoter of the company". Discuss the statement and explain the legal position of a promoter *vis-a-vis* the company being formed.
2. "Promoter is not an agent or trustee for the company he promotes; but stands in a fiduciary position towards it". Comment on this statement bringing out clearly the powers and liabilities of a promoter.
3. State the steps you would take to obtain (*i*) certificate of incorporation; and (*ii*) certificate of commencement of business in the case of a public limited company.
4. The 'certificate of incorporation' alone is not sufficient to commence business of a company. Comment.
5. Who is a promoter of a company ? Discuss, citing legal cases, his legal position in relation to the company he promotes.
6. "A certificate of incorporation is conclusive evidence that all the requirements of the Companies Act, 2013 have been complied with." Comment.
7. "A company cannot ratify a pre-incorporation contract though it is open to it to enter into a fresh contract". Comment.
8. Distinguish between 'Preliminary/pre-incorporation' Contracts and 'Provisional Contracts'.
9. Explain the steps required to be taken for the formation of a private limited company and the documents required to be filed with the Registrar of Companies.
10. Examine the validity of contracts entered into prior to incorporation of a company.

PRACTICAL PROBLEMS

1. The promoters of your company, incorporated on 9th April, 2014, had entered into a contract with M on 8th March, 2014 for supply of goods. After incorporation, your company does not want to proceed with the contract. As a company secretary, advise the management of your company.

OR

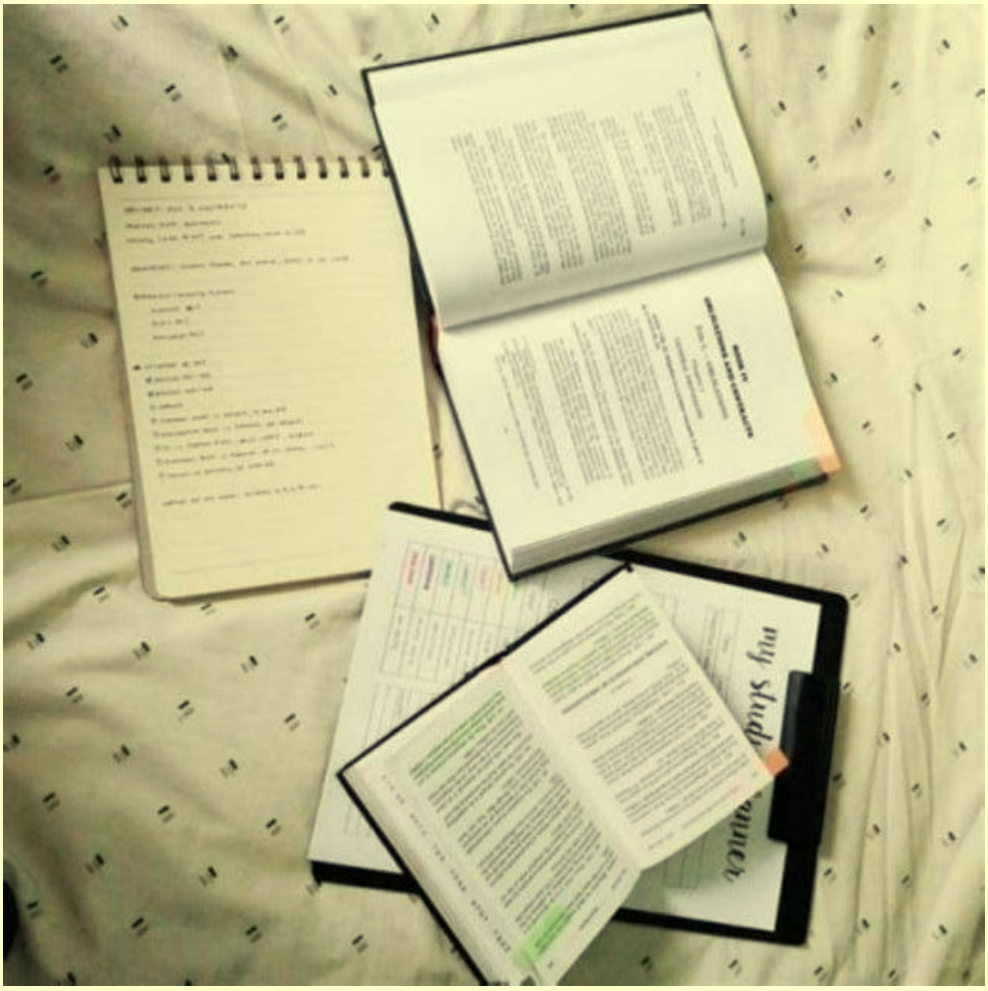
A company was incorporated on 6th October, 2013. The certificate of incorporation of the company was issued by the Registrar on 15th October, 2013. The company on 10th October, 2013 entered into a contract which created its contractual liability. The company denies the said liability on the ground that company is not bound by the contract entered into prior to issuing of certificate of incorporation. Decide, under the provisions of the Companies Act, 2013, whether the company can be exempted from the said contractual liability.

Hints : Pre-incorporation contracts in general are *void ab initio* and hence not binding on the company. However, under section 19(*e*) of the Specific Relief Act, 1963 the party to the contract can enforce the contract against the company if : (*i*) the company had adopted the same after incorporation; and (*ii*) the contract is warranted by the terms of incorporation.

Thus, unless the company adopts the contract, the other party cannot enforce the same against the company. However, promoters can be held personally liable.

2. Though six, out of the seven signatures to the Memorandum of Association were forged, the company was registered and the Certificate of Incorporation issued. Can the registration of the company be challenged subsequently on the ground of forged signatures?

Hints : See Para 4.3B



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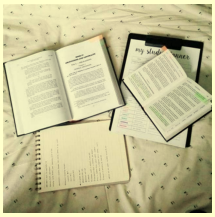

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5 Memorandum of Association

5.1 Meaning and importance

One of the first steps, in the formation of a company is to prepare a document called the memorandum of association. The memorandum of association of a company contains the fundamental conditions upon which alone the company has been incorporated. According to section 2(*56*) of the Companies Act, 2013 "Memorandum" means "Memorandum of association of a company as originally framed or altered from time to time in pursuance of any provision of any previous company law or of this Act". This definition, however, does not state the nature of this document nor is indicative of its importance. According to Palmer, the memorandum of association is a document of great importance in relation to the proposed company. It contains the objects for which the company is formed and therefore identifies the possible scope of its operations beyond which its actions cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers, that will be *ultra vires* (beyond powers of) the company and so void.

In the celebrated case of *Ashbury Railway Carriage & Iron Co. Ltd.* v. *Riche* [1875] L.R. 7 H.L. 653, Lord Cairns observed : "The memorandum of association of a company defines the limitation on the powers of the company… it contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and power which by law are given to the corporation and it states, if it is necessary to state, negatively, that nothing shall be done beyond that ambit. . . ." Thus, it serves two purposes. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities. An intending shareholder can find out the purposes for which his money is going to be used by the company and what risk he is taking in making the investment. Likewise, anyone dealing with the company, say, the supplier of goods or money, will know whether the transaction he intends to make with the company is within the objects of the company and not *ultra vires* its objects.

5.2 Memorandum of Association - Whether an unalterable charter

It has been observed in certain quarters that the memorandum of association of a company is an unalterable charter of a company. However, in the present day context, it does not appear to be wholly true. Until the year 1890, it was regarded

as an unalterable charter of the company. This led to a number of difficulties in the working of companies. Consequently, the Act was amended to provide for the alteration of the various clauses of the memorandum.

As stated by Palmer, "It is a document of great importance in relation to the proposed company." This is the primary document of the company and it is sometimes called the charter or constitution of the company. It contains information about name, address, capital, objects of the company and liability of its members. It defines the relationship of the company with outsiders.

The Memorandum of Association not only defines the powers of the company but also confines them. A company cannot act beyond the powers given to it by the Memorandum. Any action outside the scope of Memorandum shall be void and inoperative. The purpose of the Memorandum is to enable the shareholders, creditors and those who deal with the company to know what is its permitted range of activities. It tells the shareholders the purposes for which their money is likely to be used.

From the above, it is amply clear that Memorandum of Association is a document on the basis of which a company is formed. Therefore, it is but desirable that the clauses of this document should not be allowed to be changed frequently. It is for this purpose that the Companies Act has laid down elaborate rules for making alterations in the Memorandum. Section 13 of the Act provides that except the capital clause (which may be altered by passing an ordinary resolution), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. The provisions referred in section 13 relate to the name, registered office, objects, and liability clauses. These are deemed to be the conditions contained in the Memorandum. For making alterations in the name clause or shifting of the registered office from one State to another, it is necessary to obtain the approval of the Central Government. Again, for alteration of objects by a company which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless the dissenting shareholders have been given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board (SEBI).

Thus, we can state that though Memorandum of Association is the charter of the company, but it is not unalterable. The different clauses of this document can be altered by following the procedure laid down in the Act in this respect.

5.3 Form and contents

Section 4(6) requires that the memorandum of a company shall be drawn up in such a form as is given in Tables A, B, C, D & E in Schedule I to the Act as may be applicable in the case of the company.

Sections 3 and 4 read with section 7 and the Rules made thereunder require the memorandum to be signed by at least seven persons in case of a 'public company' (two in case of 'private company' and only one person, in case of 'one person company') in the presence of at least one witness, who will attest the signature(s). Each of the subscribers must write opposite his name the number of shares he takes.

The signatories to the Memorandum shall add their address, description and occupation. Similar particulars of the witness(es) should also be entered.*

Section 4 requires the *memorandum of a company* to contain the following :

(*a*) the *name of the company,* with 'limited' or 'private limited' as the last word(s) of the name in the case of a public company or a private company, as the case may be**. In case of One Person Company, Section 12 requires that the words 'One Person Company' must be mentioned in brackets below the name of the company;

(*b*) the *name of the State,* in which the registered office of the company is to be situated;

(*c*) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof;

(*d*) the liability of members of the company, whether limited or unlimited, and also state,—

(*i*) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and

(*ii*) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute—

(*A*) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and

(*B*) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves;

(*e*) in the case of a company having a share capital,—

(*i*) the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and

(*ii*) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

(*f*) in the case of One Person Company, the name of the person who, in the event of death of the subscriber, shall become the member of the company.

It may be noted that the memorandum of association of a company cannot contain anything contrary to the provisions of the Companies Act. If it does, the same shall be devoid of any legal effect (Section 6).

Now, let us discuss in detail, the various clauses of Memorandum of Association.

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*For details, *see* Para 5.3-8a.

**A Government company has been exempted from the requirement of using 'Limited' or 'Private Limited' at the end of its name - *Vide MCA Notification dated 5-6-2015.*

5.3-1 The name clause [Sec. 4(1)(a)]

A company being a distinct legal entity must have a name of its own to establish its separate identity. The promoters are free to choose any suitable name for the company provided :

(*a*) The last word(s) in the name of the company, if limited by shares or guarantee is 'limited' or 'private limited', as the case may be. However, an "association not for profit", and incorporated as a company and licensed by the Central Government, may not use the word 'limited' or 'private limited' as part of its name, even though the liability of its members is limited [Section 8].

(*b*) The name stated in the memorandum is not—

(*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*) 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.

Further, a company shall not be registered with a name which contains—

(*a*) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force. Thus, words like President, Prime Minister, Central, Municipal, Panchayat may not be allowed; or

(*b*) such word or expression, as may be prescribed

5.3-1a UNDESIRABLE NAMES - Rule 8 of the Companies (Incorporation) Rules, 2014, framed by the Central Government under the Companies Act, 2013, in this regard, provides as follows :

(1) A name applied for shall be deemed to resemble too nearly with the name of an existing company if, and only if, after comparing the name applied for with the name of an existing company the names are same.

(2) The following matters are to be disregarded while comparing the names under sub-rule (1):

- In determining whether a proposed name is identical with another, the differences on account of the following shall be disregarded. In other words, the proposed name cannot be merely different with respect to, *inter alia*, the following:

(*a*) the words like Private, Pvt, (P), OPC Pvt. Ltd. IFSC Limited, IFSC Pvt. Limited, Producer Limited, Limited, Unlimited, Ltd, Ltd., LLP, Limited Liability Partnership, company, and company, & co, corporation, corp;

(*b*) the plural or singular form of words in one or both names. Thus, Green Technology Ltd. is same as Greens Technology Ltd. and Greens Technologies Ltd. But SM Computers Ltd. is not same as SMS Computers Ltd.

(*c*) type and case of letters, spacing between letters, punctuation marks and special characters used in one or both names. Thus, (i) ABC Ltd. is same

as A.B.C. Ltd. and A B C Ltd. (ii) TeamWork Ltd. is same as Team@Work Ltd. and Team-Work Ltd.

(*d*) use of different phonetic spellings including use of misspelled words of an expression. For example, Bee Kay Ltd is same as BK Ltd, Be Kay Ltd., B Kay Ltd., Bee K Ltd., B.K. Ltd. and Beee Kay Ltd.

(*e*) use of host name such as 'www' or a domain extension such as '.net.' 'org', 'dot' or 'com' in one or both names. Thus, Ultra Solutions Ltd. is same as Ultrasolutions.com Ltd.

(*f*) the order of words in the names. For example, Ravi Builders and Contractors Ltd. is same as Ravi Contractors and Builders Ltd.

(*g*) use of the definite or indefinite article in one or both names. Thus, Congenial Tours Ltd. is same as A Congenial Tours Ltd. and The Congenial Tours Ltd.

(*h*) complete translation of an existing name, in Hindi or in English. For example, National Electricity Corporation Ltd. is same as Rashtriya Vidyut Nigam Ltd.

(*i*) addition of the name of a place to an existing name, which does not contain the name of any place. For example, If Salvage Technologies Ltd. is an existing name, it is same as Salvage Technologies Delhi Ltd and Salvage Delhi Technologies Ltd.

(*j*) addition, deletion, or modification of numerals or expressions denoting numerals in an existing name, unless the numeral represents any brand. For example, Thunder Services Ltd is same as Thunder 11 Services Ltd and One Thunder Services Ltd.

Again, a name shall be considered undesirable if:-

- it attracts the provisions of section 3 of the Emblems and Names (Prevention and Improper Use) Act, 1950;
- it includes the name of a trade mark registered or a trade mark which is subject of an application for registration under the Trade Marks Act, 1999 and the rules framed thereunder unless the consent of the owner or applicant for registration, of the trade mark, as the case may be, has been obtained and produced by the promoters;
- it includes any word or words which are offensive to any section of the people.

A name shall also generally be considered undesirable if:-

- the proposed name is identical with or too nearly resembles the name of a limited liability partnership;
- the Company's main business is financing, leasing, chit fund, investments, securities or combination thereof, such name shall not be allowed unless the name is indicative of such related financial activities, viz., Chit Fund/ Investment/Loan, etc.;
- it resembles closely the popular or abbreviated description of an existing company or limited liability partnership;
- the proposed name is identical with or too nearly resembles the name of a company or limited liability partnership incorporated outside India and reserved by such company or limited liability partnership with the Registrar:

But, if a foreign company is incorporating its subsidiary company in India, then the original name of the holding company as it may be allowed with the addition of word India or name of any Indian state or city, if otherwise available;

- the proposed name contains the words 'British India';
- the proposed name implies association or connection with embassy or consulate or a foreign government;
- the proposed name includes or implies association or connection with or patronage of a national hero or any person held in high esteem or important personages who occupied or are occupying important positions in Government;

An existing company may, however, use its abbreviated name as part of the name for formation of a new company as subsidiary or joint venture or associate company;

- the proposed name is identical to the name of a company dissolved as a result of liquidation proceeding and a period of two years have not elapsed from the date of such dissolution (since the dissolution of the company could be declared void within the period aforesaid by an order of the Tribunal under section 356 of the Act).
- it is identical with or too nearly resembles the name of a limited liability partnership in liquidation or the name of a limited liability partnership which is struck off up to a period of five years;
- the proposed name include words such as 'Insurance', 'Bank', 'Stock Exchange', 'Venture Capital', 'Asset Management', 'Nidhi', 'Mutual Fund' etc., unless a declaration is submitted by the applicant that the requirements mandated by the respective regulator, such as IRDA, RBI, SEBI, MCA etc. have been complied with by the applicant;
- the proposed name includes the word "State", the same shall be allowed only in case the company is a government company;
- the proposed name is containing only the name of a continent, country, state, city such as Asia Limited, Germany Limited, Haryana Limited, Mysore Limited;
- the name is only a general one, like Cotton Textile Mills Ltd. or Silk Manufacturing Ltd.;
- it is intended or likely to produce a misleading impression regarding the scope or scale of its activities which would be beyond the resources at its disposal;
- in case the key word used in the name proposed is the name of a person other than the name(s) of the promoters or their close blood relatives, 'No objection' from such other(s) shall be attached with the application for name.

5.3-1b TOO SIMILAR NAME - In case of too similar names, the resemblance between the names must be such as is likely to deceive. A name is likely to deceive where it suggests some connection or association with an existing company.

Examples

In *Ewing* v. *Buttercup Margarine Co. Ltd.* [1917], the plaintiff who carried on business under the name of Butter Cup Dairy Co. succeeded in obtaining an injunction against the defendant on the ground that the public might think that the two businesses were connected since the word 'Buttercup' was an unnecessary and fancy one. Again, in *Montari Overseas Ltd.* v. *Montari Industries Ltd.* [1996] 20 CLA 313 (Delhi), it was held that the name adopted was sufficiently close to the name under which the respondent was trading, acquired a reputation and the public at large was likely to be misled. The same principle of law which applied to an action for passing off of a trade-mark would apply more strongly to the passing off a trade or corporate name of one for the other. The appellant was liable for an action in passing off.

However, merely that few words are common may not render the name too identical and thus undesirable. Thus, in *Society of Motor Manufactures & Traders Limited* v. *Motor Manufactures & Traders Mutual Assurance Limited* [1925], the plaintiff company brought an action to restrain the defendant company from using the said name. But, Lawrence, J., held "anyone who took the trouble to think about the matter, would see that the defendant company was an insurance company and that the plaintiff society was a trade protection society and I do not think that the defendant company is liable to have its business stopped unless it changes its name simply because a thoughtless person might unwarrantedly jump to the conclusion that it is connected with the plaintiff society". Similarly, in *Asiatic Government Security Life Assurance Company Ltd.* v. *New Asiatic Insurance Company Limited* [1939], the Court held the two names were not too identical and therefore, did not restrain the respondents.

Again, in *Executive Board of Methodist Church in India* v. *Union of India* [1985] 57 Comp. Cas. 443 (Bom.), the Methodist Church in India sought registration of a company in the name of 'Methodist Church in India Trust Association'. There was already existing a company bearing the name Methodist Church in Northern India Trust Association (P.) Ltd. in Calcutta. The former secretary of the latter association informed the Registrar that the said company had not functioned since 1970; that no annual report or minutes had been filed with the Registrar since 1970; and that some directors died and some had left. The question was whether in these circumstances the Calcutta Company was a bar to the registration of the new company. *Held,* if a company is practically defunct, it is not a bar to registration of a new company with a similar name.

Geographical Names - How far the property of an existing company? - Geographical names are available for use by any one choosing to adopt them as part of the name of the business enterprise. It is only in a rare case where the name has been used very extensively for a long period, is so well known in the market as to be identified in the public mind with the product or service rendered by the business enterprise, that the court may consider granting injunctive relief to a plaintiff - *Manipal Housing Finance Syndicate Ltd.* v. *Manipal Stock and Share Brokers Ltd.* [1999] 98 Comp. Cas. 432 (Mad.).

Thus, whether a name is too similar or not and therefore it shall be allowed or not is a question in each case, one of fact.

5.3-1c PUBLICATION OF NAME (SEC. 12) - Sub-section (3) of Section 12 provides that every company shall—

(*a*) paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters and in the language in general use in the locality. The words 'outside of every office' do not mean outside the premises in which the office is situate - *Dr. H.L. Batliwalla Sons & Company Ltd.* v. *Emperor* [1941] 11 Comp. Cas. 154 (Bom.). Where office is situated within a compound, the display outside the office room though inside the building is sufficient;

(*b*) have its name engraved in legible characters on its seal;

(*c*) get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, bill heads, letter papers and in all its notices and other official publications; and

(*d*) have its name printed on *hundies*, promissory notes, bills of exchange and such other documents as may be prescribed.

(*e*) ***Company conducting online business:*** Every company which has a website for conducting online business or otherwise, shall disclose/publish its name, address of its registered office, the Corporate Identity Number, Telephone number, fax number if any, email and the name of the person who may be contacted in case of any queries or grievances on the landing/home page of the said website.

The Central Government may as and when required, notify the other documents on which the name of the company shall be printed. - Companies (Incorporation) Rules, 2014, as amended dated 27.7.2016.

However, where a company has changed its name or names during the last two years, it shall paint or affix or print, as the case may be, along with its name, the former name or names so changed during the last two years.

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

Penalty: If a company does not paint or affix its name and the address of its registered office in the prescribed manner. If any default is made in complying with the requirements of this section, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

Besides, sub-section (4) makes an officer of a company or any person on its behalf who signs or authorises to be signed on behalf of the company any bill of exchange, hundi, promissory note, or cheque, etc., wherein the name of the company is not mentioned in the prescribed manner, personally liable to the holder of such bill of exchange, hundi, promissory note, cheque etc., for the amount thereof unless it is paid by the company.

5.3-2 The registered office clause [Sec. 4(1)(b)]

This clause states the name of the State in which the registered office of the company will be situated. Every company must have a registered office which

establishes its domicile and is also the address at which the company's statutory books must normally be kept and to which notices and other communications can be sent. A company shall, **within thirty days** of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it[1].

Verification of the Registered Office

Sub-section (2) of Section 12 of the Companies Act, 2013 requires that the company must furnish to the Registrar verification of its registered office within a period of thirty days of its incorporation by filing any of the prescribed documents.

Again, notice of every change of the situation of the registered office, verified in the manner prescribed, after the date of incorporation of the company, shall be given to the Registrar within thirty days[2] of the change, who shall record the same.

Rule 25 of the Companies (Incorporation) Rules, 2014, in this regard, provides as follows :

1. The verification of the registered office shall be filed in Form No. INC-22 along with the prescribed fee; and
2. There shall be attached to the Form, any of the following documents, namely—
   (*a*) Registered document of the title of the premises of the registered office in the name of the company; or
   (*b*) Notarized copy of lease/rent agreement in the name of the company along with a copy of rent paid receipt not older than one month;
   (*c*) Authorization from the owner or authorized occupant of the premises along with proof of ownership or occupancy authorization, to use the premises by the company as its registered office; and
   (*d*) Proof of evidence of any utility service like telephone, gas, electricity, etc. depicting the address of the premises in the name of the owner or document, as the case may be, which is not older than 2 months.

Active Company Tagging Identities and Verification (ACTIVE)

As per Rule 25A, added by the Companies Incorporation (Amendment) Rules, 2019, every company incorporated on or before the 31st December, 2017 shall file the particulars of the company and its registered office, in e-Form ACTIVE (Active Company Tagging Identities and Verification) on or before 25.04.2019. However, any company which has not filed its due financial statements under section 137 or due annual returns under section 92 or both with the Registrar shall be restricted from filing e-Form-ACTIVE, unless such company is under management dispute and the Registrar has recorded the same on the register. Again, companies which have been struck off or are under process of striking off or under liquidation or amalgamated or dissolved, as recorded in the register, shall not be required to file e-Form ACTIVE.

In case a company does not intimate the said particulars, the Company shall be marked as "ACTIVE-non-compliant" on or after 26th April, 2019 and shall be liable for action under sub-section (9) of section 12 of the Act.

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1. *Vide* Companies (Amendment) Act, 2017 [Earlier it was 15 days].
2. *Vide* Companies (Amendment) Act, 2017 [Earlier it was 15 days].

Further, changes with respect to Authorized Capital; Paid-up Capital; Director; Registered Office; Amalgamation, demerger shall not be taken on record.

Where a company files "e-Form ACTIVE", on or after 26th April, 2019, the company shall be marked as "ACTIVE Compliant", on payment of fee of ten thousand rupees".

5.3-3 The objects clause [Section 4(1)(c)]

The objects clause defines the objects of the company and indicates the sphere of its activities. As per Section 4(1)(*c*), in this clause must be stated the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

A company cannot do anything beyond or outside its objects and any act done beyond that will be *ultra vires* and void and cannot be ratified even by the assent of the whole body of shareholders. However, a company may do anything which is incidental to and consequential upon the objects specified and such act will not be an *ultra vires* act— *Attorney General* v. *G.E. Rly. Co.* [1880]. For example, a trading company has an implied power to borrow money and draw and accept bills of exchange.

The objects of the company must not be illegal, immoral or opposed to public policy or in contravention of the Act. *For example,* a public limited company cannot finance purchase of its own shares [Section 67(2)].

5.3-4 Doctrine of ultra vires[3]

A company which owes its incorporation to statutory authority cannot effectively do anything beyond the powers expressly or impliedly conferred upon it by the statute or memorandum of association. Any purported activity beyond such powers will be ineffective even if agreed to by all the members. This rule is commonly known as *'doctrine of ultra vires'*. The word *'ultra'* means beyond and the word *'vires'* means the powers. *'Ultra vires'*, therefore, means beyond the powers. So, when used with reference to a company, it means beyond the powers of the company. The powers of a company are essentially derived from the statute constituting it and the memorandum of association.

After the advent of Joint Stock Companies, the rule of *ultra vires* was for the first time laid down by the House of Lords in *Ashbury Rly. Carriage & Iron Company* v. *Riche* [1875] LR 7 HL 653. In this case, the object of the doctrine was explained by Lord Justice Cairns as follows :

(*i*) to protect investors of the company so that they may know the objects in which their money is to be employed; and

(*ii*) to protect the creditors by ensuring that the company funds, to which they must look for payment are not dissipated in unauthorised activities.

In *Ashbury Rly. Carriage and Iron Co.* v. *Riche* (*supra*), the company had been formed with the object of carrying on business as 'Mechanical Engineers and

3. It may be of interest to note that the 'Doctrine of ultra vires' has been given a go-bye by the English Companies (Amendment) Act, 1989. Any document signed or contract entered by any officer on behalf of the company even beyond the powers of the company is now binding against the company in England. The company may, of course, proceed against the erring officer.

General Contractors'[4]. The contractors entered into an agreement for financing the construction of a railway in Belgium and there was evidence that the agreement had been ratified by all the members. The company repudiated the agreement and was sued for breach of contract. The other party brought an action for damages for breach of contract. His contentions were: *firstly,* that the contract in question came well within the meaning of the words 'general contractors' and, was, therefore, within the powers of the company, and *secondly,* that the contract was ratified by the majority of the shareholders.

The Court held that the term 'general contractors' must be taken to indicate the making generally of such contracts as were connected with the business of mechanical engineers. If, the term 'general contractors' was not so interpreted, it would authorise the making of contracts of any kind and every description, such as, for instance, fire and marine insurance and the memorandum in place of specifying the particular kind of business, would virtually allow the carrying on business of any kind whatsoever and would, therefore, be altogether unmeaningful. Hence the contract was entirely beyond the objects in the Memorandum of Association.

The doctrine of *ultra vires* has been upheld in a large number of Indian cases also. In the case of *Lakshmanaswami Mudaliar* v. *L.I.C.* AIR 1963 SC 1185, the directors of the company were authorised 'to make payments towards any charitable or any benevolent object or for any general public or useful object'. In accordance with shareholders' resolution, the directors paid Rs. 2 lakhs to a trust for the purpose of promoting technical and business knowledge. The company's business having been taken over by LIC, it had no business left of its own. The Supreme Court held that the payment was *ultra vires* the company. They could spend for the promotion only on such charitable objects as would be useful for the attainment of the company's own objects.

It may, however, be noted that section 3(1)(*c*) of the Act provides that any matter considered necessary in furtherance of the main objects can well be pursued. Thus, in case any incidental object has not been specified, it would be allowed by the principle of reasonable construction of the memorandum.

Doctrine of* ultra vires - *An illusory protection - It is important to note that the *ultra vires* doctrine is now-a-days very largely frustrated by the ingenuity of company promoters, who, by enumerating all objects possible under the sun have in actual practice fouled the doctrine and made it ineffective, except in very rare cases. *For example,* in the case of *Bell Houses Limited* v. *City Wall Properties Limited* [1966] 36 Comp. Cas. 779, the objects clause included a power 'to carry on any other trade or business whatsoever which can, in the opinion of the Board of directors, be advantageously carried on by the company'. The said clause was held to be quite in order by the court.

Implied powers: As made out in the doctrine of *ultra vires,* the powers exercisable by a company are to be confined to the objects specified in the memorandum. However, the powers exercisable in respect of the objects specified may be express or implied. Every company, in fact, possesses certain powers by virtue of its being an incorporated body, such as, *for instance,* a power to appoint and act through

4. There were, however, other specified objects, but it was conceded that this was the only relevant one.

agents, and where it is a trading company, a power to borrow and give security for the purposes of its business, and also a power to sell. Such powers as these are incidental or properly to be inferred from the powers expressed in the memorandum—*Oak Bank Oil Company* v. *Crum* [1882] 8 App. Cas. 65.

As regards implied powers, the rule is to assume that "quite apart from any general words in a company's memorandum, it has power to do all that is reasonably necessary for attaining its objects. The Courts have become increasingly ready to imply powers of this nature" (*Palmer's Company Precedents,* 17th Edn., Part I, page 278).

Powers which are not implied[5] : The following powers have been held not to be implied and it is, therefore, prudent in cases where deemed necessary, to include them expressly in the objects—

(*i*) acquire any business similar to company's own— *Ernest* v. *Nicholls* [1857] 6 HLC 401;

(*ii*) entering into an agreement with other persons or companies for carrying on business in partnership or for sharing profits, joint adventure or other arrangements. Very clear powers are necessary to justify such transactions - *Re European Society Arbitration Act* [1878] 8 Ch. 679;

(*iii*) taking shares in other companies having similar objects *Re Barned's Banking Company, ex parte. The Contract Corporation* [1867] 3 Ch. App. 105; *Re William Thomas & Co. Ltd.* [1915] 1 Ch. 325;

(*iv*) taking shares of other companies where such investment authorises doing indirectly that which will not be *intra vires,* if done directly;

(*v*) promoting other companies or helping them financially— *Joint Stock Discount Company* v. *Brown* [1869] LR 8 Eq 381;

(*vi*) a power to use funds for political purposes;

(*vii*) a power to give gift and make donations or contributions for charities not relating to the objects stated in the memorandum;

(*viii*) a power to sell and dispose of the whole of a company's undertaking;

(*ix*) entering into contracts of suretyship or guarantee;

(*x*) the making of loans by a company not engaged in financing or banking business.

Effects of* ultra vires *transactions

(1) *Void ab initio* : The *ultra vires* acts are *null* and *void ab initio.* The company is not bound by these acts; even the company cannot sue or be sued upon it— *Ashbury Railway Carriage and Iron Company* v. *Riche* (*supra*).

However, in *NEPC India Ltd.* v. *Registrar of Companies* [1999] 22 SCL 94, the Madras High Court has held that a complaint alleging that a company was indulging in activities not mentioned in the objects clause of the Memorandum of Association had to be filed within six months of the date of knowledge.

(2) *Injunction* : In case a company is about to undertake an *ultra vires* act, the members (even a single member) can get an order of injunction from the Court

5. A. Ramaiya, Guide to the Companies Act, Twelfth Edn., 1992, page 160.

restraining the company from going ahead with the *ultra vires* act.— *Attorney General* v. *G.R. Eastern Railway Company* [1880] 5 AC 473.

(3) *Personal Liability of Directors:* It is one of the duties of directors to ensure that the corporate capital is used only for the legitimate business of the company and hence if such capital is diverted into purposes foreign to company's memorandum, the directors will be personally liable to replace it. In *Jehangir R. Modi* v. *Shamji Ladha* [1866-67] 4 Bom. HCR 1855, the Bombay High Court held 'a shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have been employed in a transaction that they have no authority to enter into without making the company a party to the suit'.

In case of deliberate misapplication, criminal action can also be taken for fraud.

However, a distinction must be drawn between transactions which are *ultra vires* the company and the transactions which are *ultra vires* the directors. Where the directors exceed their authority and do something, the same may be ratified by the general body of the shareholders provided the company has the capacity to do that transaction as per its memorandum of association.

Example

The company has power to borrow money but the articles of the company provide that in case the directors borrow more than Rs. 5 lakhs they should get prior approval of the company in general meeting. The directors issue debentures to the extent of Rs. 7 lakhs without getting the approval from the shareholders. The company in general meeting may ratify the act of directors as it is *intra vires* the company though *ultra vires* the powers of the directors of the company.

(4) *Acquisition of property that is* ultra vires : Where a company's money has been used *ultra vires* to acquire some property, the company's right over such property is held secured. Besides, the company will be the right party to protect such property against damage by third persons. It is because, though the property has been acquired for some *ultra vires* object, it represents the money of the company.

(5) *Directors personally liable to third parties* : In respect of *ultra vires* transactions, directors and other officers shall be personally accountable to third parties.

5.3-5 Liability clause [Sec. 4(1)(d)]

This clause states the nature of liability of the members. In the case of a company with limited liability, it must state that liability of members is limited, whether it be by shares or by guarantee. This means that in the case of a company limited by shares, a member can be called upon at any time to pay to the company the amount unpaid on the shares. Thus, if his shares are fully paid-up, his liability is *nil*. Where a shareholder holding a 10-rupee share has paid Rs. 5 on it, he can be called upon to pay the balance of Rs. 5. But if he has paid the full value of Rs. 10, he cannot be required to pay anything more even if the company owes huge debts to its creditors.

In the case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its being wound up.

Specimen Liability Clause under the Memorandum of Association of Guarantee Company not having a share capital:

"Every member of the company undertakes to contribute:

(i) *to the assets of the company in the event of its being wound up while he is a member, or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member; and*

(ii) *to the costs, charges and expenses of winding up (and for the adjustment of the rights of the contributories among themselves), such amount as may be required, not exceeding.....rupees".*

In the case of unlimited liability company, whether having share capital or not, this clause shall state that the liability of its members is unlimited.

5.3-6 The capital clause [Sec. 4(1)(e)]

This clause must indicate the amount of capital with which the company is registered, and is known as Registered or Authorized or Nominal capital.

As per section 4(1)(*e*), in the case of a company having a share capital, the memorandum must state the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share.

In the case of a public company having a share capital, a share may be either a Preference Share or an Equity share. Thus, a company's capital may be Preference share capital and Equity share capital. This clause shall state the number and value of shares into which the capital of the company is divided.

These shares are of a certain fixed value or amount. This fixed value is known as the "Par" or "nominal" value of a share. Thus, the nominal value of an equity share may be, say, Rs.10, and that of a preference share, say, Rs.100.

The effect of this clause is that the company cannot issue more shares than stated under this clause without altering the Memorandum as per Section 61 of the Companies Act, 2013.

5.3-7 Name of a nominee in case of 'One Person Company' [Sec. 4(1)(f)]

In the case of One Person Company, the Memorandum must state the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

5.3-8 The association or subscription clause [Sec. 4(1)(e)]

At the end of the Memorandum of every company there is an association or subscription clause in which the subscribers to the Memorandum of Association make the following declaration :

> "We, the several persons, whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set against our respective names."

In case of 'One Person Company', the declaration made shall be as follows :

> "I, whose name and address is given below, am desirous of forming a company in pursuance of this memorandum of association and agree to take all the shares in the capital of the company."

According to Section 3 of the Act, the Memorandum shall be signed by at least seven subscribers in case of a public company, at least two subscribers in case of a private company and one subscriber where the company to be formed is One Person Company.

5.3-8a THE STATUTORY REQUIREMENTS REGARDING SUBSCRIPTION OF MEMORANDUM :— *The statutory requirements regarding subscription of memorandum are*[6] *:*

1. **Signing of the Memorandum and Articles:** The 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 and the witness shall state that "I witness to subscriber/subscriber(s), who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in"

   Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.

   Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.

   Type written or printed particulars of the subscribers and witnesses shall be allowed provided the same are duly signed or bear the thumb impression of the subscriber or witness, as the case may be w.e.f. 27-7-2016).

   Where the subscriber to the memorandum is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate and ***where the subscriber is a Limited Liability Partnership***, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership. However, in either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of association.

   Again, where subscriber to the memorandum is a foreign national residing outside India, the signing will be as per the prescribed procedure.

2. Each subscriber must take at least one share.
3. Each subscriber must write opposite his name the number of shares he takes [Section 4(1)(*e*)].

6. Section 4(1)(*e*) read along with Rule 13 of the Companies (Incorporation) Rules, 2014.

5.4 Alteration of memorandum

Section 13 provides that the company cannot alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provisions have been made in the Act. These provisions are explained herein below.

5.4-1 Change of name

5.4-1a CHANGE OF NAME AT THE INSTANCE OF THE COMPANY : Section 13 provides that the name of a company may be changed at any time *by passing a special resolution* at a general meeting of the company and with the written approval of the Central Government. However, no approval of the Central Government is necessary if the change of name involves only the addition or deletion of the word "private" (*i.e.,* when public company is converted into a private company or *vice versa*).

In case of a listed company, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 require that for change of its name the listed company must comply with the following conditions:

(*a*) a time period of at least one year must have elapsed from the last name change;

(*b*) at least fifty per cent of the total revenue in the preceding one year period must have been accounted for by the new activity suggested by the new name; or

(*c*) the amount invested in the new activity/project is at least fifty per cent of the assets[7] of the listed entity.

Procedure

(1) On satisfaction of the aforesaid conditions, the company shall file an application for name availability with Registrar of Companies*.

(2) On receipt of confirmation regarding name availability from Registrar of Companies*, the company, if a listed entity, shall seek approval from Stock Exchange by submitting a certificate from chartered accountant stating compliance with aforesaid conditions.

(3) The company shall file with the Registrar

(*a*) the special resolution passed by the company; and

(*b*) the approval of the Central Government.

When any change in the name of a company is made, as aforesaid, the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation in Form 2.27 with the new name and the change in the name shall be complete and effective only on the issue of such a certificate.

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7. 'assets' of the listed entity means the sum of fixed assets, advances (amounts extended to contractors and suppliers towards execution of project, specific to new activity as reflected in the new name), works in Progress/Inventories, investments, trade receivables, cash & cash equivalents

*Now Registrar of Central Registration Centre.

5.4-1b CHANGE OF NAME ON A DIRECTION FROM THE CENTRAL GOVERNMENT : If through inadvertence or otherwise, a company on its first registration or on its registration by a new name has been registered with a name which, in the opinion of the Central Government, is identical with or too closely resembles the name of an existing company, the company may change its name within a period of *three months* from the issue of such direction by passing an ordinary resolution and by obtaining the approval of the Central Government in writing [Sec. 16].

Again, the company may change its name by following the aforesaid procedure, where an application has been made to the Central Government by a registered proprietor of a trade mark within three years of incorporation or registration or change of name of the company and, in the opinion of the Central Government, the name is identical with or too nearly resembles a registered trade mark of such proprietor under the Trade Marks Act, 1999. Where such a direction is made by the Central Government, the company shall change its name or new name, as the case may be, within a period of *six months* from the issue of such direction.

In *cGMP Pharmaplan (P.) Ltd.* v. *Regional Director, Ministry of Corporate Affairs,* [2011] 105 SCL 675 (Delhi), NNE Pharmaplan (P.) Ltd., filed a representation before Regional Director under section 22 (*now section 16*) seeking a direction that petitioner-company incorporated on a later date with name cGMP Pharmaplan (P.) Ltd. should change its name. Regional Director concluded that use by petitioner of word "Pharmaplan" in its name would have a misleading effect in mind of general public and as such, it was a fit case for issue of direction under section 22(1)(*b*) (*now section 16*) and directed petitioner to delete word 'Pharmaplan' from its existing name and change its name to some other name. The Delhi High Court held that since names of both companies structurally and phonetically too nearly resembled each other, Regional Director was right in directing petitioner to change its name.

In *Vardhman Crop Nutrients (P.) Ltd.* v. *Union of India* [2015] 59 taxmann.com 335 (Punjab and Haryana), Vardhaman Fertilizers and Seeds (P.) Ltd. was incorporated on 9.7.1987. It was engaged in the business of manufacturing and marketing Class I fertilizers, water soluble fertilizers and micro nutrients. The company got registered its Trade Mark 'Vardhaman' with the Trade Mark Registry on 8.2.2007 and the same was valid for a period of ten years up to 8.2.2017. Vardhaman Crop Nutrients (P.) Ltd. was incorporated on 29.5.2009 and started its business of manufacturing and marketing Class I fertilizers, water soluble fertilizers and micro nutrients, i.e., similar to the business of Vardhaman Fertilizers and Seeds (P.) Ltd., the respondent. On 11.10.2011, the respondent company filed an application under section 16 (section 22 of the 1956 Act) seeking direction to the appellant-company to change its name by removing 'Vardhman' from its name as the same was causing great loss of business, reputation and goodwill of the respondent company.

Held that 'Vardhaman' was the registered trade mark of the respondent company since 8.2.2007 and, therefore, use of the same brand by the appellant-company which was in the same business was undesirable and thus directed the appellant company to change its name.

When registration is granted and when question is of change or giving direction to company to change name, it can also be said that direction to company under section 22 (now section 16) is in nature of quasi-judicial power and, therefore, authority taking decision must record reasons so that grounds on which order is

passed are known - *Pino Bisazza Glass (P.) Ltd.* v. *Bisazza India Ltd.* [2003] 43 SCL 666 (Guj.).

As per Rule 29(1) of the Companies (Incorporation) Rules, 2014, as amended dated 27.7.2014, the change of name shall not be allowed to a company which has not filed annual returns or financial statements due for filing with the Registrar or which has failed to pay or repay matured deposits or debentures or interest thereon.

However, the change of name shall be allowed upon filing necessary documents or payment or repayment of matured deposits or debentures or interest thereon as the case may be.

Where a company changes its name or obtains a new name under sub-section (1) of section 16, it shall within a period of fifteen days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum [Section 16(2)].

If a company makes default in complying with any direction given under sub-section (1), the company shall be punishable with fine of one thousand rupees for every day during which the default continues and every officer who is in default shall be punishable with fine which shall not be less than five thousand rupees but which may extend to one lakh rupees [Section 16(3)].

Effect of change of name :

(*i*) The change of name shall not affect any rights/obligations of the company or render the same defective in legal proceedings by or against it. Moreover, any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its new name.

Where a company changes its name and the new name has been registered by the Registrar, the commencement of legal proceedings in the former name is not competent—*Malhati Tea Syndicate Ltd.* v. *Revenue Officer* [1973] 43 Comp. Cas. 337.

(*ii*) However, if any legal proceeding is commenced, after change of name, against the company, in its old name, it is a case of mere misdescription and not a case of proceeding against a person not in existence. It is not an incurable defect and plaint can be amended to substitute the new name - *Pioneer Protective Glass Fibre (P.) Ltd.* v. *Fibre Glass Pilkington Ltd.* [1986] 60 Comp. Cas. 707 (Cal.).

(*iii*) *By change of name, constitution of company does not change* : In *Economic Investment Corporation Ltd.* v. *CIT* [1970] 40 Comp. Cas. 1 (Cal.) it was held that by change of name, the constitution of the company is not changed. The only thing that changes is its name; all the rights and obligations under the law of the old company pass to the new company. It is not similar to the reconstitution of a partnership, which in law means creation of a new legal entity altogether.

Where a company 'M' changed its name to 'E' on 23-9-1947 and it was assessed to income-tax in the name of 'M' for the year 1946-47, and in the course of certificate

proceedings for the recovery of tax, a notice was sent to Bank 'A' who was holding money in the account of the company in the name of 'E', for payment of tax, it was held that the bank was holding money for 'M' which was the assessee.

5.4-2 Change of registered office

This may include—

5.4-2a CHANGE OF REGISTERED OFFICE FROM ONE PREMISES TO ANOTHER PREMISES IN THE SAME CITY, TOWN OR VILLAGE [SEC. 12] - A company can change its registered office from one place to another within the local limits of the city, town or village where it is situated, by passing a resolution of the Board of directors. However, the company should inform the Registrar the new address within 15 days of the change who shall record the same.

5.4-2b CHANGE OF REGISTERED OFFICE FROM ONE TOWN OR CITY OR VILLAGE TO ANOTHER TOWN OR CITY OR VILLAGE IN THE SAME STATE [SECTION 12] - In this case the following procedure is to be followed:

(*i*) ***Special resolution*** - A special resolution is required to be passed at a general meeting of the shareholders.

(*ii*) ***Confirmation of Regional Director*** - Confirmation of the Regional Director is to be obtained where the change is from jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies. The application to the Regional Director shall be made in Form INC-23 along with the fee and following documents[8],

- Board Resolution for shifting of registered office;
- Special Resolution of the members of the company approving the shifting of registered office;
- a declaration given by the Key Managerial Personnel or any two directors authorised by the Board, that the company has not defaulted in payment of dues to its workmen and has either the consent of its creditors for the proposed shifting or has made necessary provision for the payment thereof;
- a declaration not to seek change in the jurisdiction of the Court where cases for prosecution are pending;
- acknowledged copy of intimation to the Chief Secretary of the State as to the proposed shifting and that the employees interest is not adversely affected consequent to proposed shifting.

The Regional Director shall communicate the confirmation within a period of thirty days from the date of receipt of application to the company.

As per Rule 28, as amended by the Companies (Incorporation) Second Amendment Rules, 2017, an application seeking confirmation from the Regional Director for shifting the registered office from the jurisdiction of one Registrar to the other, shall be filed by the company with the Regional Director in Form No. INC 23 along with the fee and following documents:

(*a*) Board Resolution for shifting of registered office;

8. The Companies (Incorporation) (Second Amendment) Rules, 2017.

(*b*) Special resolution of the members of the company approving the shifting of the registered office;

(*c*) A declaration given by the Key Managerial Personnel or any two directors authorized by the Board that the company has not defaulted in payment of dues to the workers and has either the consent of the creditors for the proposed shifting or has made necessary provision for the payment thereof;

(*d*) A declaration not to seek change in the jurisdiction of the Court where cases for prosecution are pending;

(*e*) Acknowledged copy of intimation to the Chief Secretary of the State as to the proposed shifting and that the employees interest is not adversely affected consequent to proposed shifting.

(*iii*) ***Copy of special resolution and confirmation by Regional Directors to be filed with ROC*** - A copy of the special resolution, as aforesaid, is to be filed with the Registrar within 30 days (Section 117). Copy of the confirmation by Regional Director shall be filed with the Registrar of Companies within 60 days of the date of confirmation. The Registrar is required to register the same and certify the registration within 30 days from the date of filing of such confirmation (Section 12).

The certificate issued by the Registrar shall be conclusive evidence that all the requirements of this Act with respect to change of registered office have been complied with and the change shall take effect from the date of the certificate.

If any default is made in complying with any of the aforesaid requirements, the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees.

5.4-2c CHANGE OF REGISTERED OFFICE FROM ONE STATE TO ANOTHER STATE - Section 13 contains provisions with respect to the shift of the registered office from one State to another. You should note that shift of registered office from one premise to another within the same city/town/village or even from one city to another but within the same State does not involve alteration of memorandum. It's because, in the memorandum only the name of the State where registered office shall be located is mentioned. Shift of registered office from one State to another will involve alteration of memorandum and, therefore, requires a more elaborate procedure to be followed.

Registered office of a company can be shifted from one State to another by :

1. Passing special resolution.

   Thus, where company shifted its registered office from one State to another without issuing notice to its shareholder holding substantial shares (15.26%) in company, shifting of office was held to be illegal - *Shabbir Ahmed* v. *Safedabad Cold Storage & Allied Industries (P.) Ltd.* [2017] 80 taxmann.com 46 (NCLT - Kolkata)

2. Settlement of the list of creditors including debenture holders;

3. Obtaining the consent of the creditors and in case any creditor or creditors object, his debt or claim should be discharged or determined or secured to the satisfaction of the Central Government;
4. Obtaining confirmation from the Central Government.
5. Notice of Change of the registered office, verified in the manner prescribed, to be given to ROC within 30 days of the change.

Obtaining confirmation from the Central Government

For obtaining confirmation from the Central Government, Rule 30 of the Companies (Incorporation) Rules, 2014, as amended *vide* MCA Notification dated 27-7-2017, provides that an application shall be filed with the Central Government in Form No. INC-23 along with the prescribed fee along with the fee and shall be accompanied by the following documents, namely[9]:

- a copy of Memorandum of Association, with proposed alterations;
- a copy of the minutes of the general meeting at which the resolution authorizing such alteration was passed, giving details of the number of votes cast in favour or against the resolution;
- a copy of Board Resolution or Power of Attorney or the executed Vakalatnama, as the case may be.

Besides, there shall be attached to the application, a list of creditors and debenture holders, drawn up to the latest practicable date preceding the date of filing of application by not more than one month, setting forth the following details, namely:—

- the names and address of every creditor and debenture holder of the company;
- the nature and respective amounts due to them in respect of debts, claims or liabilities:

However, the list of creditors and debenture holders, accompanied by declaration signed by the Company Secretary of the company, if any, and not less than two directors of the company, one of whom shall be a managing director, where there is one, stating that

1. They have made a full enquiry into the affairs of the company and, having done so, have concluded that the list of creditors are correct, and that the estimated value as given in the list of the debts or claims payable on a contingency or not ascertained are proper estimates of the values of such debts and claims and that there are no other debts of or claims against the company to their knowledge, and
2. No employee shall be retrenched as a consequence of shifting of the registered office from one state to another state and also there shall be an application filed by the company to the Chief Secretary of the concerned State Government or the Union territory.

9. The Companies (Incorporation) (Second Amendment) Rules, 2017.

3. A duly authenticated copy of the list of creditors shall be kept at the registered office of the company and any person desirous of inspecting the same may, at any time during the ordinary hours of business, inspect and take extracts from the same on payment of a sum not exceeding ten rupees per page to the company.
4. There shall also be attached to the application a copy of the acknowledgement of service of a copy of the application with complete annexures to the Registrar and Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.
5. The company shall, not more than thirty days before the date of filing the application in Form No. INC.23—
   - advertise in the **Form No. INC.26** in the vernacular newspaper in the principal vernacular language in the district and in English language in an English newspaper with the widest circulation in the state in which the registered office of the company is situated:

     However, a copy of advertisement shall be served on the Central Government immediately on its publication.
   - serve, by registered post with acknowledgement due, individual notice, to the effect set out in clause (*a*) on each debenture-holder and creditor of the company; and
   - serve, by registered post with acknowledgement due, a notice together with the copy of the application to the Registrar and to the Securities and Exchange Board of India, in the case of listed companies and to the regulatory body, if the company is regulated under any special Act or law for the time being in force.
6. There shall be attached to the application a duly authenticated copy of the advertisement and notices issued under sub-rule (5), a copy each of the objection received by the applicant, and tabulated details of responses along with the counter-response from the company received either in the electronic mode or in physical mode in response to the advertisements and notices issued under sub-rule (5).
7. Where no objection has been received from any person in response to the advertisement or notice under sub-rule (5) or otherwise, the application may be put up for orders without hearing and the order either approving or rejecting the application shall be passed within fifteen days of the receipt of the application.
8. Where an objection has been received,
   - the Central Government shall hold a hearing or hearings, as required and direct the company to file an affidavit to record the consensus reached at the hearing, upon executing which, the Central Government shall pass an order approving the shifting, within sixty days of filing the application.
   - where no consensus is reached at the hearings the company shall file an affidavit specifying the manner in which objection is to be resolved within a definite time frame, duly reserving the original jurisdiction to

the objector for pursuing its legal remedies, even after the registered office is shifted, upon execution of which the Central Government shall pass an order confirming or rejecting the alteration within sixty days of the filing of application.

9. The order passed by the Central Government confirming the alteration may be on such terms and conditions, if any, as it thinks fit, and may include such order as to costs as it thinks proper:

   However, the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

10. On completion of such inquiry, inspection or investigation as a consequence of which no prosecution is envisaged or no prosecution is pending, shifting of registered office shall be allowed.

The aforesaid information must, by way of an affidavit, be signed by the Company Secretary of the company, if any, and not less than two directors of the company, one of whom shall be a managing director.

Again, there shall also be attached to the application an affidavit from the directors of the company that no employee shall be retrenched as a consequence of shifting of the registered office from one State to another State.

There shall also be attached to the application a copy of the acknowledgement of service of a copy of the application with complete annexure to the Registrar and Chief Secretary of the State where the registered office is situated at the time of filing the application.

The company must also keep a duly authenticated copy of the list of creditors at the registered office.

Where any objection of any person whose interest is likely to be affected by the proposed application has been received by the applicant, it shall serve a copy thereof to the Central Government on or before the date of hearing.

Where no objection has been received from any of the parties, who have been duly served, the application may be put up for orders without hearing.

Order of Confirmation

Rule 30, read along with Section 13(5) provides that before confirming the alteration, the Central Government shall ensure that, with respect to every creditor and debenture holder who, in the opinion of the Central government, is entitled to object to the alteration, and who signifies his objection in the manner directed by the Central Government, either his consent to the alteration has been obtained or his debt or claim has been discharged or has determined, or has been secured to the satisfaction of the Central Government.

The Central Government may make an order confirming the alteration on such terms and conditions, if any, as it thinks fit, and may make such order as to costs as it thinks proper.

You may note that the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

However, on completion of such inquiry, inspection or investigation as a consequence of which no prosecution is envisaged or no prosecution is pending, shifting of registered office shall be allowed.

Sub-section (5) of Section 13 provides that the Central Government shall dispose of the application under sub-section (4) within a period of sixty days.

Filing of order of the Central Government with the Registrar

Section 13(7) read along with Rule 30 of the Companies (Incorporation) Rules, 2014 requires a certified copy of the order of the Central Government approving the alteration to be filed by the company with the Registrar of each of the States within a period of 30 days, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

5.4-3 Change in Objects Clause

Discussion on alteration of objects may be divided into :

1. Alteration of objects by a company which has not issued a prospectus
2. Alteration of objects by a company which has issued a prospectus

1. Alteration of objects by a company which has not issued a prospectus

A company which has not issued a prospectus may change its objects by passing special resolution. The special resolution is required to be passed by postal ballot except in case of OPCs and other companies having members up to 200 [Rule 22(16) of the Companies (Management and Administration) Rules, 2014

2. Alteration of objects by a company which has issued a prospectus

Section 13(8) read along with Rule 32 of the Companies (Incorporation) Rules, 2014 provides that a company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution through postal ballot* is passed by the company.

Besides,

I. The notice in respect of the resolution for altering the objects shall contain the following particulars :

(*i*) total money received;

(*ii*) total money utilized for the objects stated in the prospectus;

(*iii*) unutilized amount out of the money so raised through prospectus,

(*iv*) particulars of the proposed alteration/change in the objects;

(*v*) justification for the alteration/change in the objects;

(*vi*) amount proposed to be utilized for the new objects;

*Requirement of passing of resolution through postal ballot is not applicable to a company having members up to 200 [Rule 22(16) of the Companies (Management and Administration) Rules, 2014].

(*vii*) estimated financial impact of the proposed alteration on the earnings and cash flow of the company;

(*viii*) other relevant information which is necessary for the members to take an informed decision on the proposed resolution;

(*ix*) place from where any interested person may obtain a copy of the notice of resolution to be passed.

II. The advertisement giving details of each resolution to be passed for change in objects shall be published in the newspapers (one in English and one in vernacular language) which are in circulation at the place where the registered office of the company is situated.

III. The advertisement shall be published simultaneously with the dispatch of postal ballot notices to shareholders.

IV. The notice shall also be placed on the website of the company, if any, indicating therein the justification for such change.

V. The dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

VI. The Registrar shall register the alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution.

5.4-4 Change in Liability Clause

It appears that the Companies Act, 2013 or the Rules made thereunder do not contain any provisions with respect to the alteration of liability clause. However, since the relationship between a member and the company is a contractual relationship, the liability of a member of a company cannot be increased unless the member agrees in writing. The consent of the member may, however, be given either before or after the alteration. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

In case of unlimited liability company, the liability may be made limited or reduced by re-registration of the company (Section 18). The alteration will, however, not affect any debts, liabilities, obligations or contracts entered into by or with the company before the registration of the unlimited company as a limited company [Sec. 18(3)].

5.4-5 Alteration of Capital Clause

Section 61 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as—

1. to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
2. to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;

3. to convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;
4. to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion of paid and unpaid on each share must remain the same;
5. to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person and thus diminish the amount of its share capital by the amount of the shares so cancelled.

These five clauses are now explained.

1. *Increase of authorised share capital*: A company, limited by shares, if the articles authorise, can increase its authorised share capital by passing a resolution in its general meeting.

Within 30 days of the passing of the resolution, a notice of increase in the share capital along with an altered memorandum must be filed with the Registrar of Companies.

If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine up to Rs. 1,000 per day during which the default continues, or five lakh rupees, whichever is less (Sec. 64).

In *Amison Foods Limited* v. *Registrar of Companies* [1999] 19 SCL 82 (Ker.), the Kerala High Court held that the subsequent cancellation of the resolution to increase the share capital could not absolve the petitioners from their liability to file the prescribed form along with the prescribed fee before the Registrar of Companies within 30 days of adoption of resolution to increase the share capital.

Section 97 (now section 64) will apply when increase in share capital is a consequence of scheme of amalgamation - *Shaily Engineering Plastics Ltd., In re* [2003] 42 SCL 115 (Bom.).

2. *Consolidation and sub-division of shares**: Consolidation is the process of combining shares of smaller denomination. *For instance,* 10 shares of Rs. 10 each may be consolidated into one share of Rs. 100.

Sub-division of shares is just the opposite of consolidation *e.g.,* one share of Rs. 100 may be divided into 10 shares of Rs. 10 each.

Once a resolution has been passed, a copy of the resolution is required to be sent within thirty days to the Registrar of Companies.

3. *Conversion of shares into stock and* vice versa: Stock is simply a set of fully-paid up shares put together and is transferable in any denomination or fraction. On the other hand, a share is transferable as a whole; it cannot be split into parts. For example, a share of Rs. 10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of Rs. 10 each fully paid are converted into stock, of Rs. 100, then the stockholder can transfer stock, say, worth Rs. 17 also.

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*You may note that consolidation and sub-division of shares is considered as an arrangement under section 230 of the Act and accordingly will require the procedure specified thereunder to be complied with.

Section 61 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within thirty days of the passing of the resolution specifying the shares so converted.

It is to be noted that stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also, stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

4. Diminution of share capital: Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 61 provides that a company may, if its articles authorise, by resolution in general meeting, cancel shares which at the date of the passing of the resolution in that behalf have not been taken or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital which is discussed under Chapter on 'Share capital'.

Test your knowledge

[Questions have been selected from past examinations of C.A. (Inter)/ PE-II/PCC/Final, C.S. (Inter)/Final, ICWA (Inter)]

1. Comment on the following :

   "Alteration of any provision of the memorandum of association invariably involves passing of special resolution."

2. Comment on the following :

   "The memorandum of association is an unalterable charter of a company".

3. Examine the following statement :

   "The doctrine of *ultra vires* is an illusory protection to the shareholders and a pitfall to the outsiders."

4. Discuss the legal significance of the 'Registered Office' clause in the memorandum of association. Indicate the steps to be taken by a company to effect changes in the location of its registered office in different situations.

5. "A company cannot alter the conditions contained in its memorandum except in cases, in the mode and to the extent for which express provision is made in the Act." Amplify.

6. "The memorandum of a company is its charter of existence." Discuss. Set out in detail the various clauses which must be incorporated in the company's memorandum.

7. "The memorandum of association of a company is its charter and defines the limitations of the powers of the company..... it contains in it both that which is affirmative and that which is negative". Discuss.

8. (*a*) What do you mean by alteration of share capital ?

(*b*) What formalities should a company follow to alter its share capital ?

9. Discuss the provisions of the Companies Act with regard to alterations of objects of the company contained in its memorandum of associations.

10. Explain the procedure, as provided in the Companies Act, 2013 for change of registered office of a company from one State to another.

11. Briefly explain the doctrine of *ultra vires*. What are the consequences of *ultra vires* acts of the company?

12. "The doctrine of *ultra vires* is a protection to the shareholders of a company". Comment.

13. When shall the shifting of registered office of a company require alteration of Memorandum of Association ? State the procedure for effecting such an alteration.

PRACTICAL PROBLEMS

1. The object clause of the Memorandum of a company empowers it to carry on distillery business and any other business that is allied to it. The company wants to alter its Memorandum so as to include the cinema business in its objects clause. Advise the company.

Hints : *Refer Para 5.4-3*

2. Advise 'Asiatic Government Security Life Insurance Co. Ltd.' whether it can seek an injunction against 'The New Asiatic Insurance Co. Ltd.' which was subsequently formed restraining it from having in its name the word 'Asiatic' on the ground that it has caused confusion and can deceive the public.

Hints : The Companies Act, 2013 permits the promoters of a company to choose any suitable name for the company provided the name chosen is not undesirable.

A name may be considered undesirable where it is too similar to the name of an already existing company. In the present problem since the two companies are in insurance business, it may lead to a natural inference on the part of the public that the two are inter-related because of the word 'Asiatic' which is quite an imaginary word and does not mean anything. Mere addition of the word 'New' is not likely to give an impression that the two companies are different. Therefore, on a suit by Asiatic Government Security Life Insurance Co. Ltd. Court is likely to advise the New Asiatic Insurance Co. Ltd., to change its name and remove the word 'Asiatic' therefrom.

3. The main object of a company is to manufacture cement. Seeing the potential for new business, the Board of Directors decided to go in for manufacture of steel and steel related products. These are included in the 'Other objects' of the company. Can the company undertake the aforesaid new business? Discuss.

Hints : *Refer Para 5.4-3*

6 Articles of Association

6.1 Introduction

The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business.

According to section 2(5) of the Act 'articles' means the articles of association of a company as originally framed or as altered from time to time in pursuance of any previous company laws or of the present Act, *i.e.*, the Act of 2013.

The articles regulate the internal management of the company. They define the powers of its officers. They also establish a contract between the company and the members and between the members *inter se*. This contract governs the ordinary rights and obligations incidental to membership in the company [*Naresh Chandra Sanyal* v. *Calcutta Stock Exchange Association Ltd.* AIR 1971 SC 422].

Articles are like the partnership deed in a partnership. They set out provisions for the manner in which the company is to be administered. In particular, they provide for matters like the making of calls; forfeiture of shares; directors' qualifications, appointment, powers and duties of auditors[1]; procedure for transfer and transmission of shares and debentures.

6.2 Memorandum and articles - Their relationship

The articles regulate the manner in which the company's affairs will be managed. The memorandum defines the company's objects and various powers it possesses; the articles determine how those objects shall be achieved and those powers exercised. But the Companies Act, 2013, does not require the articles to provide for certain specified matters in the same way as it requires the memorandum to do. Consequently, the contents of the articles of different companies may vary substan-

1. These are governed by the specific provisions of the Act and hence if these are contained in the articles, then they have to conform to the specific statutory requirements except in the matter of duties, where the responsibility cast on the auditor may contain matters additional to the specific statutory requirements.

tially, and the utmost flexibility is allowed to the persons who form the company to organise its management as they wish.

The articles of a company are subordinate and controlled by the memorandum of association which is the dominant instrument and contains the general constitution of the company. The memorandum is fundamental and can be altered only under certain circumstances provided by the Act. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to what they think fit. Care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum - *Ashbury* v. *Watson* [1885] 30 Ch. D 376 CA - Articles going beyond the Memorandum are *ultra vires* - *Shyam Chand* v. *Calcutta Stock Exchange* AIR 1947 Cal. 337.

Subject to the rule that the memorandum prevails in the event of a conflict, the memorandum and the articles are contemporaneous documents, must be read together, and ambiguity or uncertainty in the one may be removed by reference to the other. Thus, where the memorandum was silent as to whether the company's shares were to be all of one class or might be of different classes, it was held that a power given by the articles to issue shares of different classes resolved the uncertainty and enabled the company to do so [*Re, South Durham Brewery Company* [1885] 31 Ch. D 261]. Where the memorandum of a trading company empowered to do all things incidental to achieving the object, it was held that provision in the articles empowering the company to lend money merely exemplifies the general words of the memorandum, and the company was, therefore, entitled to lend money to its employees [*Rainford* v. *James Keith and Blackman Company Ltd.* [1905] 2 Ch. 147]. Again, where the memorandum empowered the company to borrow on the security of its assets or credit and the articles provided that it might mortgage its uncalled capital, it was held that the articles merely made specific the general words of the memorandum so that the company could have power to mortgage its uncalled capital [*Re Pyle Works (No. 2)* [1891] 1 Ch. 173].

The memorandum and articles can be read together only to remove an ambiguity or uncertainty. If the memorandum is perfectly clear, a doubt as to its meaning cannot be raised by reference to the articles; in such a case the articles are simply inconsistent with the memorandum and are disregarded. Thus, where the memorandum exhaustively defined the rights of preference shareholders, and the articles provided that on a winding up the company's surplus assets, after paying all its debts and repaying share capital, should be distributed among all its shareholders, it was held that preference shareholders were not entitled to share any surplus assets; because their rights were to be ascertained from the memorandum alone, and the memorandum did not confer the right to participate on them [*Duncan Gilmour & Co. Ltd., Re* [1952] All. ER 871].

The relationship between memorandum and articles has been aptly summed up by *Lord Cairns, L.C.* in *Ashbury Railway Carriage & Iron Co. Ltd.* v. *Riche* [1875] L.R. 7 H. L. 653 as follows :—

> "The articles play a part subsidiary to a memorandum of association. They accept the memorandum of association as a charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of governing body as between themselves and the company at large, and the mode and form in which

business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made. . . . The memorandum is as it were. . . . , the area beyond which the actions of the company cannot go; inside that area, the shareholders may make such regulations for their own government as they think fit."

6.3 Distinction between memorandum of association and articles of association

The main points of distinction between memorandum and articles may be noted as follows:—

1. The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. These conditions are introduced for the benefit of the creditors, and the outside public, as well as the shareholders. The articles of association are the internal regulations of the company; they only regulate the relationship between company and the members and members *inter se* (*i.e.,* amongst members themselves).
2. Memorandum lays down the area beyond which the activities of the company cannot go. Articles provide for regulations inside that area. Thus, memorandum lays down the parameters for the articles.
3. Memorandum of association can be altered only under certain circumstances and in the manner provided in the Act. In most of the cases permission of the Central Government/Tribunal is required, besides the approval of the shareholders in a general body meeting either by way of an ordinary resolution or special resolution. Generally, articles can be altered by the members by passing a special resolution only.
4. Memorandum of association cannot include any clause contrary to the provisions of the Companies Act. The articles of association are subsidiary both to the Companies Act and the memorandum of association.
5. Acts done by a company beyond the scope of the memorandum are *ultra vires* and, thus, absolutely void. They cannot be ratified even by unanimous vote by all the shareholders. But the acts beyond the articles can be ratified by the shareholders provided the relevant provisions are not beyond the memorandum.

6.4 Contents

You have learnt that the Articles of Association of a company contains the rules and regulations for the internal management of the company. As per Section 5 of the Companies Act, 2013, the Articles shall also contain such matters, as may be prescribed. However, company may include such additional matters in its articles as may be considered necessary for its management.

6.4-1 Provisions for Entrenchment

For the first time Companies Act, 2013 contains provisions relating to entrenchment from Articles. Sub-section (3) of Section 5 provides that the articles may contain provisions for entrenchment. What it means is that Articles may provide that certain

provisions of the Articles will not be alterable merely by passing a special resolution; they will require a more elaborate prescribed procedure to be followed.

The provisions for entrenchment referred to above shall only be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed.

The Articles of Association of a company usually contain rules and regulations relating to the following matters:

(*i*) The exclusion, wholly or in part, of the model articles as contained in respective Tables.

(*ii*) Share capital - shares and their value and their division into equity and preference shares, if any.

(*iii*) Rights of each class of shareholders and procedure for variation of their rights.

(*iv*) Procedure relating to the allotment of shares, making of calls and forfeiture of shares.

(*v*) Increase, alteration and reduction of share capital.

(*vi*) Rules relating to transfer or transmission of shares and the procedure to be followed for the same.

(*vii*) Lien of the company on shares allotted to the members for the amount unpaid in respect of such shares and the procedure in respect thereof.

(*viii*) Appointment, remuneration, powers, duties etc. of the directors and officers of the company.

(*ix*) Constitution and composition of Audit Committee, Remuneration Committee, CSR Committee.

(*x*) Procedure for conversion of shares into stock and *vice versa*.

(*xi*) Notice of the meetings, voting rights of members, proxy, quorum, poll, etc.

(*xii*) Audit of accounts, transfer of amount to reserves, declaration of dividend, etc.

(*xiii*) Borrowing powers of the company and the mode of exercise of those powers.

(*xiv*) Issue of share certificates including procedure for issue of duplicate shares.

(*xv*) Winding up of the company.

The Articles of Association must be prepared carefully and it must contain rules in regard to all such matters which are required to be contained therein and which are necessary for the smooth functioning of the company.

But you must remember that the Articles must not contain anything which is against the provisions of the Companies Act or the Memorandum of Association. For example, Articles must not contain a rule permitting the payment of dividend

out of capital, because according to Section 123, dividend can be paid only out of profits.

6.4-2 Regulations required in case of unlimited company, company limited by guarantee and private company limited by shares

Tables G, H, I and J appended to Schedule I require the Articles of Association of a guarantee company having share capital and an unlimited liability company having share capital to mention the number of members with which the company proposes to be registered and in case of a guarantee company not having share capital and an unlimited liability company not having share capital, the Articles of Association should also state that the subscribers to the memorandum and such other persons as the Board shall admit to membership shall be members of the company.

A private company having a share capital must provide in the articles, the three restrictions specified in sub-clauses (*i*), (*ii*) and (*iii*) of sub-section (68) of Section 2, *viz.*, (*i*) as to the right to transfer shares (*ii*) limit as to number of its members (*iii*) invitation to public to subscribe for any securities of the company. Any other private company (*i.e.*, not having share capital) must provide in its articles, restrictions as given under (*i*) and (*ii*) as mentioned above.

6.5 Model form of articles

As per Section 5 of the Companies Act, 2013, the articles of a company shall be in respective forms specified in Tables F, G, H, I and J in Schedule I as may be applicable to such company. You may note that Table F contains model articles for a company limited by shares. Tables G, H, I and J contain model articles for a company limited by guarantee and having a share capital, a company limited by guarantee and not having a share capital, an unlimited company and having a share capital and an unlimited company but not having a share capital respectively.

A company may adopt all or any of the regulations contained in the model articles applicable to such company.

In case of any company, which is registered under the Companies Act, 2013, 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, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

With respect to companies registered under any previous law, the existing articles may continue unless the company decides to change the same as per the model articles contained in the respective applicable table, as aforesaid.

6.6 Signing of articles

As per Rule 13 of the Companies (Incorporation) Rules, 2014, the Memorandum and Articles of Association of the company shall be signed in the following manner:-

- 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 state that "I witness to subscriber/subscriber(s) who has/have subscribed and signed in my presence (date and place to be given). Further I have verified his/their ID for their identification and satisfied myself of his/her/their identification particulars as filled in.

- ***Where a subscriber to the memorandum is illiterate***, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature. He shall also write against the name of the subscriber, the number of shares taken by him. Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.
- ***Where the subscriber to the memorandum is a body corporate***, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized in this behalf by a resolution of the board of directors of the body corporate.
- ***Where the subscriber is a Limited Liability Partnership***, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership.
- ***Where subscriber to the memorandum is a foreign national residing outside India***, memorandum and articles of association shall be signed in the manner prescribed in the rules.

6.7 Alteration of articles

Section 14 provides that subject to the provisions of the Act and to the conditions contained in its memorandum; a company may, by *special resolution* alter its articles including alterations having the effect of conversion of—

(*a*) a private company into a public company; or

(*b*) a public company into a private company.

Conversion of a private company into a public company

Where a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company, that is, the restrictions contained in Section 2(*68*), the company shall, as from the date of such alteration, cease to be a private company.

In other words, a private company may convert itself into a public company by omitting the three restrictive clauses of Section 2(*68*) [*Already discussed under definition of a private company*].

Conversion of a public company into a private company where alteration of the Articles shall have the effect of conversion of a public company into a private company, the same shall not take effect unless the approval of the Tribunal has been obtained. In other words, if a public company wants to convert itself into a public

company by introducing the three restrictive clauses of Section 2(*68*), merely passing of special resolution will not be sufficient; it will have to obtain the approval of the Tribunal also.

Filing copy of special resolution : A copy of special resolution altering the articles must be filed with the Registrar within 30 days of the passing of the special resolution as required by section 117. The right to alter articles just by passing special resolution is so important that a company cannot, in any manner, deprive itself of this power - *Walker* v. *London Tramway Company* [1879].

Filing copy of altered Articles - Sub-section (2) of Section 14 requires every alteration of the articles and a copy of the order of the Tribunal approving the alteration, where applicable, shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed and the Registrar shall register the same.

Any alteration of the articles registered under sub-section (2) shall, subject to the provisions of this Act, be valid as if it were originally in the articles.

6.7-1 Limitation on power to alter articles

These are :—

1. *The alteration must not exceed the powers given by the memorandum or be in conflict with any provisions of the memorandum.* In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
2. *The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.* For example, no company can finance purchase of its own shares (section 67) and if the articles of a company are altered so as to have such power to purchase its own shares, then such power will be void.

   Similarly, where a resolution was passed expelling a member and authorising the director to register the transfer of his shares without an instrument of transfer, the resolution was held to be invalid as being against the provisions of the Act [*Madhava Ramachandra Kamath* v. *Canara Banking Corporation* [1941] 11 Comp. Cas. 78 (Mad.)].

   However, articles may impose on the company conditions stricter than those provided under the law; for example, they may provide that a resolution should be passed by a special majority when the Act requires it to be passed by an ordinary majority. However, no provision in the articles can dilute the conditions of the memorandum or of the Act.
3. *Not be inconsistent with any alteration made by the Tribunal*: Where under Section 242, the Tribunal makes an order with respect to any alteration in the memorandum or articles of a company, then the company shall not have the power to make any alteration which is inconsistent with its orders except with the approval of the Tribunal [Sec. 242(5)].
4. *The altered articles must not include anything which is illegal or opposed to public policy or unlawful.*

5. *The alteration must be* bona fide *for the benefit of the company as a whole.* The alteration will not, however, be bad merely because it inflicts hardship on an individual shareholder.

   In *Allen* v. *Gold Reefs of West Africa Limited* [1900] 1 Ch. 656, a company had a lien on all shares 'not fully paid-up' for calls due to the company. There was only one shareholder 'A', who owned fully paid-up shares. He also held partly paid shares in the company. 'A' died. The company altered its articles by striking the words "fully paid-up" and thus giving itself a lien on all shares - whether fully paid-up or not. The legal representative of 'A' challenged the alteration on the ground that the alteration had retrospective effect. *Held that,* the alteration was good, as it was done *bona fide* for the benefit of the company as a whole, even though the alteration had a retrospective effect. Again, in *Side Bottom* v. *Kershaw Leese & Co.* [1920] Ch. 154 (C.A.), a company was empowered by an alteration in the articles, to expropriate shares held by any member who was in business in competition with the company. At the time of alteration, there was only one member doing business in competition with the company. He challenged the alteration. *Held that,* the alteration was valid, as the alteration was *bona fide* for the benefit of the company. [This ruling seems to apply to private companies and closely held public companies].

   When a person comes as a member, he is not entitled to assume that the articles will always remain in a particular form, and so long as the proposed alteration does not unfairly discriminate, it cannot be open to objection, provided the resolution is *bona fide* passed [*Greenhalgh* v. *Anderne Cinemas* [1950] 2 All ER 1120 (CA)].

6. *The alteration must not constitute a fraud on the minority by a majority.* If the alteration is not for the benefit of the company as a whole, but for majority of shareholders, then the alteration would be bad. *In other words,* an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage over the latter.

   In *Brown* v. *British Abrasive Wheel Co.* [1919] 1 Ch. 290, the majority which held 98% of the shares passed a special resolution that upon the request of holders of 9/10th of the issued shares, a shareholder shall be bound to sell and transfer his share to the nominee of such holder at a fair value. The alteration was held to be invalid since it amounted to oppression of minority.

   Again, in *Mathrubhumi Printing & Publishing Co. Ltd.* v. *Vardhaman Publishers Ltd.* [1992] 73 Comp. Cas. 80 (Ker.), the Kerala High Court held that the power conferred on the company under section 31 (now section 14) to alter the articles by special resolution is not to be abused by the majority of shareholders so as to oppress the minority. The court further observed that no majority of shareholders can, by altering the articles retrospectively, affect, to the prejudice of the consenting owners of shares, the right already existing under a contract nor take away the right accrued, *e.g.,* after a transfer of share is lodged, the company cannot have a right of lien so as to defeat the transfer.

A company cannot deprive itself of the statutory power of altering the articles of association either by a statement in the articles or by a contract that they shall not be altered. The only limit on alteration is that the action cannot be used to oppress or defraud a minority of shareholders or so as to violate any statutory provision or principle of law and that the power like the other powers, must be exercised fairly and according to law [*All India Railway Men's Benefit Fund* v. *Jamadar Baheshwarnath Bali* [1945] 15 Comp. Cas. 142 (Nag.)].

7. *An alteration of articles to effect a conversion of a public company into a private company cannot be made without the approval of the Tribunal [section 14].*

8. *A company cannot justify breach of contract with third parties or avoid a contractual liability by altering articles.*

   In *British Murac Syndicate Ltd.* v. *Alperton Rubber Co.* [1915] 2 Ch. 186, an agreement provided that so long as the plaintiff syndicate should hold 5,000 shares in the defendant company, it should have the right of nominating two directors on the Board of the defendant company. A provision to the same effect was contained in 'article 88' of the defendant company's articles. The plaintiff syndicate nominated two directors whom the defendant company refused to accept. An attempt was then made to cancel article 88, but an injunction was granted to restrain it. The learned judge observed that the contract clearly involved, as one of its terms, that article 88 was not to be altered.

   It may also be noted that an alteration cannot be made to avoid the rigours of a contract validly undertaken.

   However, where the damage is capable of being measured in terms of money, the company may alter its articles, subject to being answerable in damages in breach.

   By effecting alteration in its articles, a company cannot defeat or escape from its contractual obligation with any person. The company will always be liable for damages in case the alteration results in a breach of the contract the company had entered into with any person [*Mathrubhumi Printing & Publishing Co. Ltd.* v. *Vardhaman Publishers Ltd. (supra)*].

   In *Southern Foundries (1926) Ltd.* v. *Shirlaw* [1940] 10 Comp. Cas. 255 (HL), the articles of the company provided that the directors may appoint one of them to be the managing director. *In other words,* a managing director had to be a director and if he ceased to be a director, he could not function as managing director. In December 1933 an agreement was entered into between 'S' and the company, by which 'S' was appointed as managing director for 10 years, and he could not resign his office during this period nor was the power to remove him to be exercised. Within three years of the agreement, the company became a fully owned subsidiary of another company 'F' and its articles were altered giving 'F' the power to remove any director of the company, and in 1937 'S' was removed from the directorship with the consequence that he also ceased to be the managing director. The

question was whether the company exercising this statutory right of altering the articles, committed a breach of an implied obligation to 'S'.

Held, that the altered articles had provided for dismissal of the managing director and the said dismissal would be *intra vires* the company, but would, nevertheless expose the company to an *action for damages* as the appointment had been made for a term of 10 years and he was dismissed before the term was over.

9. The amended regulation in the articles of association cannot operate retrospectively, but only from the date of amendment [*Pyare Lal Sharma* v. *Managing Director, J & K Industries Ltd.* [1989] 3 Comp. L.J. (SL) 70].

10. Provisions by way of contractual obligation in articles of association of a company cannot limit statutory power of a company to alter its articles. In *State of Karnataka* v. *Mysore Coffee Curing Works Ltd.* [1984] 55 Comp. Cas. 70 (Kar.), the State Government held shares in company 'M' and the articles of the company provided that the State Government could nominate three directors and also the chairman of the Board in consideration of having subscribed to the capital of the company. Later, the company issued right shares in the ratio of 1:1 which the State Government did not take and consequently its shareholding dwindled to 19.6 per cent. The company proposed to alter the relevant articles affecting the State Government's right to nominate directors and the chairman.

    Held, it could do so. The Karnataka High Court observed that the only restriction on the unfettered power under section 31(1) [now section 14(1)] is the restriction imposed by the proviso to that section, and it is, that a public company cannot convert itself into a private company by merely carrying out an amendment to the articles of association of such a company.

11. Amendment of articles to empower Board of Directors to expel a member is opposed to the fundamental principles of company jurisprudence and is *ultra vires* of the company - *Circular No. 32/75, dated 1-11-1975.*

6.7-2 What amounts to alteration of articles

An interesting situation arose in *Gur Prasad Kapoor* v. *Rameshwar Prasad* [1933] 3 Comp. Cas. 153 (All.). The articles of association of a company provided that until otherwise determined by a general meeting, the number of directors shall not be less than five and more than nine. The question was whether, where the company in a general meeting, without passing a special resolution resolved to increase the number of directors to 16, the resolution was valid.

Held, that merely increasing the number of directors did not involve any alteration in the articles which itself gave power to the shareholders in that respect. Therefore, the resolution passed was valid. The right construction of the articles was that it was upon the shareholders to vary the number of directors in the company without in any way necessitating an alteration in the articles.

Again in *Topandas Mohanlal Advani* v. *Yeotmal Electric Supply Co.* [1940] 10 Comp. Cas. 133 (Sind), the relevant article 98 provided that until otherwise determined by a general meeting the number of directors shall be not less than three or more than seven. At a general meeting, a resolution was passed to the effect that 'until

otherwise determined by a general meeting the number of directors shall not be less than 3 or more than 11, and the present strength of the board be increased to 11'. The question was whether the resolution was a resolution under the relevant article or whether this amounted to alteration of article.

Held, that the language of the resolution suggested the replacement of Article 98 by the resolution, but it can be held without any difficulty that this resolution was a resolution made under Article 98. It only did what this article contemplated might be done. There is nothing in the Companies Act which requires that articles of association must be rigid and may not in themselves provide for varying sets of circumstances. The impugned resolution at a general meeting that the number of directors should be increased was valid and no special resolution was required.

6.7-3 Effect of altered articles

Alteration binds members in the same way as original articles. The provision of section 10 providing that the articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means the articles as originally framed, or as they may from time to time stand after they have been altered are valid under the provisions of the Act. There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles[2].

Right of a shareholder to transfer his shares is always subject to provisions in articles of association as well as section 31 [now section 14]. A transferee, therefore, cannot have a better right than the transferor. The rights of a transferee until the transfer becomes effective, as against the company will again be subject to the provisions of the articles of association and the relevant provisions of the Act. The alteration affecting the articles of association in exercise of the said power cannot, therefore, be challenged by the transferee on the ground of *mala fide*- *Mathrubhumi Printing & Co. Ltd.* v. *Vardhaman Publishers Ltd.* (*supra*).

6.7-4 Procedure for alteration of articles of association

For effecting alteration to the articles of association, the following procedure is required to be followed :—

1. The proposal has to be approved by the Board of directors. The Board will fix the date and time of the general meeting. It will also approve the draft notice of the meeting, the special resolution and explanatory statement. The secretary, if any, will be authorised to convene the general body meeting.
2. The secretary shall convene the meeting on the appointed day. In the meeting the necessary special resolution amending the articles of association shall be passed.
3. Within 30 days of the passing of the resolution, a certified copy thereof shall be filed with the Registrar of Companies [*vide* section 117 of the Companies Act].
4. Where the alteration of the articles has the effect of converting a public company into a private company, the company shall seek the approval of the

2. *Malleson* v. *National Insurance & Guarantee Corpn.* [1894] 1 Ch. 200 (Ch. D.)

Tribunal which shall make such order as it may deem fit (*vide* section 14 of the Companies Act).

5. After getting the approval of the Tribunal, printed copy of the articles, as altered, should be filed by the company with the Registrar of Companies in Form No. INC-27 within 15 days of the date of receipt of order of approval from the Tribunal.
6. Six copies of the amendments (one of which shall be certified) should be sent to the stock exchange(s) on which the shares of the company are listed, as soon as they have been adopted by the company in the general meeting (*as per the Standard Listing Agreement*).
7. Alteration should be noted in every copy of the articles of association, and the articles issued after the date of alteration should be in accordance with the altered articles (section 15). A default in this regard shall invite penalty against the company as well as every officer in default. The penalty provided under the section is fine of Rs. 1000 for each copy so issued.

6.8 Binding effect of memorandum and articles

Section 10 provides that the memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member and contain covenants on its and his part to observe all the provisions of the memorandum and of the articles. Thus, the company is bound to the members; the members are bound to the company; and the members are bound to the other members by whatever is contained in these documents. But, in relation to articles, neither a company nor its members are bound to outsiders.

The articles of association merely govern the internal management, business or administration of a company. They may be binding between the persons affected by them but they do not have the force of statute - *Irrigation Development Employees' Association* v. *Government of Andhra Pradesh* [2005] 55 SCL 459 (AP).

Binding on company and its directors - Merely because in articles of association, the board of directors is empowered to refer any claim or demand to arbitration, provisions of section 36 [now section 10] cannot be interpreted to mean that the company or its directors shall be bound to incorporate a provision for arbitration in every agreement that the company executes - *Skypark Builders & Distributors* v. *Kerala Police Housing & Construction Corpn. Ltd.* [2004] 50 SCL 254 (Ker.).

The discussion on legal effect of the memorandum and articles may be made under the following heads :—

(*a*) Members bound to the company;

(*b*) Company bound to the members;

(*c*) Members bound to the members;

(*d*) Company and the outsiders.

6.8-1 Members bound to the company

Each member must observe the provisions of the articles and memorandum. *For instance,* a company has a right of lien on member's shares, or to forfeit the shares

on non-payment of calls. Every member is bound by whatever is contained in the memorandum and articles. In *Borland's Trustee* v. *Steel Bros. Co. Ltd.* [1901] 1 Ch. 279, the articles of a company contained a clause that on the bankruptcy of a member, his shares should be sold to other person and at a price fixed by the directors. 'B', a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at the true value.

Held, that the trustee was bound by the articles as a share was purchased by 'B' in terms of the articles. However, it may be noted that in the current position, this decision will have a restricted application to private companies or closely held public companies. It appears that such a restrictive clause in the articles will not be acceptable to the Registrar of Companies.

Again, a company's memorandum provided that it shall have a first and paramount lien upon each share for debts due to the company by members of the company. One of the members owed some amount to the company. He pledged his share with a bank to secure an overdraft and the bank gave notice of pledge to the company. The company claimed priority over the pledge of the bank and contended that the shares pledged with the bank were bound by the company's lien as given in the articles of association.

The court upheld the contention of the bank in respect of debts incurred by the member before the notice of pledge was given to the company - *Bradford Baking Co.* v. *Briggs Son & Co.* [1886] 12 AC 29 (HL).

Each member is bound by the covenants of memorandum and articles as originally framed or as altered from time to time in accordance with the provisions of the Companies Act - *Malleson* v. *National Insurance & Guarantee Corpn.* (*supra*).

In *Hickman* v. *Kent Sheepbreeders' Assn.* [1915] 1 Ch. 881, the learned Judge observed that though the articles can neither constitute a contract between the company and an outsider nor give any individual member of the company special contractual right beyond those of the members generally, they in fact constitute a contract between the company and its members in respect of their ordinary rights as members. Thus, an article referring to arbitration of any dispute between the company and any member does not constitute a submission to arbitration of a dispute between the company and one of its directors as such, notwithstanding that the director was a member of the company [*Also* see *Beattie* v. *Beattie* [1938] Ch. 708.]

The articles of association are the regulations of the company binding on the company and on its shareholders. Shareholders, therefore, cannot, among themselves, enter into an agreement which is contrary to or inconsistent with the articles of association of the company - *V.B. Rangaraj* v. *V.B. Gopalkrishnan* [1992] 73 Comp. Cas. 201 (SC).

6.8-2 Company bound to members

A company is bound to members by whatever is contained in its memorandum and articles of association. The company is bound not only to the "members as a body" but also to the individual members as to their individual rights. The members can restrain a company from spending money on *ultra vires* transaction. An individual

member can make the company fulfil its obligation to him, such as to send the notice for the meetings, to allow him to cast his vote in the meeting.

In *Wood* v. *Odessa Waterworks* [1889] 42 Ch. D. 636, the directors proposed to pay dividend in kind by issuing debentures. The articles provided for payment of dividends. The court held that payment means payment in cash and therefore the company could be compelled to pay dividend in terms of the articles.

In *World Phone India (P.) Ltd.* v. *WPI Group Inc., USA* [2013] 32 taxmann.com 238 (Delhi), where respondent shareholder asserted affirmative vote in board meeting in terms of JVA entered into between parties but Articles of Association had not been amended to incorporate affirmative vote provided to respondent, it was held that JVA was not binding on company and respondent could not insist on exercise of affirmative vote.

Normally, action for breach of articles against the company can be brought only by a majority of the members. Individual or minority members cannot bring such a suit except when it is intended for enforcement of personal rights of members or to prevent the company from doing any *ultra vires* or illegal act, fraud, or acts of oppression and mismanagement.

6.8-3 Members bound to members

The articles bind the members *inter se, i.e.,* one to another as far as rights and duties arising out of the articles are concerned.

It is well settled that the articles of association will have a contractual force between the company and its members as also between members *inter se* in relation to their rights as such members - *Ramakrishna Industries (P.) Ltd.* v. *P.R. Ramakrishnan* [1988] 64 Comp. Cas. 425 [Also *see, Smt. Claude - Lila Parulekar* v. *Sakal Papers (P.) Ltd.* [2005] 59 SCL 414 (SC)].

After the articles are registered, they not only constitute a contract between the association or company on the one hand and its constituent members on the other, but they also constitute a contract between the members *inter se*.[3]

The articles of a company provided that whenever any member wished to transfer his shares, he was under an obligation to inform the directors of his intention and the directors were under an obligation to take the said shares equally between them at a fair value. The directors refused to take shares of a particular member on the ground that the articles did not impose an enforceable liability upon them.

Held that the directors were under an obligation to purchase the shares, as members of the company, in terms of the provisions of the articles. There was a personal liability of members *inter se* [*Rayfield* v. *Hand* [1960] Ch. 1].

However, articles to not create an express contract among the members of the company. A member of a company has no right to bring a suit to enforce the articles in his own name against any other member or members. It is the company alone which can sue the offender so as to protect the aggrieved member. It is in this way that the rights of members *inter se* are regulated.

3. *Shiv Omkar Maheshwari* v. *Bansidhar Jagannath* [1957] 27 Comp. Cas. 255 (Bom.).

A shareholder may, however, sue in his own name to restrain another, or others from doing fraudulent or *ultra vires* act. In *Jahangir R. Modi* v. *Shamji Ladha* [1866-67] 4 Bom. HCR [1855], the Bombay High Court held : "a shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have (by them) been employed in transaction that they have no authority to enter into, without making the company a party to the suit".

6.8-4 Whether company or members bound to outsiders

The memorandum or articles do not confer any contractual rights upon outsiders against the company or its members, even though the name of the outsider is mentioned in the articles. An outsider (*i.e.,* a non-member) cannot rely on articles of association for his action against the company.

The articles of a company provided that the Board of directors could from time to time appoint anyone or more of them as managing director(s). Under the articles, a managing director can be removed in the same way as other directors of the company, namely, by a special resolution. 'S' was appointed on 24-6-1957 as managing director by a resolution of the Board. The contention of 'S' was that the special resolution not having being passed, he could not be removed. The question was whether 'S' who was not a shareholder could rely upon the articles. Held that the plaintiff was not entitled to place any reliance on the articles. It was observed that even between a member and the company the articles of association constitute a contract only in respect of his rights and liabilities as a shareholder, but not in respect of rights and liabilities which he has in a capacity other than that of a member. But as between the company and outsiders, *i.e.,* persons who are not shareholders, the articles do not constitute a contract which that person can take advantage of - *Major-General Shanta Shamsher Jung Bahadur Rana* v. *Kamani Bros. (P.) Ltd.* [1959] 20 Comp. Cas. 501 (Bom.).

Thus, where a person is in a dual capacity, namely, an outsider as well as a member, articles shall constitute a contract between the company and the member but in his capacity as member only.

The articles of a company provided that 'E' should be a solicitor for life to the company and should not be removed from office except for misconduct. Later on, he also became a member of the company. But, after employing him as a solicitor for a number of years, the company discontinued his services. He, being a member, sued the company for damages for breach of the contract contained in the articles of association. His case was dismissed on the ground that, he, as a solicitor, was no party to the articles. He must prove a contract independent of the articles. There was no infringement of his right as a member. A breach of contract was there but in his capacity as a non-member [*Eley* v. *Positive Government Security Life Assurance Co.* [1876] 1 Ex. D. 88].

No article can constitute a contract between a company and a third person and that no right merely purporting to be given by an article to a person, whether a member or not, in a capacity other than that of a member, as for instance, solicitor, promoter, director, can be enforced against the company [*Hickman* v. *Kent or Romney Marsh Sheep Breeders' Association* [1914-15] All. ER 900 (Ch.D)].

While the articles cannot create a contract between the company and any person other than a member in his capacity as a member, they may indicate the basis upon

which contracts may be made by the company. If such a contract is entered into whether with a member of the company or any other person, the conditions stated in the articles will be tacitly adopted by that contract, unless expressly negatived or guaranteed by the contract itself - *Swable* v. *Port Darwin Gold Mining Co.* [1989] 1 Meg. 385.

In this case, the articles provided for the payment to each director, by way of remuneration, a specified sum per annum. By a special resolution, in July, the company reduced this with retrospective effect from the end of the preceding year. The plaintiff thereupon resigned and sued the company for three months' remuneration for services prior to the date of his resignation. The court held that he was entitled to recover on the footing of an implied contract in terms of this clause. "The articles", said Lord Esher, "do not themselves form a contract, but from them you get the terms upon which the director is serving".

6.8-5 Whether Directors are bound by whatever is contained in the articles

The directors of a company derive their powers from the articles and are subject to limitation, if any, applied on their powers by the articles. If they contravene any provision of articles, two parties may be affected, *i.e.*, the company itself, and the outsiders.

In case of contravention of the provisions of the articles, the directors render themselves liable to an action at the instance of the members. However, members may ratify the act of directors, if they so desire. But, if as a result of breach of duty any loss has resulted to the company, the directors are liable to reimburse to the company any loss so suffered.

Further, where the directors contravene the provisions of the articles, it may affect outsiders' interests also. This is explained below with the help of a case law, namely, *Royal British Bank* v. *Turquand* which lays down the doctrine of indoor management.

6.9 Doctrine of constructive notice

Section 399 provides that the Memorandum and Articles when registered with Registrar of Companies 'become public documents' and then they can be inspected by any one by electronic means on payment of the prescribed fee. Again, Section 17 read along with Rule 34 of the Company (Incorporation) Rules, 2014 provides that a company shall on payment of the prescribed fee send a copy of each of the following documents to a member within seven days of the request being made by him-

1. the memorandum;
2. the articles, if any;
3. every agreement and every resolution referred to in sub-section (1) of section 117, if and so far as they have not been embodied in the memorandum and articles.

Failure to supply the copy(ies), as above, will make the company as well as every officer in default liable to a fine @ Rs. 1,000 per day for each day of the default or Rs. 1,00,000, whichever is less.

Therefore, any person who contemplates entering into a contract with the company has the means of ascertaining and is thus presumed to know the powers of the company and the extent to which they have been delegated to the directors. *In other words,* every person dealing with the company is presumed to have read these documents and understood them in their true perspective. This is known as "doctrine of constructive notice". Even if the party dealing with the company does not have actual notice of the contents of these documents it is presumed that he has an implied (constructive) notice of them.

Example

One of the articles of a company provides that a bill of exchange to be effective must be signed by two directors. A bill of exchange is signed only by one of the directors. The payee will not have a right to claim under the bill.

6.10 Doctrine of indoor management

The rule of constructive notice proved too inconvenient for business transactions, particularly where the directors or other officers of the company were empowered under the articles to exercise certain powers subject only to certain prior approvals or sanctions of the shareholders. Whether those sanctions and approvals had actually been obtained or not could not be ascertained because the investors, vendors, creditors and other outsiders could not dare ask the directors in so many words about those sanctions having been obtained or to produce the relevant resolutions. Quite naturally, suppose if you desire to buy a 'bond' or 'debenture' issued by a company, you are not going to ask directors of the company to produce shareholders' resolution authorising them to issue such bonds before you subscribe the same. Likewise, if a director approaches you to buy certain goods worth, say, a few thousands of rupees, you will not ask him for a power of attorney or other relevant document authorising him to make those purchases on behalf of the company. And if you do, may be, you will lose a good customer once for all. Since there are no means to ascertain whether necessary sanctions and approvals have been obtained before a certain officer exercises his powers which, as per articles, can only be exercised subject to certain approvals, those dealing with the company can assume that if the directors or other officers are entering into those transactions, they would have obtained the necessary sanctions. This is known as the 'doctrine of indoor management' and was first laid down in the case of *Royal British Bank* v. *Turquand* [1856] 6 E & B 327.

The facts of *Turquand's* case were that the directors of a company were authorised by the articles to borrow on bonds such sums of money as should from time to time, by a resolution of the company in general meeting, be authorised to be borrowed. The directors gave a bond to T without the authority of any such resolution. The question arose whether the company was liable on the bond. *Held,* the company was liable on the bond, as T was entitled to assume that the resolution of the company in general meeting had been passed.

Once again, in the Madras case of *Official Liquidator, Manasube & Co. (P.) Ltd.* v. *Commissioner of Police* [1968] 38 Comp. Cas. 884 (Mad.). Also *see M. Rajendra Naidu* v. *Sterling Holiday Resorts (India) Ltd.* [2009] 93 SCL 11 (Mad.). The learned judge observed that the lenders to a company should acquaint themselves with memoran-

dum and articles, but they cannot be expected to embark upon an investigation as to legality, propriety and regularity of acts of directors.

Thus, you would have observed from the foregoing discussion that the 'doctrine of constructive notice' throws a burden on people entering into contracts with a company by making a presumption that they would have read the company's memorandum and the articles even though they might not have actually read them. The 'doctrine of indoor management', on the other hand allows all those who deal with the company to assume that the provisions of the articles have been observed by the officers of the company. *In other words,* the persons dealing with the company are not bound to inquire into the regularity of internal proceedings[4].

EXCEPTIONS TO THE DOCTRINE OF INDOOR MANAGEMENT

The above noted 'doctrine of indoor management' is, however, subject to certain exceptions. In other words, relief on the ground of 'indoor management' cannot be claimed by an outsider dealing with the company in the following circumstances:

1. *Where the outsider had knowledge of irregularity* - The rule does not protect any person who has actual or even an implied notice of the lack of authority of the person acting on behalf of the company. Thus, a person knowing full well that the directors do not have the authority to make the transaction but still enters into it cannot seek protection under the rule of indoor management. In *Howard* v. *Patent Ivory Co.* (38 Ch.D 156), the articles of a company empowered the directors to borrow up to one thousand pounds only. They could, however, exceed the limit of one thousand pounds with the consent of the company in general meeting. Without such consent having been obtained, they borrowed 3,500 pounds from one of the directors who took debentures. The company refused to pay the amount. *Held* that, the debentures were good to the extent of one thousand pounds only because the director had notice or was deemed to have the notice of the internal irregularity. The director being an insider, the doors of the company are not closed to him.

   The benefit of rule of indoor management is not available to directors - *Morris* v. *Kanssen* [1946] 16 Comp. Cas. 186 (HL).

2. *No knowledge of articles* - Again, the rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them. In *Rama Corporation* v. *Proved Tin & General Investment Co.* [1952] 1 All. ER 554, T was a director in the investment company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles. Later, it

4. In England, however, the Companies Act, 1985 now grants further protection to those dealing with companies by making a statutory provision under section 35 of the said Act which provides that if a company enters into a transaction which has been decided on by its directors, and the transaction infringes a limitation on the powers of the directors contained in the company's memorandum and articles, the other party to the transaction may nevertheless treat the company as bound by it if he entered into it in good faith [Pennington's Company Law, 5th edn., P. 138

was found that the directors of the company did not delegate their powers to T. Plaintiff relied on the rule of indoor management. *Held,* they could not, because they even did not know that power could be delegated.

3. *Forgery* - The rule of indoor management does not extend to transactions involving forgery or otherwise void or illegal *ab initio.* In the case of forgery it is not that there is absence of free consent but there is no consent at all. The person whose signatures have been forged is not even aware of the transaction, and the question of his consent being free or otherwise does not arise. Since there is no consent at all there is no transaction. Consequently, it is not that the title of the person is defective but there is no title at all. Therefore, howsoever clever the forgery might be (even as skilful as by the famous cheat Mr. Natwar Lal), the person gets no rights at all. Thus, where the secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company. The certificate was held to be a nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management - *Ruben* v. *Great Fingal Consolidated* [1906] AC 439.

   Forgery, in the case of a company, can take different forms. It may, besides forgery of the signatures of the authorised officials, include the execution of a document towards the personal discharge of an official's liability instead of the liability of the company. Thus, a bill of exchange signed by the manager of a company with his own signature under words stating that he signed on behalf of the company, was held to be a forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted - *Kredibank Cassel GmbH* v. *Schenkers Ltd.* [1927] 1 KB 826. The bill in this case was held to be forged because it purported to be a different document from what it was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

   'Forgery' may further include the unauthorised use of the company's seal. In the case of *South London Greyhound Racecourse Ltd.* v. *Wake* [1931] 1 Ch. 496, a share certificate bearing the company's seal and attested by a director and the secretary was held to be a forgery because the affixing of the company's seal had not been authorised by a resolution of the Board as required by the articles.

4. *Negligence* - The 'doctrine of indoor management', in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make an enquiry, he is estopped from relying on the Rule. In *Al Underwood* v. *Bank of Liverpool* [1924] 1 KB 775, a person who was a sole director and principal shareholder of a company paid into his own account cheques drawn in favour of the company. *Held,* that, the bank should have made inquiries as to the power of the director. The bank was put upon an enquiry and was accordingly not entitled to rely upon the ostensible authority of director.

Similarly, in *B. Anand Behari Lal* v. *Dinshaw & Co. (Bankers) Ltd.* AIR 1942 Oudh 417, an accountant of a company transferred some property of a company in favour of Anand Behari. On an action brought by him for breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.

5. *Again,* the doctrine of indoor management does not apply ***where the question is in regard to the very existence of an agency.*** In *Varkey Souriar* v. *Keraleeya Banking Co. Ltd.* [1957] 27 Comp. Cas. 591, the Kerala High Court held that the 'doctrine of indoor management' cannot apply where the question is not one as to the scope of the power exercised by an apparent agent of a company but is in regard to the very existence of the agency.
6. Doctrine is also not applicable ***where a pre-condition is required to be fulfilled*** before company itself can exercise a particular power. *In other words,* the act done is not merely *ultra vires* the directors/officers but *ultra vires* the company itself - *Pacific Coast Coal Mine* v. *Arbuthnot* [1917] AC 607.
7. ***Oppression*** - Doctrine of indoor management can be invoked only with reference to acts which relate to provisions of memorandum and articles, and not in a case where oppression is alleged [*Navin R. Shah* v. *Simshah Estates and Trading Co. (P.) Ltd.* [2007] 74 SCL 372 (CLB - New Delhi)]

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/PCC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Distinguish between 'Memorandum of association' and 'Articles of association'.

2. "The articles of association play a subordinate role to the memorandum of association" Comment.

3. Write a short note on : Doctrine of indoor management.

4. "The doctrine of indoor management is a 'silver lining' to strangers dealing with the company." Comment.

5. Discuss the binding effect of memorandum and articles of association when registered, on the shareholders and outsiders.

6. (*a*) "Articles of association constitute a contract between the company and the members and Members *inter se.*" Discuss.

(*b*) "The altered articles will bind the members just in the same way as did the original articles, but that will not give the alteration a retrospective effect". Comment.

7. Examine the following statement :

"The power of altering the articles is wide, yet it is subject to a large number of limitations."

8. Can the shareholders enter into an agreement amongst themselves which is inconsistent with the articles of association of the company?

9. The benefit of 'doctrine of indoor management' is not available under certain circumstances. Comment.

10. "Doctrine of 'constructive notice' and of 'indoor management' are conflicting doctrines". Examine this statement and state what matters would not be covered by the respective doctrines.

11. Enumerate the exceptions to the 'doctrine of indoor management'.

12. Discuss, whether it is legally compulsory for a company to have its own Articles of association ? What restrictions should the Articles provide to give a company the status of a private company ?

13. Explain the rule laid down in the *Royal British Bank* v. *Turquand* and state the exceptions to the rule.

PRACTICAL PROBLEMS

1. A limited Company is formed with its Articles stating that one Mr. Srivastava shall be the solicitor for the company, and that he shall not be removed except on the ground of misconduct. Can the company remove Mr. Srivastava from the position even though he is not guilty of misconduct?

Hints : As between outsiders and the company, Articles do not give any right to outsiders against the company, even though their names might have been mentioned in the Articles. An outsider cannot take advantage of the Articles to found a claim thereon against the company. Thus, in the given case, the company shall succeed in removing Mr. Srivastava as the solicitor of the company without incurring any obligations. The facts given are based on the decided case of *Eley* v. *Positive Government Security Life Assurance Co.* in which similar decision was pronounced.

2. A company, in which the directors hold majority of the shares, altered its Articles so as to give power to directors to require any shareholder, who competed with the company's business, to transfer his shares, at their full value, to any nominee of the directors. S had some shares in the company, and he was in competition with the company. Is S bound by the alteration ?

Hints : The power of the members to effect alteration in the Articles by passing special resolution is limited inasmuch as the alteration must be *bona fide* and in the interest of the company. In the given case, alteration requires taking over the shares of only those who competed with company's business. Therefore, empowering the directors to take over shares of such members seems to be in the general interest of the company as a whole and hence shall be valid. S shall be held bound by the alteration.

3. Document on which a company borrowed a sum of money was executed by the managing director, who was the chief functionary of the company and to comply with the requirements of the Articles the signatures of two other directors were forged. Can the company be allowed to deny liability under this document ?

Hints : In *Ruben* v. *Great Fingall Consolidated,* Lord Loreburn held that protection under doctrine of indoor management could not be extended to cases of forgery. A transaction effected by forgery is rendered *void ab initio* for absence of consent and not voidable on ground of mere fraud. The rule of indoor management only covers the gap created by lack of authority. It cannot apply to transactions which are void or illegal *ab initio.*

However, in *Sri Kishan* v. *Mondal Bros. & Co.,* it was held that a company may be held liable for fraudulent acts of its officers acting under their ostensible authority on its behalf. Thus, where a managing director practises a fraud on the company and does not place the money borrowed by him on behalf of the company with the company, the company cannot defeat a *bona fide* creditor's claim for recovery of the money on the ground of fraud of its own officers.

In the given problem, therefore, the company will not be allowed to deny liability on the document in question.

4. The Articles of a company provided that the shares of a member who became bankrupt would be offered for sale to other shareholders at a certain price. Is the provision binding on the shareholders ?

Hints : The facts of the given problem are based on the decided case of *Boreland Trustee* v. *Steel Bros. & Co. Ltd.,* in which case, the provisions in the Articles were held to be binding on the members. The learned judge observed that "Shares having been purchased on these terms and conditions, it is impossible to say that those terms and conditions are not to be observed". Thus, since Articles constitute a binding contract between the company and its members, the shareholders shall be held bound by the stated provisions in the Articles.

5. The plaintiffs contracted with a director of the defendant company and gave him a cheque under the contract. The director could have been authorised under the company's articles, but was not in fact so authorised. The plaintiffs had not seen the Articles. The director misappropriated the cheque and the plaintiffs sued the company.

Is the company liable ?

Hints : The problem relates to the protection that the outsider may claim against lack of authority on the part of the officers of the company. The rule commonly known as the Doctrine of Indoor Management, was first laid down in the case of *The Royal British Bank* v. *Turquand.* However, it has been held that the rule of indoor management cannot be invoked in favour of a person who had no knowledge of the Articles of the company. It is because, in such a case the person cannot assume that the power (of which he has no knowledge) has been rightly exercised. In *Rama Corporation* v. *Proved Tin & General Investment Co.,* on which the problem in question is based, it was held that the plaintiffs could not rely on the rule of indoor management because they did not know the existence of the power to authorise the director.

Thus, in the present case, company shall not be held liable by the act of the director who has transacted beyond the scope of his authority. A principal can be held liable for the frauds of his agent only to the extent they are committed within the scope of the authority conferred upon him.

7 Prospectus

7.1 Steps which are necessary before the issue of Prospectus

We have mentioned earlier that a private company is prohibited from inviting public to subscribe to its share capital or debentures. It arranges its share capital primarily from friends and relatives. The shares are, therefore, subscribed by a small number of persons who are known to the promoters or are related to them by family connections.

A public company may also decide not to invite public to subscribe to its share capital and arrange its share capital privately like a private company. However, a public company limited by shares, generally issues shares to the public for which it has to issue a prospectus. Where it issues a prospectus, it has to follow the procedure as given below :—

After the certificate of incorporation is obtained, the affairs of the public company are taken over by the first directors appointed in accordance with the provisions of law. They generally elect one of their members as the chairman of the Board of directors, if none is named in the articles of association. The Board attends to the following matters :—

(*a*) Appointment of various expert agencies such as bankers, registrars to the issue, auditors, secretary, etc.

(*b*) Entering into underwriting contract, brokerage contracts, etc.

(*c*) Making arrangements for the listing of shares on stock exchange(s).

(*d*) Drafting a prospectus for the purpose of issue to the public.

The appointment of a banker is necessary as it has to receive the share applications along with application money.

7.2 Meaning and definition of a prospectus

A prospectus, as per Section 2(70), means any document described or issued as a prospectus and includes a red herring prospectus or shelf prospectus or any notice,

circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.

Thus, a prospectus is not merely an advertisement; it may be a circular or even a notice. A document shall be called a prospectus if it satisfies two things :

1. It invites subscription to, or purchase of, shares or debentures or any other security of a body corporate;
2. The aforesaid invitation is made to the public.

7.2-1 What constitutes an offer to the public?

Explanation III to Section 42(3) along with the rules framed thereunder provide that if a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than 200 persons in a financial year, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public. Thus, we may say that if any company invites subscription or allots any security to 200 or more persons *in a financial year*, it will be said to have made a public offer. However, while counting the aforesaid figure of 200 persons, the following shall not be taken into account:

1. Qualified institutional buyers;
2. Employees, who are offered securities under a scheme of employees stock option as per provisions of section 62(1)(*b*).

In *Sahara India Real Estate Corpn. Ltd.* v. *SEBI* [2012] 25 taxmann.com 18, the Supreme Court of India ruled that:

1. *'Share and debenture issue' meant for more than 49 (now 200 or more) persons would be a public issue* - OFCDs issued to more than forty nine persons requires compliance of norms of public issue, in violation of which money collected from public is to be refunded.
2. *Company offering shares to public should file application on recognised stock exchange* - Every company which intends to offer shares or debentures to public for subscription by way of a prospectus is legally obliged to make an application on a recognized stock exchange.
3. *SEBI's powers under section 11 of SEBI Act are applicable to both listed and unlisted companies* - Functions and powers of SEBI under section 11, insofar as protecting interest of investors in securities market, as also, for promotion, development and regulation of securities market, would be applicable to 'listed' as well as 'unlisted companies'.
4. *Definition of securities u/s 2(*45AA*) includes hybrids* - Definition of 'securities' under section 2(45AA) of Companies Act includes 'hybrids' and SEBI has jurisdiction over hybrids like OFCDs.

To be a prospectus, it must be 'issued to the public'. Single private communication does not amount to issue to the public [*Nash* v. *Lynde* [1929] A.C. 158]. In this case, several copies of a document marked "strictly confidential" and containing particulars of a proposed issue of shares, were sent by the managing director of a company

to a co-director, who in turn sent a copy to a solicitor, who gave it to a client who, in turn, passed it on to a relation. Thus, a document was passed on privately through a small circle of friends of the directors. The House of Lords held that there had been no issue to the public. In *Pramatha Nath Sanyal* v. *Kali Kumar Dutt* AIR 1925 Cal. 714, an advertisement was inserted in a newspaper stating: "some shares are still available for sale according to the terms of the prospectus of the company which can be obtained on application". This was held to be a prospectus as it invited the public to purchase shares. The directors were, therefore, penalised, for not complying with the requirements of filing a copy thereof with the Registrar of Companies.

1. An invitation shall not be an invitation to the public if it cannot be calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the invitation. Thus, it will not be an invitation to public where B, a friend of A who receives the invitation, also desires to subscribe, but his offer is refused because he was not invited to make the offer[1]. On the other hand, it will become an invitation to public where his (B's) offer shall also be considered.
2. The offering of shares to kith and kin of a director is not an invitation to the public to buy shares - *Rattan Singh* v. *Managing Director, Moga Transport Co. Ltd.* [1959] 29 Comp. Cas. 165. Further, the learned judge in this case held that in all cases the determination of the question of an offer being made to the public depends upon the facts and language of the notice and the particular circumstances of each case.

   In *Nash* v. *Lynde* [1929] AC 158, Justice Viscount Summer observed : "The 'public' is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be open to anyone who brings his money and applies in proper form, whether the prospectus was addressed to him on behalf of the company or not."
3. An offer to shareholders of an existing company 'A', of shares in a new company 'B' in exchange for existing shares of 'A' is not an offer to public - *Govt. Stock Securities Investment Co. Ltd.* v. *Christopher* [1956] 1 WLR 237. In this case, an offer was made to shareholders of company A to transfer their existing shares to company B against which they would be issued shares of company B. The question was whether the letter of offer was 'prospectus' inviting public subscription. *Held that* the test is not who receives the circular, but who can accept the offer put forward. In this case it could only be persons legally or equitably interested as shareholders in the shares of company A. In these circumstances the impugned letter of offer was not a prospectus inviting public subscription.

1. This, however, is limited to 200 persons only.

7.3 Contents of a prospectus

As per the requirement of Section 26 of the Companies Act, 2013, contents of a prospectus shall comprise of:

(*i*) Information to be given in a Prospectus

(*ii*) Reports to be set out in the Prospectus

(*iii*) Declaration to be made

(*iv*) Other matters

7.3-1 Information to be given and Reports to be set out in a Prospectus

Section 26 of the Companies Act, 2013, as amended by the Companies (Amendment) Act, 2017 requires a prospectus to be dated and signed and to state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government. However, until the Securities and Exchange Board specifies the information and reports on financial information under sub-section (1) of Section 26, the information to be stated, in this regard, shall be as per the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992.

7.3-2 Declaration

There shall be included a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

7.3-3 Other Matters

Prospectus shall also state such other matters and set out such other reports, as may be prescribed.

7.3-4 Statement of an Expert included in a Prospectus

A prospectus may contain a statement purporting to be made by an expert. The term "expert" includes an engineer, a valuer, a chartered accountant, a company secretary, a cost accountant and any other person who has the power to issue a certificate in pursuance of any law. The reports from an expert must not be included in a prospectus unless:

(*i*) such expert is a person who is not and has not been engaged or interested in the formation or promotion or management of the company,

(*ii*) he gave his written consent to the issue of the prospectus and had not withdrawn the consent until the prospectus is delivered to the Registrar for registration,

(*iii*) a statement that he has given and not withdrawn his consent thereto is included in the prospectus.

7.3-5 Penalty for non-compliance

If a prospectus is issued in contravention of the provisions of this section, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

7.3-6 Exemptions

The aforesaid requirements of Section 26, that is, with respect to the contents do not apply to:

(*a*) ***Rights Issue,*** i.e., the issue to existing members or debenture-holders of a company, of a prospectus or form of application relating to shares in or debentures of the company, whether an applicant has a right to renounce the shares in favour of any other person or not.

(*b*) ***Shares/Debentures Uniform in all respects*****:** The provisions of Section 26 do not apply to the issue of a prospectus or form of application relating to shares or debentures which are, or are to be, in all respects uniform with shares or debentures previously issued and for the time being dealt in or quoted on a recognized stock exchange.

7.3-7 Variation in terms of contract or objects in prospectus (Section 27)

If, at any time, the company wants to vary the terms of a contract referred to in the prospectus or objects for which the prospectus was issued, it shall not be allowed to do so except by way of special resolution. The notice of the special resolution must clearly indicate the justification for such variation and the same should be published in the newspapers (one in English and one in vernacular language) in the city where the registered office of the company is situated.

Again, it may be noted that a company cannot use any amount raised by it through prospectus for buying, trading or otherwise dealing in equity shares of any other listed company.

Exit Option

The Companies Act, 2013 has for the first time given an exit option to shareholders who do not agree to the proposal to vary the terms of contracts or objects referred to in the prospectus. The exit option shall be given by promoters or controlling shareholders at such exit price and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

7.3-8 Offer of sale of shares by certain members of company (Section 28)

You may note that, the Companies Act, 2013, for the first time, has incorporated provisions with respect to offer of sale of shares by certain members of company to be effected by the company on their behalf.

It provides that where certain members of a company (whether individuals or body corporate) propose, in consultation with the Board of Directors to offer whole or part of their holding of shares to the public, they shall collectively authorise the company to take all actions in respect of offer of sale for and on their behalf. They shall reimburse the company all expenses incurred by it on this matter.

Section 28, in this regard provides that any document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company and all laws and rules made thereunder as to the contents of the prospectus and as to liability in respect of misstatements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

7.4 SEBI Regulations relating to prospectus

The offer document shall contain all material information which shall be true and adequate so as to enable the investors to make informed decision on the investments in the issue.

The offer document shall also contain the information and statements specified in Part B of Schedule VI of SEBI Regulations, 2018.

(I) Cover Pages: The cover page paper shall be of adequate thickness (minimum hundred GSM quality).

(A) Front Cover Pages:

i. Front inside cover page shall be kept blank.

ii. Front outside cover page shall contain only the following details:

(*a*) Type of letter of offer ("Draft Letter of Offer" or "Letter of Offer").

(*b*) Date of the draft letter of offer/letter of offer.

(*c*) Name of the issuer, its logo, date and place of its incorporation, corporate identity number, telephone number, address of its registered and corporate offices, contact person, website address and e-mail address (where there has been any change in the address of the registered office or the name of the issuer, reference to the page of the offer document where details thereof are given).

(*d*) Nature, number and price of specified securities offered and issue size, as may be applicable.

(*e*) The following clause on "General Risk" shall be incorporated in a box format: "Investment in equity and equity related securities involve a degree of risk and investors should not invest any funds in this offer unless they can afford to take the risk of losing their investment. Investors are advised to read the risk factors carefully before taking an investment decision in this offering. For taking an investment decision, investors must rely on their own examination

of the issuer and the offer including the risks involved. The securities have not been recommended or approved by the Securities and Exchange Board of India (SEBI) nor does SEBI guarantee the accuracy or adequacy of this document. Specific attention of investors is invited to the statement of 'Risk factors' given on page number ….. under the section 'General Risks'."

(*f*) The following clause on 'Issuer's Absolute Responsibility' shall be incorporated in a box format: "The issuer, having made all reasonable inquiries, accepts responsibility for and confirms that this letter of offer contains all information with regard to the issuer and the issue, which is material in the context of the issue, that the information contained in the letter of offer is true and correct in all material aspects and is not misleading in any material respect, that the opinions and intentions expressed herein are honestly held and that there are no other facts, the omission of which make this document as a whole or any of such information or the expression of any such opinions or intentions misleading in any material respect."

(*g*) Names, logos and addresses of all the lead manager(s) with their titles who have signed the due diligence certificate and filed the letter of offer with the Board, along with their telephone numbers, website addresses and e-mail addresses. (Where any of the lead manager(s) is an associate of the issuer, it shall disclose itself as an associate of the issuer and that its role is limited to marketing of the issue.)

(*h*) Name, logo and address of the registrar to the issue, along with its telephone number, website address and e-mail address.

(*i*) Issue schedule: · Date of opening of the issue · Date of closing of the issue · Last date for request for split.

(*j*) Name(s) of the stock exchanges where the specified securities are listed and the details of their in-principle approval for listing obtained from these stock exchange(s).

(II) Back cover pages: The back inside cover page and back outside cover page shall be kept blank.

(III) Table of contents: The table of contents shall appear immediately after the front inside cover page.

7.5 Draft Prospectus to be made public

As per the existing procedure, the draft prospectus filed with SEBI is not a public document. The final prospectus becomes available to the public only 2-3 weeks prior to the opening of the issue. In order to introduce enhanced transparency it has been decided that the draft prospectus filed with SEBI would be made a public

document. The lead Merchant Bankers shall simultaneously file copies of the draft document with the stock exchanges where the issue is proposed to be listed. Lead Merchant Bankers shall also make copies available to the public. Lead Managers/ stock exchanges can charge an appropriate sum to the person requesting such a copy(ies).

7.6 Abridged Form of Prospectus

Section 33 of the Companies Act provides that no form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus:

However, the aforesaid requirement with respect to abridged prospectus will not be relevant if it is shown that the form of application was issued—

(*a*) in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to such securities; or

(*b*) in relation to securities which were not offered to the public.

Further, sub-section (2) obligates a company to furnish a copy of the prospectus if a request is made by any person before the closing of the subscription list and the offer.

If a company makes any default in complying with the provisions of this section, it shall be liable to a penalty of fifty thousand rupees for each default [sub-section (3)].

SEBI regulations with respect to abridged prospectus[2] provide that the Lead Merchant Banker shall ensure that the abridged prospectus shall contain the disclosures as prescribed under section 33 of the Companies Act, 2013 and additional disclosures as specified in **Part E of Schedule VI.**

Part E of Schedule VI requires the abridged prospectus to contain the following general instructions:

(*i*) Information which is of generic nature and not specific to the issuer shall be brought out in the form of a General Information Document (GID) as specified by the Board and which shall be available separately and not be included in the draft offer document or offer document.

(*ii*) Abridged Prospectus shall be printed in a booklet form of A4 size paper.

(*iii*) The Abridged Prospectus shall be printed in a font size which shall not be visually smaller than Times New Roman size 11 (or equivalent).

(*iv*) The application form shall be so positioned that on the tearing-off of the application form, no part of the information given in the abridged prospectus is mutilated.

(2) The abridged letter of offer shall contain the disclosures as specified in Part F of Schedule VI.

2. For contents of abridged prospectus, see Parts E and F of Schedule VI to SEBI Regulations, 2018.

7.7 Is issue of prospectus (including abridged prospectus) compulsory/When prospectus is not required to be issued

Issue of a prospectus by a company is not compulsory in the following cases :

1. A private company is not required to issue a prospectus.
2. Even a public company need not issue a prospectus if the promoters or directors feel that they can mobilise resources through personal relationships and contacts, and, therefore, the shares or debentures are not offered to the public.
3. Where the shares or the debentures are offered to existing holders of shares or debentures by way of right (*i.e.,* rights issue) with or without the right of renunciation in favour of other person [Section 26(2)(*a*)].
4. Where the issue relates to shares or debentures which are, or to be, uniform in all respects with shares or debentures previously issued and dealt in and quoted on a recognised stock exchange [Section 26(2)(*b*)].

7.7A Statutory requirements in relation to a prospectus

7.7A-1 Dating of prospectus

As per section 26, a prospectus issued by or on behalf of a company or in relation to an intended company must be dated. The Section further provides that ***the date on the prospectus shall be deemed to be the date of the publication of the prospectus.***

7.7A-2 Registration of prospectus

Section 26(1) requires the delivery of a copy of the prospectus to the Registrar on or before the date of its publication. The copy of the prospectus so delivered, should be signed by all the persons named therein as director or proposed director or by his duly authorised attorney.

Every prospectus issued under sub-section (1) shall, on the face of it,—

(*a*) state that a copy has been delivered for registration to the Registrar as required under sub-section (4); and

(*b*) specify any documents required by this section to be attached to the copy so delivered or refer to statements included in the prospectus which specify these documents.

The Registrar **shall not register a prospectus** unless the requirements of this section with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus.

The aforesaid requirements apply to existing company or any intended company.

No prospectus shall be issued after ninety days from the date on which a copy of it was delivered to the Registrar.

7.7A-3 When Registrar shall refuse registration of a prospectus

Section 26(7) provides that the Registrar shall not register a prospectus unless the requirements of Section 26 with respect to its registration are complied with and the prospectus is accompanied by the consent in writing of all the persons named in the prospectus. Thus, the Registrar will refuse to register a prospectus if—

(*a*) It is not dated;

(*b*) It does not contain matters, reports and declaration to be set out in it;

(*c*) It contains statements or reports of experts engaged or interested in the formation or promotion or management of the company;

(*d*) It includes a statement purported to be made by an expert without a statement that he has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of a copy of the prospectus to the Registrar for registration ;

(*e*) A copy delivered to the Registrar is not signed by every person who is named therein as a director or proposed director of the company or by his duly authorized attorney;

7.7A-4 Penalty

If a prospectus is issued in contravention of the aforesaid provisions of Section 26, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both [Section 26(9)].

7.8 Prospectus by implication/Deemed prospectus [Sec. 25]

In general, the provisions of the Companies Act relating to prospectus are restricted to cases where the invitation is made by or on behalf of a company for subscription of its shares or debentures. As such it was possible at one time for a company to avoid the statutory provisions relating to prospectus by allotting shares or debentures to the public through the medium of Issue Houses. The shares or debentures will be allotted to these Issue Houses which will in turn invite subscription from the public through their own offer documents. Thus, the company could indirectly raise subscriptions from the members of the public without issuing an offer document or prospectus.

Section 25[3] covers documents issued by the Issue Houses. Accordingly, such an offer document is treated as a prospectus issued by the company. Section 25 has been essentially designed to check the by-passing of the provisions of Section 26 (Section 26 requires certain information to be disclosed and certain reports to be

3. Identical provisions, in this regard, were contained in Section 64 of the Companies Act, 1956

set out in the prospectus) by making an offer of sale of shares or debentures through the medium of Issue Houses.

Section 25(1) provides that where a company allots or agrees to allot any shares or debentures with a view to these being offered for sale to the public, any document by which the offer of sale to the public is made, shall for all purposes be deemed to be a prospectus issued by the company.

Further, sub-section (2) of Section 25 provides that unless the contrary is proved, an allotment of, or an agreement to allot, shares or debentures shall be deemed to have been made with a view to the shares or debentures being offered for sale to the public, if it is shown :

(*a*) that the offer of the shares or debentures for sale to the public was made within six months after the allotment or agreement to allot; or

(*b*) that at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

7.8-1 Additional requirements relating to deemed prospectus

In respect of a document deemed as a prospectus, Section 25(3) requires that it must contain certain information in addition to the information required to be stated in a prospectus under Section 26. Additional information requirements are as under:

(*a*) the net amount of consideration received or to be received by the company in respect of the shares or debentures to which the offer relates; and

(*b*) the place and time at which the contract under which the said shares or debentures have been or are to be allotted may be inspected. Section 26, dealing with registration of prospectus applies to the deemed prospectus in terms of Section 25(3)(ii) and accordingly it renders the persons making the offer of sale to the public as deemed directors of the company.

Where the person making the offer is a company or a firm, the document (i.e., deemed prospectus) must be signed by at least two directors or one-half of the partners, as the case may be [Section 26(4)].

7.9 Shelf Prospectus and Information Memorandum [Section 31]

"Shelf prospectus" means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus - *Explanation* to Section 31.

Sub-section (1) of Section 31 provides that a 'Shelf prospectus' may be issued by any class or classes of companies as the Securities and Exchange Board of India (SEBI) may provide by regulations in this behalf. Raising finance from the public by means of various securities is a time consuming process. Every time any such issue comes, a fresh prospectus is required to be filed. Although it is a repetitive matter, the procedural aspects take a lot of time. In order to minimise the burden on companies, 'shelf prospectus' has been introduced. The validity period of a 'shelf prospectus' cannot exceed one year from the date of opening of the first offering of securities

under that prospectus. For subsequent offerings, information memorandum updating the information under the various heads will have to be filed and entire set comprising of shelf prospectus and the information memorandum shall constitute the prospectus and have to be circulated to the general public. *The provisions of Section 31, in this regard, are as follows:*

(i) A shelf prospectus may be issued by any class or classes of companies as the Securities and Exchange Board of India (SEBI) may provide by regulations in this behalf.

(*ii*) The shelf prospectus shall have a validity period not exceeding one year which shall commence from the date of opening of the first offer of securities under that prospectus.

(*iii*) The validity period not exceeding one year should be indicated in the shelf prospectus.

(*iv*) In respect of second/subsequent offer of securities during the validity period, no further prospectus shall be required.

(*v*) A company filing a shelf prospectus shall be required to file an information memorandum with the Registrar before making of any second or subsequent offer of securities under the shelf prospectus.

(*vi*) The information memorandum shall contain all material facts relating to:

- New charges created.
- Changes in financial position as have occurred between the first offer of securities and the succeeding offer of securities.
- Such other changes as may be prescribed.

(*vii*) Where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of such change, the company or other person shall intimate the changes to such applicants. If the applicants express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within 15 days thereof.

(*viii*) Where an information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall be deemed to be a prospectus.

7.10 Red-herring prospectus [Section 32]

Section 32 of the Companies Act, 2013 contains the following provisions with respect to 'red herring prospectus':

1. A company proposing to make an offer of securities may issue a red herring prospectus prior to the issue of a prospectus.

   "Red herring prospectus" means a prospectus which does not include complete particulars of the quantum or price of the securities included therein.

2. A company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.
3. The red-herring prospectus shall carry same obligation as are applicable in the case of a prospectus.
4. Any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.
5. Upon the closing of the offer of securities, the prospectus stating therein:
   (*a*) the total capital raised, whether by way of debt or share capital,
   (*b*) the closing price of the securities, and
   (*c*) any other details as are not included in the red herring prospectus

shall be filed with the Registrar and the Securities and Exchange Board of India.

7.11 Mis-statements in a prospectus and their consequences

The prospective shareholders are entitled to true and faithful disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not to omit material facts.

7.11-1 What is an untrue statement/mis-statement ?

According to section 34(1) of the Act, a statement included in a prospectus shall be deemed to be untrue:

(*a*) if the statement is misleading in the form or context in which it is included; or

(*b*) where any inclusion or omission from a prospectus of any matter is likely to mislead.

The expression 'included' with reference to a prospectus means included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

Thus, in regard to considering a prospectus as fraudulent, it is not necessary that there should be false representation in it; even if every word included in the prospectus is true, the suppression of material facts may render it fraudulent. To judge its effect, it should be read as a whole. It is not necessarily enough if the prospectus refers to the contracts and puts the intending shareholder upon enquiry as to their contents. Sometimes half a truth is no better than a downright falsehood—*M.K. Sreenivasan, In re* [1944] 14 Comp. Cas. 193 (Mad.)[4]

In this case the prospectus gave an estimate of the profits to be earned by the company from acquisition of interest of the accused in T Ltd. and it did not disclose that under the agreement with T Ltd. the accused had no interest in T Ltd. that could be assigned, and also suppressed the fact that the accused were in arrears in making

4. Also *see Gluckstein* v. *Barnes* [1900] AC 240 (HL).

payment of instalment to T Ltd. and for this default the company could cancel their contract.

The *Madras High Court* held that this was a case of suppression of material facts. The reference to the assignment of the interest in the agreement with T Ltd. was on the face of the prospectus itself a half truth intended to deceive and not better than a downright falsehood. In the light of the circumstances, the failure to disclose that the accused were in arrears with their payment and that the agreement might be cancelled for that reason, was also intended to deceive and amounted to a deliberate suppression of material facts.

Similarly, where on basis of representation of accused that shares of company would be offered for sale to public by certain date, complainant purchased shares of company and an agreement had also been entered into between complainant and accused with regard to same but three days before that date, without knowledge of complainant, accused entered into supplementary agreement where 'date as agreed' stood altered as 'date to be decided by sponsor in his sole discretion', it was held that there was an element of cheating at time of representation and there was sufficient ground for Magistrate to take cognizance of offence as against accused - *Sundaram Finance Service & Ltd.* v. *Grandtrust Finance Ltd.* [2003] 42 SCL 89 (Mad.).

In *Rex* v. *Kylsant* [1932] 1 K.B. 422, all the statements included in the prospectus issued by the company were literally true. One of the statements disclosed the rates of dividends paid for a number of years. But, dividends had been paid not out of trading profits but out of realised capital profits. This material fact was not disclosed. Held, that the prospectus was false in material particulars and Lord Kylsant, the managing director and chairman, who knew that it was false, was held guilty of fraud.

However, mere silence cannot be a sufficient foundation for setting aside the allotment of shares. The withholding of facts should be such that if not stated it makes that which is stated absolutely false - *Peek* v. *Gurney* [1873] LR 6 (HL) 377.

Again, claiming experience of the promoters as the experience of the company was held as not a mis-representation. In *Progressive Aluminium Ltd.* v. *Registrar of Companies* [1997] 26 CLA 277 A.P.

The prospectus stated that the company PCL was a large construction company engaged in the construction activity for two and half decades and, was a profit making and dividend paying company.

The fact of the matter was that the promoters of PCL were the partners of a firm called Progressive Engineering Corporation (PEC) and it was through their experience that the company claimed that it had acquired experience in a particular field.

The Andhra Pradesh High Court held that considering the fact that the partners of PEC, who were the promoters of the petitioner company, did have the necessary experience in the field spread over a period of two and a half decades, the statement made in the prospectus could not be termed as untrue; it was not be smeared with any *mala fide* intention of fraud upon the subscribers. It suffered at the most as wanting in clarification that the experience claimed was that of the persons

manning the partnership firm and not of the firm itself. Omission of such clarification could not be treated as rendering any credibility to the substratum of the statement because it was a matter of ordinary prudence that the experience of a body corporate was always that of the persons manning the body corporate and not of the body corporate itself.

7.11-2 Remedies for mis-statement in a prospectus

A person who has applied for shares in the company, and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus. But a buyer of shares in the open market or a subscriber to the memorandum has no such right[5]. If, however, a prospectus is issued with the object of inducing persons to buy shares in the open market, any person who buys shares even in the open market on the basis of the statement made in it has a right of action if the statements are untrue or there is material omission from the prospectus.

The principles to be applied in such cases were laid down in *Gurney's* case (*supra*) as follows :

(*i*) Every man must be held responsible for the consequences of a false representation made by him to another, upon which that other acts, and, so acting, is injured or damnified;

(*ii*) Every man must be held responsible for the consequences of a false representation made by him to another, upon which a third person acts, and so acting, is injured or damnified, provided it appears that such false representation was made with the intent that it should be acted upon by such third person in the manner that occasions injury or loss;

(*iii*) The injury must be immediate and not the remote consequence of the representation thus made.

If there is any misrepresentation of a material fact in a prospectus, there may arise (i) civil liability, and (ii) criminal liability.

7.11-3 Civil Liability

Section 35(1) provides that where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

(*a*) is a director of the company at the time of the issue of the prospectus;

(*b*) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

(*c*) is a promoter of the company;

(*d*) has authorised the issue of the prospectus; and

(*e*) is an expert referred to in sub-section (5) of section 26,

shall, besides punishment under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

5. *Peek* v. *Gurney* (*supra*).

In *Ritika Awasty* v. *Hassad Netherlands BV*[6], appellant was promoter of company and was party to share purchase agreement by which shares of company were fraudulently sold to respondent, the Delhi High Court held that the award passed by Arbitral Tribunal fastening liability upon appellant and her husband to pay damages to respondent was justified.

You should note that Section 36 provides for punishment for fraudulently inducing persons to invest money. We shall discuss the provisions of Section 36 a little later.

7.11-3a DEFENCES AVAILABLE TO AVOID CIVIL LIABILITY - No person shall be liable under Section 35(1), if he proves—

(a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, or

(b) that it was issued without his authority or consent; or

(c) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

(*d*) that, as regards every misleading statement purported to be made by an expert or contained in what purports to be a copy of or an extract from a report or valuation of an expert, it was a correct and fair representation of the statement, or a correct copy of, or a correct and fair extract from, the report or valuation; and he had reasonable ground to believe and did up to the time of the issue of the prospectus believe, that the person making the statement was competent to make it and that the said person had given the consent required by sub-section (5) of section 26 to the issue of the prospectus and had not withdrawn that consent before delivery of a copy of the prospectus for registration or, to the defendant's knowledge, before allotment thereunder.

However, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in sub-section (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus [Section 35(3)].

7.11-4 Criminal Liability

According to Section 34, read along with section 447, where a prospectus, issued, circulated or distributed includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus involving an amount of at least 10 lac rupees or 1% of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than six months (3 years where fraud involves public interest) but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in the fraud.

6. [2016] 73 taxmann.com 204 (Delhi)

However, where the amount involved in the fraud is less than Rs. 10 lac or 1% of the turnover of the company, whichever is lower and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment up to 5 years or fine up to Rs. 20 lac or both.

7.11-4a DEFENCES AVAILABLE TO AVOID CRIMINAL LIABILITY - The aforesaid criminal liability will not be attracted if the person proves that : (*i*) such statement or omission was immaterial; or (*ii*) he had reasonable grounds to believe, and did up to the time of issue of the prospectus believe, that the statement was true; or (*iii*) the inclusion or omission was necessary.

7.11-5 Liability under Section 36, i.e., Punishment for fraudulently inducing persons to invest money

Section 36 provides that any person who,

(*i*) either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or

(*ii*) deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into specified agreements ,

shall be punishable 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.

Agreements covered under Section 36 include:

(*a*) any agreement for, or with a view to, acquiring, disposing of, subscribing for, or underwriting securities; or

(*b*) any agreement, the purpose or the pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities; or

(*c*) any agreement for, or with a view to obtaining credit facilities from any bank or financial institution.

7.11-6 Class Action Suit/Action by Affected Persons (Section 37)

A suit may be filed or any other action may be taken under section 34 or section 35 or section 36 by any person, group of persons or any association of persons affected by any misleading statement or the inclusion or omission of any matter in the prospectus.

Thus, Section 37, not only provides for individual action but also for class action.

7.12 Golden Rule for framing of Prospectus

The 'Golden Rule' for framing of a prospectus was laid down by Justice Kindersley in *New Brunswick & Canada Rly. & Land Co.* v. *Muggeridge* (1860). Briefly, the rule is :

Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is

invited to take shares on the faith of the representations contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so, and no fact should be omitted the existence of which might in any degree affect the nature or quality of the principles and advantages which the prospectus holds out as inducement to take shares. In a word, the true nature of the company's venture should be disclosed.

In *Rex* v. *Kylsant* (1932), the prospectus stated that dividends of 5 to 8 per cent had been regularly paid over a long period. The truth was that the company had been incurring substantial losses during the seven years preceding the date of the prospectus and dividends had been paid out of the realised capital profits. *Held,* the prospectus was false and misleading. The statement though true in itself was rendered false in the context in which it was stated.

A half truth, for instance, represented as a whole truth may tantamount to a false statement [Lord Halsbury in *Aarons Reefs* v. *Twisa*].

Thus, the persons issuing the prospectus must not only include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge which might in any way affect the decision of the prospective investor to invest in the company.

7.13 Allotment of shares in fictitious names prohibited [Section 38]

Section 38 provides that any person who—

(*a*) makes or abets making of an application in a fictitious name to a company for acquiring, or subscribing for, its securities; or

(*b*) makes or abets making of multiple applications to a company in different names or in different combinations of his name or surname for acquiring or subscribing for its securities; or

(*c*) otherwise induces directly or indirectly a company to allot, or register any transfer of, securities to him, or to any other person in a fictitious name,

shall be punishable 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.

The aforesaid penal provisions must be prominently reproduced in every prospectus issued by a company and in every form of application for securities.

Further, where a person has been convicted under this section, the Court may also order disgorgement of gain, if any, made by, and seizure and disposal of the securities in possession of, such person [Sub-section (3)].

The amount received through disgorgement or disposal of securities shall be credited to the Investor Education and Protection Fund.

7.14 Announcement regarding proposed issue of capital

It is very common for companies to get an announcement regarding proposed issue of shares/debentures inserted in the leading newspapers. It is not required by company law to do so. But it is done in order to invite the attention of the public to the proposed issue. On the top of the insertion it is given that, "It is only an announcement and not a prospectus", in order to avoid penal provisions under Sections 34 and 35 for publishing an incomplete prospectus.

Section 30, in this regard, provides that where an advertisement of any prospectus of a company is published in any manner, it shall be necessary to specify therein:

(*i*) the objects as stated in the Memorandum;

(*ii*) the liability of members;

(*iii*) the amount of authorized share capital of the company;

(*iv*) the names of the signatories to the memorandum and the number of shares subscribed for by them; and

(*v*) the capital structure of the company.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER) IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. A company issued a prospectus containing material mis-statements of fact. Relying on the prospectus Mr. Gullible purchased shares from the market. Would the company be liable in damages to him ? Can he rescind the contract ?
2. What is prospectus ? Who are liable for mis-statements in a prospectus ? Explain the remedies available to a shareholder against the company, who has been so induced.
3. Write short note on : 'Statement in lieu of prospectus'.
4. Mention cases in which a prospectus is not required to be issued by a public company.
5. What is an 'Abridged Prospectus'? Under what circumstances such abridged prospectus is not required to be accompanied with the share application form?
6. Explain the defences available to a Director, who is held liable for issue of a Prospectus containing an untrue statement, in a suit filed against him by an aggrieved party.
7. Explain the provisions of the Companies Act, 2013 with regard to the registration of a prospectus of a public company going for public issue of equity share. What are the documents required to be submitted by the company to the Registrar of Companies for the above purpose?
8. In what way does the Companies Act, 2013 regulate the furnishing of an 'Abridged form of prospectus' by a company, along with the share application form ? When may a Registrar refuse to register a prospectus?
9. When and by whom can the allotment of shares be rescinded on the ground of a false and misleading prospectus under the Companies Act, 2013 ?
10. When is a company not required to issue prospectus in connection with issue of shares or debentures? When can the invitation for offer to subscribe for shares be treated as not having been made to the public?

OR

Write a note on : Private Placement.

11. Who is an expert? Ascertain the liability of an expert for untrue statements given by him in the prospectus of a company.

12. (*a*) What is a prospectus ? Briefly state the contents of a prospectus.

(*b*) State the cases in which a prospectus containing details required under section 26 is not necessary.

13. (*a*) What is an untrue statement in a prospectus?

(*b*) How to prove a mis-statement in a prospectus?

(*c*) Amar subscribed shares issued by Fasttrak Ltd. The prospectus of Fasttrak Ltd. included a statement which was misleading in the form and content. On the faith of the prospectus believing it to be a true; Amar subscribed for shares and sustained loss. Can Amar sue for compensation of loss? If so, who will be sued for such loss?

14. What do you understand by the term 'Golden Rule' ?

15. Define and elucidate 'Shelf Prospectus', and 'Red herring Prospectus'.

PRACTICAL PROBLEMS

1. X Co. Ltd., intended to buy a rubber estate in Peru. Its prospectus contained extracts from an expert's report giving the number of rubber trees in the estate. The report was inaccurate. Will any shareholder buying the shares of the company on the basis of the above representation have any remedy against the company ? Can the persons authorising the issue of the prospectus escape from their liability ?

OR

2. A prospectus issued by a company contained a promise of subscription of a substantial amount by some persons so as to induce the public to subscribe. The plaintiff who was allotted 10 shares alleged material misrepresentation. Decide ?

Hints : Section 35(1) provides that where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

(*a*) is a director of the company at the time of the issue of the prospectus;

(*b*) has authorised himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

(*c*) is a promoter of the company;

(*d*) has authorised the issue of the prospectus; and

(*e*) is an expert referred to in sub-section (5) of section 26,

shall, besides punishment under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

A person shall, however, be not liable, if he proves—

(a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, or

(b) that it was issued without his authority or consent; or

(c) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

However, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any

fraudulent purpose, every person referred to in sub-section (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus [Section 35(3)].

3. All statements in a prospectus issued by X & Co. Ltd. were literally true, but it failed to disclose that the dividends stated in it as paid were not paid out of trading profits, but out of realised capital profits. The statement that the company had paid dividends for a number of years was true. But the company had incurred losses for all those years, however, no disclosure of this was made in the prospectus. An allottee of shares wanted to avoid the contract on the ground that the prospectus did not disclose this fact which, in his opinion, was very material. Would he succeed ?

Hints : Yes, concealment of a material fact is fraudulent. The prospectus accordingly can be described as containing a mis-statement as to material fact. *The problem is based on the facts of Rex* v. *Kylsant* [*see* para 7.10]

4. An allottee of shares in the company has brought an action against Director Q in the company in respect of false statements in the prospectus. The director has contended that the statements were prepared by promoters and he had relied on them. Is the director liable under the circumstances ?

Hints : Yes, director shall be held liable. A director can escape liability for mis-statements in a prospectus only on grounds specified under section 35(2). Relying on statements prepared by promoters is not a ground included thereunder. Accordingly, no defence shall be available to the director.

5. A company issued a prospectus advertising that the company has a great "potential turnover" of a million bags of cement in a year. It is discovered later that while the company did have the installed capacity of one million bags, it had never produced more than six lakh bags of cement in a year. Buyers of the shares seek remedy against the misleading statement to rescind the contract. Will they succeed? Explain with reasons.

[**Hints** : Not a misstatement. It's only an expression of opinion.]

6. 'A' purchased from 'B' 1000 shares of a company on the basis of prospectus containing wrong statement. What remedies are available to 'A' against the company?

Hints : A shall have no remedy against the company; there being no privity of contract between 'A' and 'the company'.

7. Directors of a company issued letter of offer inviting shareholders to subscribe to a rights issue. One of the shareholders subscribed 200 shares offered to him by the company and, immediately thereafter, also purchased 300 shares through the stock market. Subsequently, he sued the company alleging that the statements in the letter of offer were misleading and claimed damages for the entire 500 shares recently subscribed and purchased by him. Will he succeed? Support your answer with case law.

Hints : In the instant case letter of offer was prepared for inviting shareholders to subscribe to rights issue. Thus the issue was communicated to a particular class of persons. There was no sufficient proximity for a duty to be owed to those who bought shares through stock market. Therefore, in the given case the shareholder cannot have a claim for damages in respect of 300 shares purchased from the stock market. He can claim damages only for 200 shares.

8 Acceptance of Public Deposits

8.1 Meaning of deposits

Section 2(31) of the Companies Act, 2013 defines the term 'deposit' as follows :

"Deposit" includes any receipt of money by way of deposit or loan or in any other form by a company. However, as per the Companies (Acceptance of Deposits) Rules, 2014*, "Deposit" does not include—

(*i*) any amount received from the Central Government or a State Government, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government;

(*ii*) any amount received from the notified foreign Governments and foreign/ international banks and multilateral financial institutions;

(*iii*) any amount received as a loan or facility from any banking company or from a banking institution notified by the Central Government or from a co-operative bank;

(*iv*) any amount received as a loan or financial assistance from the notified Public Financial Institutions, regional financial institutions, Insurance Companies, Scheduled Banks;

(*v*) any amount received against issue of commercial paper or any other instrument issued in accordance with the guidelines or notification issued by the Reserve Bank of India;

(*vi*) any amount received by a company from any other company;

(*vii*) any share application money or advance towards allotment of securities pending allotment;

However, if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15

*As amended upto 30th June, 2017.

days from the date of completion of sixty days, such amount shall be treated as a deposit under these rules.

Vide the Companies (Acceptance of Deposits) Amendment Rules, 2015 dated 31 March, 2015, it has been provided that unless otherwise required under the Companies Act, 1956 or the Securities and Exchange Board of India Act, 1992 or rules or regulations made thereunder to allot any share, stock, bond, or debenture within a specified period, if a company receives any amount by way of subscriptions to any shares, stock, bonds or debentures before 1 April, 2014 and disclosed in the balance sheet for the financial year ending on or before 31 March, 2014 against which the allotment is pending on 31 March, 2015, the company shall, by 1 June, 2015, either return such amounts to the persons from whom these were received or allot shares, stock, bonds or debentures or comply with these rules.

(*viii*) any amount received from a person who, at the time of the receipt of the amount, was a director of the company or a relative of the director of the Private company.

The money so deposited should not have been acquired by him by borrowing or accepting loans or deposits from others. The director is required to make a declaration in this regard and the company shall disclose the details of money so accepted in the Board's report;

(*ix*) any amount raised by the issue of secured bonds or debentures compulsorily convertible into shares of the company within 10 years provided that the amount of such bonds or debentures does not exceed the market value of such assets as assessed by a registered valuer;

(*ixa*) any amount raised by issue of non-convertible debenture not constituting a charge on the assets of the company and listed on a recognized stock exchange;

(*x*) any amount received from an employee not exceeding his annual salary, under a contract of employment with the company in the nature of non-interest bearing security deposit;

(*xi*) any non-interest bearing amount received and held in trust;

(*xii*) any amount received in the course of or for the purposes of the business of the company :

(*a*) as an advance for the supply of goods or provision of services provided that such advance is appropriated against supply of goods or provision of services within a period of 365 days from acceptance of such advance;

(*b*) as advance received under an agreement for sale of immovable property provided that such advance is adjusted against such property in accordance with the terms of agreement or arrangement;

(*c*) as security deposit for the performance of the contract for supply of goods or provision of services;

(*d*) as advance received under long term projects or for supply of capital goods;

(*e*) as an advance towards consideration for providing future services in the form of warranty or maintenance contract as per written contract or arrangement, if the period for providing such services does not exceed the prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less;

(*f*) as an advance received and as allowed by any sectoral regulator or in accordance with directions of Central or State Government;

(*g*) as an advance for subscription towards publication, whether in print or in electronic to be adjusted against receipt of such publications.

However, if the amount received under items (*a*), (*b*) and (*d*) above becomes refundable (with or without interest) due to the reasons that the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be deposit on expiry of 15 days from the date it became due for refund.

(*xiii*) any amount brought in by the promoters of the company by way of unsecured loan in pursuance of the stipulation of any lending financial institution or a bank subject to fulfilment of certain conditions.

(*xiv*) any amount accepted by a Nidhi company in accordance with the prescribed rules;

(*xv*) any amount received by way of subscription in respect of a chit under the Chit Fund Act, 1982;

(*xvi*) any amount received by the company under collective investment scheme in compliance with the SEBI regulations;

(*xvii*) any amount of Rs. 25 lakh or more received by a start up company (i.e. a private company incorporated under the Companies Act) by way of a note convertible into equity shares or repayable within a period of five years from the date of issue, in a single tranche, from a person;

(*xviii*) any amount received by a company from Alternate Investment Funds, Domestic Venture Capital Funds, Mutual Funds registered with SEBI, Infrastructure Investment Trusts and Real Estate Investment Trusts.

Deposit and loan : As per section 2(31) of the Companies Act, 2013 as well as the Companies (Acceptance of Deposits) Rules, 2014, referred to above, the expression 'deposit' includes 'loan' *i.e.*, any amount borrowed by a company. However, there had been a number of judicial decisions in the past bringing out distinction between a loan and a deposit. In *Abdul Hamid Sahib* v. *Rahmat Bi* (1965), it was observed that in a sense, deposit is also a loan with the difference that a loan is repayable the minute it is incurred. In the case of deposits, repayment will depend on the maturity date fixed therein or the terms of agreement relating to the demand on the making of which the deposit becomes payable. In other words, unlike a loan which may become repayable instantly or on notice, there is no immediate obligation to repay in the case of deposits. It is repayable only on the basis provided in the Companies (Acceptance of Deposits) Rules, 2014.

In another case, the Supreme Court observed that the terms 'deposit' and 'loan' are not synonymous and whether a transaction is a deposit or a loan does not merely depend on the terms of documents, but has to be judged from the intention of the

parties - *Annamalai* v. *Veerappa* (1956). Even the Limitation Act, 1963 provides for different periods of limitation for loan and deposit. In the case of a loan the period of limitation commences from the date when the loan is made, whereas in the case of deposits, it commences from the date when the demand is made.

Deposit and Debenture : According to section 2(30) of the Companies Act, 2013, debenture includes debenture stock, bonds and any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. A debenture is thus a document which either creates or acknowledges a debt. A debenture may be secured or unsecured. **Where the debenture is unsecured, it will squarely fall within the definition of deposit.** It is only the debentures which satisfy the conditions stipulated in Rule 2(1)(*c*)(*ix*) of the Companies (Acceptance of Deposits) Rules, 2014 (discussed earlier), which are excluded from the definition of deposits.

8.2 Acceptance of deposits

Section 73 and Companies (Acceptance of Deposits) Rules, 2014 made thereunder contain the restrictions and limitations subject to which deposits may be invited or accepted by companies. The discussion on acceptance of deposits is being divided into :

(*i*) Acceptance of deposits from members

(*ii*) Acceptance of deposits from public

8.2-1 Acceptance of Deposits from Members :

1. As per section 73(2) read along with the Companies (Acceptance of Deposit) Second Amendment Rules, 2017, a company (public as well as private) may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, **accept deposits from its members** on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely*:—

(*a*) issuance of a circular to its members including therein a statement showing: *(i)* the financial position of the company, *(ii)* the credit rating obtained, *(iii)* the total number of depositors, *(iv)* the amount due towards deposits in respect of any previous deposits accepted by the company, and *(v)* such other particulars in such form and in such manner as may be prescribed;

(*b*) filing a copy of the circular along with such statement with the Registrar within thirty days before the date of issue of the circular;

(*c*) depositing, on or before the thirtieth day of April each year, such sum which shall not be less than twenty per cent of the amount of its deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called 'Deposit Repayment Reserve Account'.

*These conditions shall not apply to a private company which accepts from its members monies not exceeding 100% of aggregate of the paid up share capital and free reserves – *Vide MCA Notification dated 5-6-2015*

(*d*) certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where a default had occurred, the company made good the default and a period of five years had lapsed since the date of making good the default; and

(*e*) providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company :

Where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as "unsecured deposits" and shall be so quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

2. No company shall accept or renew any deposit from its members, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits **exceeds thirty five per cent** of the aggregate of the paid-up share capital and free reserves of the company.

However, a specified IFSC public company* and a private company may accept from its members monies not exceeding one hundred per cent of aggregate of the paid up share capital, free reserves and securities premium account and such company shall file the details of monies so accepted to the Registrar in the prescribed manner.

Again, the maximum limit in respect of deposits to be accepted from members shall not apply to following classes of private companies, namely:—

(*i*) a private company which is a start-up, for five years from the date of its incorporation;

(*ii*) a private company which fulfils all of the following conditions, namely:—

(*a*) which is not an associate or a subsidiary company of any other company;

(*b*) the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is less; and

(*c*) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under section 73.

All the companies accepting deposits shall file the details of monies so accepted to the Registrar in Form DPT-3.

3. Every deposit accepted by a company from its members shall be repaid with interest in accordance with the terms and conditions of the agreement.

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*For the purpose of this rule, a Specified IFSC Public company means an unlisted public company which is licensed to operate by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 (28 of 2005) read with the Special Economic Zones Rules, 2006.

4. Where a company fails to repay the deposit or part thereof or any interest thereon, the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.

5. The 'deposit repayment reserve account' referred to above shall not be used by the company for any purpose other than repayment of deposits.

Proposed Exemption to small Private companies: Section 73(2) shall not apply to private companies having 50 or less number of members if they accept monies from their members not exceeding 25% of aggregate of the paid up capital and free reserves or 100% of the paid up capital, whichever is more, and which inform the details of such monies to the Registrar in the prescribed manner – *Vide Draft Notification F. No. 1/1/2014-CL.V, dated 24-6-2014*

Amounts received by private companies from their members, directors or their relatives before 1st April, 2014 – Clarification regarding applicability of Companies (Acceptance of Deposits) Rules 2014

Ministry of Corporate Affairs *vide* its clarification dated 30th March clarified that such amounts received by private companies prior to 1st April, 2014 shall not be treated as 'deposits' under the Companies Act, 2013 and Companies (Acceptance of Deposits) Rules, 2014 subject to the condition that relevant private company shall disclose, in the notes to its financial statement for the financial year commencing on or after 1st April, 2014 the figure of such amounts and the accounting head in which such amounts have been shown in the financial statement.

Any renewal or acceptance of fresh deposits on or after 1st April, 2014 shall, however, be in accordance with the provisions of Companies Act, 2013 and rules made thereunder.

8.2-2 Acceptance of Deposits from Public

As per section 73(1) on and after the commencement of the Companies Act, 2013, no company, other than a banking company and non-banking financial company shall invite, accept or renew deposits under this Act **from the public** except in a manner provided under this Act.

Section 76 read along with the Companies (Acceptance of Deposits) Rules, 2014 as amended by the Companies (Acceptance of Deposits) Amendment Rules, 2019 allows a public company, having a net worth of not less than one hundred crore rupees or a turnover of not less than five hundred crore rupees, to accept deposits from persons other than its members. Such a company is called an "eligible company". An "eligible company" may accept deposits from the public subject to the following requirements :

1. **Special Resolution:** Pass a special resolution in the general meeting of the company.
2. **File** the said special resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits.
3. **Obtain the rating** (including its networth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing

the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety. The rating shall be obtained for every year during the tenure of deposits and a copy of the rating shall be sent to the Registrar of Companies along with the return of deposits in Form DPT-3.

The credit rating shall not be below the minimum investment grade rating or other specified credit rating for fixed deposits, from any one of the approved credit rating agencies as specified for Non-Banking Financial Companies in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, issued by the Reserve Bank of India.

4. **Creation of a charge on its assets: Within thirty days** of acceptance of deposits, the company shall create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders.
5. **Deposits to be not less than six months or more than thirty six months:** The company shall not accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice within a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposit.
6. **Deposits less than six months:** A company may, **for the purpose of meeting** any of its **short-term requirements** of funds, **accept or renew such deposits for repayment earlier than six months** from the date of deposit or renewal, as the case may be, subject to the condition that—
   (*a*) such deposits shall not exceed ten per cent of the aggregate of the paid up share capital and free reserves of the company, and
   (*b*) such deposits are repayable not earlier than three months from the date of such deposits or renewal thereof.
7. **Deposits in joint names:** Deposits may be accepted in joint names **not exceeding three**, with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor".
8. **Ceiling on Deposits: No eligible company** shall accept or renew—
   (*a*) any **deposit from its members**, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members **exceeds ten per cent** of the aggregate of the paid-up share capital and free reserves of the company;
   (*b*) **any other deposit**, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred to in clause (a), outstanding on the date of acceptance or renewal **exceeds twenty-five per cent** of aggregate of the paid-up share capital and free reserves of the company.

   An **eligible Government Company** may, however, accept deposits **up to thirty five per cent** of the aggregate of its paid up share capital and free reserves of the company.
9. **Interest or brokerage on deposits** must not exceed the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for accep-

tance of deposits by non-banking financial companies. Further, no brokerage can be paid except to a person who is authorised, in writing, by a company to solicit deposits on its behalf.

10. **Issue of circular/advertisement:** For inviting deposits, the company must issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper and in vernacular language in one vernacular newspaper having wide circulation in the State in which the registered office of the company is situated. It must also upload a copy of the circular on its website, if any.
11. **Filing of copy of the circular/advertisement:** At least thirty days before the date of such issue, there must have been delivered to the Registrar for registration a copy of the aforesaid circular/advertisement signed by a majority of the directors or their agents, duly authorized by them in writing.
12. **The circular/advertisement issued shall be valid until the expiry of six months** from the date of closure of the financial year in which it is issued or until the date on which the financial statement is laid before the company in annual general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.
13. **Deposit Insurance:** Every company inviting deposits shall enter into a contract for providing deposit insurance at least thirty days before the issue of circular or advertisement or at least thirty days before the date of renewal, as the case may be.
14. **Appointment of Trustees:** The company must appoint one or more trustees for depositors for creating security for the deposits and execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.
15. **Nomination:** A depositor may, at any time, nominate any person to whom his deposits shall vest in the event of his death.
16. **Receipt of the deposit** must be given to the depositor or his agent within a period of twenty one days from the date of receipt of money or realisation of cheque or date of renewal.
17. **Register of Deposits:** Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed, in which there shall be entered separately in the case of each depositor the prescribed particulars.
18. **Repayment of premature deposits:** No interest to be paid for repayment before a period of six months from the date of such deposit. In other cases, the rate of interest payable on such deposit shall be reduced by one per cent from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run.
19. **Return of deposits to be filed with the Registrar:** Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, return of deposit or particulars of transaction not considered as deposit or both by every company other than Government

company in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company.

20. **Return of outstanding receipt of money or loan by a company but not considered as deposits**[1]: Every company other than Government company shall file a one time return of outstanding receipt of money or loan by a company but not considered as deposits, in terms of clause (c) of sub-rule (1) of rule 2 from the 1st April, 2014 to the date of publication of this notification in the Official Gazette, as specified in Form DPT-3 within ninety days from the date of said publication of this notification along with fee as provided in the Companies (Registration Offices and Fees) Rules, 2014.

21. **Disclosures in the financial statement**[2]**:**

(1) Every company, other than a private company, shall disclose in its financial statement, by way of notes, about the money received from the director.

(2) Every private company shall disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors.

22. **Penal rate of interest:** Every company shall pay a penal rate of interest of eighteen per cent, per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

23. **Default in repayment of Deposits:** As per section 76A added by the Companies (Amendment) Act, 2015 (w.e.f. 29-5-2015) :

Where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest due thereon within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under section 73,—

(*a*) the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees or twice the amount of deposit accepted by the company, whichever is lower; and

(*b*) every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years and with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees*.

Further, if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.

Supreme Court ordered release of Sahara contemnor directors including Mr. Subrata Rao, the managing director subject to furnishing Bank Guarantee. Conditions imposed include full payment of Rs. 36,000 crores in 9 instalments and surrender on

1. Rule 16A, inserted *vide* the Companies (Acceptance of Deposits) Amendment Rules, 2019.

2. w.e.f. 29-6-2016.

*As per Companies (Amendment) Act, 2017.

failure to deposit any three instalments and liability to re-arrest on failure to surrender. The Apex Court also ordered deposit of passports in court by these contemnor directors.

24. **Credit rating for deposits:** Every eligible company shall obtain, at least once in a year, credit rating for deposits accepted by it in the specified manner and a copy of the rating shall be sent to the Registrar of Companies along with the return of deposits in Form DPT-3 - Vide *Companies (Acceptance of Deposits) Amendment Rules, 2015 dated 31.3.2015.*

8.2-3 Rescheduling repayment of Deposits - Whether allowed

Company Law Board (now Tribunal), in the case of *Unitech Ltd., In re* [2015] 131 SCL 162 has held that where a company failed to repay matured FDs despite making profits and it wanted to reschedule repayment thereof, it was to be directed to repay deposits as rescheduling of deposits was not allowed under new Companies Act, 2013.

Again in *Unitech Ltd., In re* [2016] 71 taxmann.com 156 (NCLT-New Delhi), on Unitech Ltd. failing to pay deposits of Rs. 550 crores, NCLT, New Delhi Bench passed an order against the petitioner company on 11-3-2016 for repayment of Rs. 30 crores on or before 30-6-2016 to pay Rs. 10 crores each on 30-4-2016, 31-5-2016 and remaining Rs. 10 crores on 30-6-2016, but no payment was made in spite of the MD of the company having filed an affidavit to that effect.

NCLT observed that when this petitioner company could not repay Rs. 30 crores of money in the time given by it, as asked by the company on 11-3-2016, it could not be possible for the company to clear Rs. 550 crores dues payable to the depositors even if further time is extended. Accordingly, dismissing the petition seeking further time for repayment, NCLT suggested RoC concerned to take appropriate action against the company u/s. 74(3) of the Companies Act, 2013.

However, where petitioner-company accepting deposits never defaulted in fulfilling its obligations in past to repay matured deposits on time but in instant case failed to pay in time due to acute financial crises, petitioner was to be given benefit of repayment in phased manner - *Ansal Housing & Construction Ltd., In re* [2016] 75 taxmann.com 260 (NCLT - New Delhi).

But, where petitioner-company failed to adhere to scheme of payment framed by NCLT to depositors, no further extension of time was to be granted for payment and on failure company was to be prosecuted as per section 74 - *SRS Ltd., In re* [2018] 90 taxmann.com 129 (NCLT - Chd.)

Again, in *Ind-Swift Ltd., In re* [2018] 89 taxmann.com 149 (NCLT - Chd.), when applicant company started facing liquidity problems, it failed to repay deposits taken from public and proposed a scheme of repayment which was sanctioned by Company Law Board. But, ROC was regularly receiving complaints against company for irregularities in repayment of fixed deposits. On another request for extension of time, it was held that once at time of sanction of scheme, company had brought its financial position before CLB/now NCLT notice and got relief of huge extension of time from original period of maturity and even it was getting relief of reduced interest, there was no reason to accept plea for further extension.

8.2-4 Deposits accepted before commencement of the Companies Act, 2013

Sections 74 and 75 contain provisions with respect to deposits accepted before commencement of the Companies Act, 2013. A brief summary of these provisions is as follows :

1. Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall—
   (*a*) file, within a period of three months from the commencement of the Act or from the date on which such payments, are due, with the Registrar :
      (*i*) a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon;
      (*ii*) the arrangements made for such repayment; and
      (*iii*) repay within three years from such commencement or on or before expiry of the period for which the deposits were accepted, whichever is earlier. However, renewal of any such deposits shall be done in accordance with the provisions of the Companies Act, 2013 with respect to acceptance of deposits and the rules made thereunder[3].
2. The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit including the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.
3. If a company fails to repay the deposit or part thereof or any interest thereon within the time, as aforesaid, or such further time as may be allowed by the Tribunal, the company shall, in addition to the payment of the amount of unpaid deposit and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.
4. Further, if it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, besides the penalty provided under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.

Test your knowledge

1. In what way does the Companies Act, 2013 regulate the acceptance of public deposits by the public companies? Explain. [**Hints:** *Refer Para 8.2.2*]

3. *Vide* Companies (Amendment) Act, 2017.

2. Explain the provisions of the Companies Act regarding acceptance of deposits by companies. [**Hints:** *Refer Para 8.2*]

3. State the restrictions and limitations on inviting and accepting deposits by the companies. [**Hints:** *Refer Para 8.2*]

4. Write briefly the formalities to be observed by a company for accepting deposits from its own members. State the ceiling with respect to such deposits [**Hints:** *Refer Para 8.2.1*]

5. Comment on the following:

'A company cannot accept public deposits as much as it wants'. [**Hints:** *Refer Para 8.2*]

6. (*a*) Explain the term 'deposit'. [**Hints:** *Refer Para 8.1*]

9 Share and Share Capital

9.1 Meaning and nature of a share

9.1-1 Meaning

The capital of a company is divided into a number of indivisible units of a fixed amount. These units are known as 'shares'. According to section 2(84) of the Companies Act, 2013, a share is a share in the share capital of a company, and includes stock. The Supreme Court of India in *CIT* v. *Standard Vacuum Oil Co.* [1966] Comp. LJ 187 observed "By a share in a company is meant not any sum of money but an interest measured by a sum of money and made up of diverse rights conferred on its holders by the articles of the Company which constitute a contract between him and the Company".

In another case Supreme Court defined a share as "a right to participate in the profits made by a company, while it is a going concern and declares a dividend, and in the assets of the company when it is wound up [*Bucha F. Guzdar* v. *Commissioner of Income-tax, Bombay* LR 617 (SC)].

In short, a 'share' does not merely represent an interest of a shareholder in a company, it carries with it certain rights and liabilities while the company is a going concern or while the company is being wound up. It thus represents a 'bundle of rights and obligations'.

[1]9.1-2 Nature of a share

A 'share' is not a sum of money but is the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual 'covenants' entered by all the shareholders *inter se [Borland's Trustees* v. *Steel Bros. & Co. Ltd.* [1901] 1 Ch. 279 (Ch.D.)]

1. Vishwanath v. East India Distilleries [1957] 27 Comp. Cas. 175.

A share is a chose-in-action. A chose-in-action implies the existence of some person entitled to the rights, which are rights in action as distinct from rights in possession, and until the share is issued no such person exists.[2]

In India, a share is regarded as 'goods'. Section 2(7) of the Sale of Goods Act, 1930 defines 'goods' to mean any kind of movable property other than actionable claims and money and includes stock and shares. However, section 44 of the Companies Act, while recognising shares as movable property, suggests that they shall be transferable only in the manner provided by the articles of the company.

In *Vishwanathan* v. *East India Distilleries* [1957] 27 Comp. Cas. 175, it was observed :

"A share is undoubtedly movable property but it is not movable property in the same way in which a bale of cloth or a bag of wheat is movable property. Such commodities are not brought into existence by legislation, but a share in a company belongs to a totally different category or property. It is incorporeal in nature, and it consists merely of a bundle of rights and obligations."

A share is not a negotiable instrument

A share is an expression of proprietary relationship between a shareholder and the company [*CIT* v. *Associated Industrial Development Co.* [1969] 2 Comp. LJ 19].

Certain interesting and comprehensive observations were made regarding nature of a share in *Shree Gopal Paper Mills Ltd.* v. *CIT* [1967] 37 Comp. Cas. 240 (Cal.). The learned Judge observed :

The statutory meaning of share covers the three phases of the share, share when it is a part of the share capital still remaining unexploited by the company; share when it is exploited by the company finding a shareholder and *lastly,* when the share is converted into stock. The first phase arises because under the company law every company limited by shares has nominal or authorised or registered share capital. This capital is one of the essential features in the company's constitution. It is to be mentioned in the memorandum of association and the capital so mentioned is to be divided into shares of a fixed amount. The capital is usually fixed at some round figures according to the requirements of the company assessed by the promoters of the company. Therefore, it seems that the first part of the definition of the word 'share' refers to the share in this limited sense when the share is still in the womb of the company or in the shell of the company and has no shareholder. The second phase arises when it attracts section 44. Therefore, the share when it becomes associated with a member becomes a movable property. It is, however, not a movable property whose transfer is solely regulated by the Sale of Goods Act. Its transfer is also governed by the Companies Act and/or Articles of the Company. Each share again bears a distinguishing number. *It may be noticed that certificate of shares is not the shares or a share.* Under section 46 a certificate, under the common seal of the company, specifying any share or stock held by any member, shall be a *prima facie* evidence of the title of the member to the shares or stock therein specified. Hence, a share certificate is not the share; it is only a *prima facie* evidence of the title to the share. Therefore, it is necessary to consider what the character of a share is? Section 44 says it is a movable property. It is, however, not

2. *See Sri Gopal Jalan & Co.* v. *Calcutta Stock Exchange Association Ltd.* [1963] 33 Comp. Cas. 862 (SC).

a tangible property for it is not the share certificate; it only consists of a bundle of rights and obligations. A share can be either in the first phase or stage or in the second phase or stage. It remains either in its shell as a part of the capital or resides in a shareholder. It cannot be suspended in any intermediate phase or stage.

9.2 Share v. Share certificate[3]

A common man uses 'share' and 'share certificate' to mean one and the same thing. It is, therefore, important to note the exact difference between the two. Section 44 of the Companies Act, 2013 in this regard describes a share as a movable property transferable in the manner provided by the articles of the company. Section 46, on the other hand, describes a 'certificate of shares', to mean a certificate, under the common seal[4] of the company, specifying any shares held by any member. Section 46 further suggests that a share certificate shall be *prima facie* evidence of title of the member to such shares. Thus, whereas 'share' represents property (movable), 'share certificate' is an evidence (*prima facie*) of the title of the member to such property.

Thus, the share certificate being *prima facie* evidence of title, it gives the shareholder the facility of dealing more easily with his shares in the market. It enables him to sell his shares by showing at once marketable title.[5]

Also, a share certificate serves as an estoppel as to payment against a *bona fide* purchaser of the shares from alleging that the amount stated as being paid on the shares has not been paid. However, a person who knows that the statements in a certificate are not true cannot claim an estoppel against the company [*Crickmer's* case [1875] 46 L.J. Ch. 870].

An elaborate distinction between 'share' and 'certificate of shares' was made out in the case of *Shree Gopal Paper Mills Ltd.* v. *CIT* [1967] 37 Comp. Cas. 240 (Cal.). The learned Judge observed :

> "It may be noticed that 'Certificate of shares' is not the shares or a share. Under section 46 a certificate, under the common seal of the Company, specifying any share or stock held by any member shall be *prima facie* evidence of the title of the member to the shares or stock therein specified. Hence, a share certificate is not the share; it is only a *prima facie* evidence of the title to the share. Therefore, it is necessary to consider what the character of a share is? Section 44 says it is a movable property. It is, however, not a tangible property for it is not the share certificate; it only consists of a bundle of rights and obligations.
>
> Each share bears a distinctive number and it is not the same as share certificate number; the two are different. In fact, a single certificate may be an evidence of many shares, say 50, 100 or even 1 lakh. Thus, whereas there will be only one number as the share certificate number for one certificate, there will be as many distinctive numbers in respect of shares as are evidenced by the share certificate."

3. For a detailed discussion on share certificate, see **Para 9.20**
4. As per Companies (Amendment) Act, 2015, share certificate may be issued under the signatures of two directors and the company secretary, if the company has appointed a company secretary.
5. Cockburn, C.J in Bhia & Sons Francis Co. Rly. In re, [1868] L.R. 3 Q. B. 584 (Ch.D)

9.3 Share v. Stock

Once again, these two expressions need to be distinguished for clarity. As already noted, a share represents a unit into which the capital of a company is divided. Thus, if the share capital of the company is Rs. 5 lakhs divided into 50,000 units of Rs. 10, each unit of Rs. 10 shall be called a share of the company.

The term 'stock' on the other hand may be defined as the aggregate of fully paid-up shares of a member merged into one fund of equal value. It is a set of shares put together in a bundle. The 'stock' is expressed in terms of money and not as so many shares. Stock can be divided into fractions of any amount and such fractions may be transferred like shares.

A company cannot make an original issue of the stock. A company limited by shares may, if authorised by its Articles, by a resolution passed in the general meeting, convert all or any of its fully paid-up shares into stock [Section 61]. On conversion into stock, the register of members must show the amount of stock held by each member instead of the number of shares. The conversion does not affect the rights of the members in any way.

Following are the main points of difference :

Share	***Stock***
1. A share has a nominal value	1. A stock has no nominal value.
2. A share has a distinctive number which distinguishes it from other shares.	2. A stock bears no such number.
3. Originally Shares can only be issued.	3. A company cannot make an original issue of stock. Stock can be issued by an existing company by converting its fully paid-up shares.
4. A share may either be fully paid-up or partly paid up.	4. A stock can never be partly paid-up, it is always fully paid-up.
5. A share cannot be transferred in fractions. It is transferred as a whole.	5. A stock may be transferred in any fractions.
6. All the shares of a class are of equal denomination.	6. Stock may be of different denominations.

9.4 Kinds of shares

As per the Companies Act, 2013, only two kinds of shares can be issued by a company. Section 43 of the Act provides that the share capital of a company limited by shares shall be of two kinds only*, namely :

(*a*) equity share capital—

(*i*) with voting rights, or

*Memorandum of Association or Articles of Association of a private company may provide for any other kind of shares to be issued.—*Vide MCA Notification dated 5 June, 2015.*

(*ii*) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed[6];

(*b*) preference share capital.

Besides, a company may also issue Global Depository Receipts (GDRs) under section 41.

9.4-1 Preference Shares or Preference Share Capital

Preference share capital means that part of the share capital of the company which fulfils both the following requirements:

(1) During the life of the company it must be assured of a preferential dividend. The preferential dividend may consist of a fixed amount (say, one lakh rupees) payable to preference shareholders before anything else is paid to the equity shareholders. Alternatively, the amount payable as preferential dividend may be calculated at a fixed rate, *e.g.*, 10% of the nominal value of each share.

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6. **With respect to issue of shares with differential voting rights, the Ministry of Company Affairs has notified *the Companies (Share Capital and Debentures) Rules, 2014*. As per Rule 4 of these rules, no company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, unless it complies with, *inter alia*, the following conditions**:

(*a*) the articles of association of the company authorizes the issue of shares with differential rights;

(*b*) the issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders:

Provided that where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot ;

(*c*) the shares with differential rights shall not exceed twenty-six per cent of the total post-issue paid up equity share capital including equity shares with differential rights issued at any point of time;

(*d*) the company has consistent track record of distributable profits for the last three years;

(*e*) the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;

(*f*) the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;

(*g*) the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

A company may, however, issue equity shares with differential voting rights upon expiry of five years from the end of the financial year in which such default was made good*.

(*h*) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts (Regulation) Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies are being regulated by sectoral regulators;

(*i*) the company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice versa*.

*MCA Notification No. G.S.R. 704(E) dated 19.7.2016

(2) On the winding-up of the company it must carry a preferential right to be paid, *i.e.,* amount paid up on preference shares must be paid back before anything is paid to the equity shareholders.

9.4-2 Types of Preference shares :

a. *Participating or non-participating* - Participating preference shares are those shares which are entitled to a fixed preferential dividend and, in addition, carry a right to participate in the surplus profits along with equity shareholders after dividend at a certain rate has been paid to equity shareholders. *For example,* after 20% dividend has been paid to equity shareholders, the preference shareholders may share the surplus profits equally with equity shareholders. Again, in the event of winding-up, if after paying back both the preference and equity shareholders, there is still some surplus left, then the participating preference shareholders get additional share in the surplus assets of the company. Unless expressly provided, preference shareholders get only the fixed preferential dividend and return of capital in the event of winding-up out of realised values of assets after meeting all external liabilities and nothing more. The right to participate may be given either in the memorandum or articles or by virtue of their terms of issue.

b. *Cumulative and non-cumulative shares* - With regard to the payment of dividends, preference shares may be cumulative or non-cumulative. A cumulative preference share confers a right on its holder to claim dividend fixed at a sum or a percentage for the past and the current years out of future profits. The fixed dividend keeps on accumulating until it is fully paid. The non-cumulative preference share gives right to its holder to a fixed amount or a fixed percentage of dividend out of the profits of each year. If no profits are available in any year or no dividend is declared, the preference shareholders get nothing, nor can they claim unpaid dividend in any subsequent year.

   Preference shares are cumulative unless expressly stated to be non-cumulative.[7] Dividends on preference shares, like equity shares, can be paid only out of profits and on declaration of dividend for preference shares.

c. *Redeemable and Irredeemable Preference shares* - As per Section 55 of the Companies Act, 2013:

   1. No company limited by shares can issue any preference shares which are irredeemable.
   2. A company limited by shares may, if so authorized by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue.

However, a company may issue preference shares for a period exceeding twenty years for infrastructure projects, subject to the redemption of such percentage of shares as may be prescribed on an annual basis at the option of such preferential shareholders. Rule 10 of *the Companies (Share Capital and Debentures) Rules, 2014,* in this regard, provides that a company engaged in the setting up of infrastructure projects may issue preference shares for a period exceeding twenty years but not exceeding thirty years, subject to the redemption of a minimum 10% of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.

7. *Henry* v. *Great Northern Rly. Co.* [1857].

Conditions for issue of Redeemable Preference Shares

(*a*) No such shares shall be redeemed except out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption;

(*b*) no such shares shall be redeemed unless they are fully paid;

(*c*) where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account;

(*d*) the capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

(*e*) the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed.

(*f*) the issue of further redeemable preference shares or the redemption of preference shares shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

Rule 9 of *the Companies (Share Capital and Debentures) Rules, 2014, inter alia*, provide:

1. A company having a share capital may issue preference shares only if so authorized by its articles.
2. A special resolution in the general meeting of the company must have been passed authorizing the issue.
3. The company, at the time of such issue of preference shares, must not have any subsisting default in the redemption of preference shares issued earlier or in payment of dividend due on any preference shares.
4. The Register of Members maintained under section 88 must contain the particulars in respect of such preference shareholder(s).
5. A company intending to list its preference shares on a recognized stock exchange shall issue such shares in accordance with the Securities and Exchange Board of India (Issue and Listing of Non-convertible Redeemable Preference Shares) Regulations, 2013.
6. A company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act. The preference shares may be redeemed:
   (*a*) at a fixed time or on the happening of a particular event;
   (*b*) any time at the company's option; or
   (*c*) any time at the shareholder's option.

3. Where a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares hereinafter referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal, on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend

thereon, in respect of the unredeemed preference shares. On the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

However, the Tribunal shall, while giving the approval, order the redemption forthwith of preference shares held by such persons who have not consented to the issue of further redeemable preference shares.

It may be further noted that notice of redemption of preference shares must be sent to the Registrar under Section 64 of the Act.

9.4-3 Equity shares [Sec. 43]

The equity shares are those shares which are not preference shares. In other words, shares which do not enjoy any preferential right in the matter of payment of dividend or repayment of capital, are known as equity shares. After satisfying the rights of preference shares, the equity shares shall be entitled to share in the remaining amount of distributable profits of the company. The dividend on equity shares is not fixed and may vary from year to year depending upon the amount of profits available. The rate of dividend is recommended by the Board of directors of the company and declared by shareholders in the annual general meeting.

Every member of a company limited by shares and holding equity share capital therein, shall have:

(*a*) a right to vote on every resolution placed before the company; and

(*b*) his voting rights, on a poll, shall be in proportion to his share in the paid-up equity share capital of the company.

As compared to this, the holders of preference shares can vote only on such resolutions which directly affect the rights attached to the preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital. However, if the preference dividend is not paid for two years or more, the preference shareholders shall also get voting right on every resolution placed before the company (Section 47).

Voting rights of a preference shareholder, on a poll, shall be in proportion to his share in the paid-up preference share capital of the company.

Where members of unincorporated association become members of company - Where company was incorporated to take over as going concern unincorporated association and enroll its members of all categories as members of company, as long as names of members of unincorporated association were entered in register of members of company, they would have right to vote under section 87 [Now section 47] and restrictions, if any, on their rights as members of unincorporated association would not haunt their rights as members of company - *C.P. Singhania* v. *Garware Club House* [2003] 46 SCL 659 (Bom.).

9.4-4 Preference shares compared with equity shares

(1) Preference shares are entitled to a fixed rate/amount of dividend. The rate of dividend on equity shares depends upon the amount of net profit available after payment of dividend to preference shareholders and the fund requirements of the company for future expansion etc.

(2) Dividend on the preference shares is paid in preference to the equity shares. *In other words*, the dividend on equity shares is paid only after the preference dividend has been paid.

(3) The preference shares have preference in relation to equity shares with regard to the repayment of capital on winding-up.

(4) If the preference shares are cumulative, the dividend not paid in any year is accumulated and until such arrears of dividend are paid, equity shareholders are not paid any dividend.

(5) Redeemable preference shares are redeemed by the company on expiry of the stipulated period, but equity shares cannot be redeemed.

(6) The voting rights of preference shareholders are restricted. An equity shareholder can vote on all matters affecting the company but a preference shareholder can vote only when his special rights as a preference shareholder are being varied or their dividend is in arrears for at least two years.

(7) A company may issue rights shares or bonus shares to the company's existing equity shareholders whereas it is not so allowed in case of preference shares (Section 62).

9.4-5 Non-voting shares

'Non-voting shares' as the term suggests are shares which carry no voting rights. These are contemplated as shares which may carry additional dividends in lieu of the voting rights. Section 43 allows issue of equity shares without voting rights [*See* Para 9.4].

9.4-6 Par Value of Shares

SEBI Regulations permit the companies to issue shares of any par value subject only to the value being not less than Re. 1 or being other than multiple of Re. 1. Thus, different companies may now issue shares of different par value. *For instance,* XYZ Ltd. can issue shares to the public at say, Rs. 3, while ABC Ltd. can issue at Rs. 5.

Further, companies whose shares are dematerialised or who have applied for it would be eligible to alter the par value of shares indicated in the Memorandum and Articles of Association.

However, at any given time there shall be only one denomination for the shares of a company.

9.4-7 Global Depository Receipts [Section 41]

Section 41 read along with Companies (Issue of Global Depository Receipts) Rules, 2014 allows a company which is eligible to do so in terms of the Scheme and relevant provisions of the Foreign Exchange Management Rules and Regulations to issue depository receipts in any foreign country. The depository receipts can be issued by way of public offering or private placement or in any other manner prevalent abroad and may be listed or traded in an overseas listing or trading platform.

Conditions for issue of GDRs, *inter alia,* include passing of a resolution by the Board as well as special resolution at a general meeting; the GDRs shall be issued by an overseas bank appointed by the company and the underlying shares shall be kept in the custody of a domestic custodian bank; the company shall appoint a merchant banker or a practising chartered accountant/practising cost accountant/practis-

ing company secretary to oversee all the compliances relating to issue of depository receipts and take the compliance report from them.

The provisions of the Act and any rules issued thereunder insofar as they relate to public issue of shares or debentures shall not apply to issue of depository receipts abroad.

9.5 Raising of capital/Issue of shares

Companies limited by shares have to issue shares to raise the necessary capital for their operations. Issue of shares may be made in 3 ways :

(*i*) By private placement of shares;

(*ii*) By allotting entire shares to an 'Issue-House', which in turn, offers the shares for sale to the public; and

(*iii*) By inviting the public to subscribe for shares in the company through a prospectus.

9.5-1 Private placement of shares [Section 42 read along with the Companies (Prospectus and Allotment of Securities) Rules, 2014 as amended vide Second (Amendment) Rules, 2018]

Explanation I to section 42 defines "private placement" to mean any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application.

If a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be an offer to the public and shall be governed accordingly.

A private placement may be made subject only the following conditions:

(1) A company may, subject to the provisions contained in section 42, make a private placement of securities.

(1A) A company shall not make an offer or invitation to subscribe to securities through private placement unless the proposal has been previously approved by the shareholders of the company, by a special resolution for each of the offers or invitations.[8]

(2) A private placement shall be made only to a select group of persons who have been identified by the Board (herein referred to as "identified persons"), whose number shall not exceed fifty or such higher number as may be prescribed, 200, as per the Rules, [excluding the qualified institutional buyers[9] and employees of the company being offered securities under a

8. "Qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009, as amended from time to time, made under the Securities and Exchange Board of India Act, 1992.

9. Inserted *vide* the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2018 w.ef. 7.8.2018

scheme of employees stock option in terms of provisions of clause (*b*) of sub-section (1) of section 62], in a financial year subject to such conditions as may be prescribed.

(3) A company making private placement shall issue private placement offer and application in such form and manner as may be prescribed to identified persons, whose names and addresses are recorded by the company in such manner as may be prescribed:

However, the private placement offer and application shall not carry any right of renunciation.

In **Mrs. Proddaturi Malathi v. SRP Logistics (P.) Ltd. [2018] 96 taxmann.com 565 (NCL-AT),** respondent directors increased share capital of company and further allotted shares of company to R2-director and to outsider at par by preferential allotment/private placement without following necessary procedure, said increase in share capital and subsequent allotment of shares was held to be invalid and thus same was to be set aside.

(4) Every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking channel and not by cash:

Provided that a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar in accordance with sub-section (8).

(5) No fresh offer or invitation under this section shall be made unless the allotments with respect to any offer or invitation made earlier have been completed or that offer or invitation has been withdrawn or abandoned by the company:

Provided that, subject to the maximum number of identified persons under sub-section (2), a company may, at any time, make more than one issue of securities to such class of identified persons as may be prescribed.

(6) A company making an offer or invitation under this section shall allot its securities within sixty days from the date of receipt of the application money for such securities and if the company is not able to allot the securities within that period, it shall repay the application money to the subscribers within fifteen days from the expiry of sixty days and if the company fails to repay the application money within the aforesaid period, it shall be liable to repay that money with interest at the rate of twelve per cent per annum from the expiry of the sixtieth day:

Provided that monies received on application under this section shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

(*a*) for adjustment against allotment of securities; or

(*b*) for the repayment of monies where the company is unable to allot securities.

(7) No company issuing securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

(8) A company making any allotment of securities under this section, shall file with the Registrar a return of allotment within fifteen days from the date of the allotment in such manner as may be prescribed, including a complete list of all allottees, with their full names, addresses, number of securities allotted and such other relevant information as may be prescribed.

(9) If a company defaults in filing the return of allotment within the period prescribed under sub-section (8), the company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding twenty-five lakh rupees.

(10) Subject to sub-section (11), if a company makes an offer or accepts monies in contravention of this section, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or two crore rupees, whichever is lower, and the company shall also refund all monies with interest as specified in sub-section (6) to subscribers within a period of thirty days of the order imposing the penalty.

(11) Notwithstanding anything contained in sub-section (9) and sub-section (10), any private placement issue not made in compliance of the provisions of sub-section (2) shall be deemed to be a public offer and all the provisions of this Act and the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 shall be applicable.

In *Rose Valley Real Estates & Construction Ltd. v. Securities and Exchange Board of India* [2014] 42 taxmann.com 188 (SAT - Mumbai), Appellant-company issued debentures to employees and their relatives/associates on private placement basis. Adjudicating Officer held appellant guilty of not furnishing information/records as required and imposed penalty of Rs. 1 crore on appellant. Held, since appellant had issued debentures on private placement basis, question of furnishing documents which were applicable to issuance of debentures through public did not arise at all; and as such appellant could not be held guilty of not furnishing documents. Besides, since appellant was willing to furnish documents relating to issuance of debenture through private placement from time to time and had, in fact, fully furnished particulars, though belatedly, in adjudication proceedings which were also initiated belatedly, it would be just and proper to restrict penalty to Rs. 10 lakhs.

A *Public Company* can also raise its capital by placing the shares privately and without inviting the public for subscription of its shares or debentures. In this kind of arrangement, an underwriter or a broker finds persons, normally his clients who wish to buy the shares. He acts merely as an agent and his function is simply to procure buyer for the shares, *i.e.*, to place them. Since no public offer is made for shares, there is no need to issue any prospectus. As per the regulations issued by SEBI, private placement of shares should not be made by subscription of shares from unrelated investors through any kind of market intermediaries. This means promoters' shares should not be contributed by subscription of those shares by

unrelated investors through brokers, merchant bankers, etc. However, subscription of such shares by friends, relatives and associates is allowed.

9.5-2 By an offer for sale

Under this arrangement, the company allots or agrees to allot shares or debentures at a price to a financial institution or an Issue-House for sale to the public. The Issue-House publishes a document called an offer for sale, with an application form attached, offering to the public shares or debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus [Section 25]. On receipt of applications from the public, the Issue-House renounces the allotment of the number of shares mentioned in the application in favour of the applicant purchaser who becomes a direct allottee of the shares.

9.5-3 By inviting public through prospectus

This is the most common method by which a company seeks to raise capital from the public. The company invites offers from members of the public to subscribe for the shares or debentures through prospectus. An investor is expected to study the prospectus and if convinced about the prospects of the company, may apply for shares.

9.5-4 Issue of shares to existing shareholders

Further capital is also raised by issue of rights shares to the existing shareholders (Section 62). In this case, the shares are allotted to the existing equity shareholders in proportion to their original shareholding, *e.g.*, one share against every two shares held by a member.

9.6 Public issue of shares

Public Issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus. For raising capital from the public by the issue of shares or debentures, a public company has to comply with the provisions of the Companies Act, the Securities Contracts (Regulation) Act, 1956 including the Rules made thereunder and the regulations and instructions issued by the concerned Government authorities, the Stock Exchange and the Securities and Exchange Board of India (SEBI), etc. Management of a public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrars to the issue, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/statutory agencies such as Registrar of Companies, Reserve Bank of India, Stock Exchange, SEBI etc.

9.6-1 Book Building*

Book Building is defined to mean a process by which demand for the securities proposed to be issued by a body corporate is elicited and built-up and the price for such securities is assessed for the determination of the quantum of such securities to be issued by means of a notice, circular, advertisement or other document.

*Also, *see* discussion under Para 9.8.

Thus, in case of a public issue through the process of book-building, though the total size of the issue is known, the number of shares is not known. It is because the price at which shares will be allotted is not known, it's determined through the process of book-building only. The prospectus only mentions the price band [*i.e.*, the lowest (floor price) and the highest (maximum price)]. As per SEBI Regulations, 2009 the maximum price cannot be more than 20% of the floor price. As part of the process, bids are invited from the prospective investors and final price determined (that is, the price at which the issue is likely to be fully subscribed). By dividing the total issue size by the price so determined, the number of shares to be issued is arrived at.

As per SEBI Regulations, 2009, an issuer company may make an issue of securities to the public through a prospectus by making 100% of the net offer to the public through book-building process.

Advantages of Book-building - Advantages of book-building include :

(*i*) the demand for security proposed to be issued by a body corporate may be created and built-up.

(*ii*) the quantum of security to be issued may be determined with a certain degree of accuracy.

The price at which the issue is likely to be fully subscribed may be ascertained

9.6-2 SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 with respect to public issue of equity shares or any other security convertible into equity shares[10]

Initial Public Offer (IPO)

(A) Entities not eligible to make an initial public offer

(1) *An issuer shall not be eligible to make an initial public offer—*

(*a*) if the issuer, any of its promoters, promoter group or directors or selling shareholders are debarred from accessing the capital market by the Board.

(*b*) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board.

(*c*) if the issuer or any of its promoters or directors is a wilful defaulter.

(*d*) if any of its promoters or directors is a fugitive economic offender.

The restrictions under (a) and (b) above shall not apply to the persons or entities mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the Board.

(2) An issuer shall not be eligible to make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer.

10. W.e.f. November, 2018.

However, *the provisions of this sub-regulation shall not apply to* :

(*a*) outstanding options granted to employees, whether currently an employee or not, pursuant to an employee stock option scheme in compliance with the Companies Act, 2013;

(*b*) fully paid-up outstanding convertible securities which are required to be converted on or before the date of filing of the red herring prospectus (in case of book-built issues) or the prospectus (in case of fixed price issues), as the case may be.

(B) Eligibility requirements for an initial public offer

(1) ***An issuer shall be eligible to make an initial public offer only if*:**

(*a*) it has net tangible assets of at least three crore rupees, calculated on a restated and consolidated basis, in each of the preceding three full years (of twelve months each), of which not more than fifty per cent are held in monetary assets.

If more than fifty per cent of the net tangible assets are held in monetary assets, the issuer should have utilised or made firm commitments to utilise such excess monetary assets in its business or project.

Further, the limit of fifty per cent on monetary assets shall not be applicable in case the initial public offer is made entirely through an offer for sale.

(*b*) it has an average operating profit of at least fifteen crore rupees, calculated on a restated and consolidated basis, during the preceding three years (of twelve months each), with operating profit in each of these preceding three years;

(*c*) it has a net worth of at least one crore rupees in each of the preceding three full years (of twelve months each), calculated on a restated and consolidated basis;

(*d*) if it has changed its name within the last one year, at least fifty per cent of the revenue, calculated on a restated and consolidated basis, for the preceding one full year has been earned by it from the activity indicated by its new name.

(2) ***An issuer not satisfying the condition stipulated in sub-regulation (1) shall be eligible to make an initial public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer to qualified institutional buyers and to refund the full subscription money if it fails to do so.***

(C) General conditions

(1) *An issuer making an initial public offer shall ensure that:*

(*a*) it has made an *application to one or more stock exchanges to seek an in-principle approval for listing* of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange;

(*b*) it has entered into an agreement with a depository for dematerialisation of the specified securities already issued and proposed to be issued;

(*c*) all its specified securities held by the promoters are in dematerialised form prior to filing of the offer document;

(*d*) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

(*e*) it has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for a specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

(2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document shall not exceed twenty five per cent of the amount being raised by the issuer.

Offer for Sale - Additional conditions

1. Only such fully paid-up equity shares may be offered for sale to the public, which have been held by the sellers for a period of at least one year[11] prior to the filing of the draft offer document.
2. In case the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities, including depository receipts, as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation.
3. If the equity shares arising out of the conversion or exchange of the fully paid-up compulsorily convertible securities are being offered for sale, the conversion or exchange should be completed prior to filing of the offer document (*i.e.* red herring prospectus in the case of a book built issue and prospectus in the case of a fixed price issue).
4. The requirement of holding equity shares for a period of one year shall not apply:

   (*a*) in case of an offer for sale of a Government company or statutory authority or corporation or any special purpose vehicle set up and controlled by any one or more of them, which is engaged in the infrastructure sector;

   (*b*) if the equity shares offered for sale were acquired pursuant to any scheme merger or acquision, etc. approved by a High Court/Tribunal or the Central Government in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme;

   (*c*) if the equity shares offered for sale were issued under a bonus issue on securities held for a period of at least one year prior to the filing of the draft offer document with the Board and further subject to the following:

11. Holding period of one year shall be required to be complied with at the time of filing of the draft offer document.

(*i*) such specified securities being issued out of free reserves and share premium existing in the books of account as at the end of the financial year preceding the financial year in which the draft offer document is filed with the Board; and

(*ii*) such equity shares not being issued by utilisation of revaluation reserves or unrealized profits of the issuer.

(D) Promoters' contribution

Minimum promoters' contribution

(1) The promoters of the issuer shall hold at least twenty per cent of the post-issue capital.

In case the post-issue shareholding of the promoters is less than twenty per cent, alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India may contribute to meet the shortfall in minimum contribution, subject to a maximum of ten per cent of the post-issue capital.

In case an issuer does not have any identifiable promoter, the requirement of minimum promoters' contribution shall not apply.

(2) *The minimum promoters' contribution shall be as follows:*

(*a*) The promoters shall contribute twenty per cent as stipulated in sub-regulation (1) either by way of equity shares or by way of subscription to convertible securities.

(*b*) In case of any issue of convertible securities which are convertible or exchangeable on different dates and if the promoters' contribution is by way of equity shares (conversion price being pre-determined), such contribution shall not be at a price lower than the weighted average price of the equity share capital arising out of conversion of such securities.

(*c*) Subject to the provisions of clauses (*a*) and (*b*) above, in case of an initial public offer of convertible debt instruments without a prior public issue of equity shares, the promoters shall bring in a contribution of at least twenty per cent of the project cost in the form of equity shares, subject to contributing at least twenty per cent of the issue size from their own funds in the form of equity shares.

(*d*) If the project is to be implemented in stages, the promoters' contribution shall be with respect to total equity participation till the respective stage *vis-à-vis* the debt raised or proposed to be raised through the public issue.

(3) The promoters shall satisfy the requirements of this regulation at least one day prior to the date of opening of the issue.

(4) In case the promoters have to subscribe to equity shares or convertible securities towards minimum promoters' contribution, the amount of promoters' contribution shall be kept in an escrow account with a scheduled

commercial bank, which shall be released to the issuer along with the release of the issue proceeds.

(5) Where the promoters' contribution has already been brought in and utilised, the issuer shall give the cash flow statement disclosing the use of such funds in the offer document.

(6) Where the minimum promoters' contribution is more than one hundred crore rupees and the initial public offer is for partly paid shares, the promoters shall bring in at least one hundred crore rupees before the date of opening of the issue and the remaining amount may be brought on a *pro rata* basis before the calls are made to the public.

Securities ineligible for minimum promoters' contribution

(1) *For the computation of minimum promoters' contribution, the following specified securities shall not be eligible:*

(*a*) Specified securities acquired during the preceding three years, if these are:

(*i*) acquired for consideration other than cash and revaluation of assets or capitalisation of intangible assets is involved in such transaction; or

(*ii*) resulting from a bonus issue by utilisation of revaluation reserves or unrealised profits of the issuer or from bonus issue against equity shares which are ineligible for minimum promoters' contribution.

(*b*) Specified securities acquired by the promoters and alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India, during the preceding one year at a price lower than the price at which specified securities are being offered to the public in the initial public offer.[12]

(*c*) Specified securities allotted to the promoters and alternative investment funds during the preceding one year at a price less than the issue price, against funds brought in by them during that period, in case of an issuer formed by conversion of one or more partnership firms or limited liability partnerships, where the partners of the erstwhile partnership firms or limited liability partnerships are the promoters of the issuer and there is no change in the management.

12. Nothing contained in this clause shall apply: (*i*) if the promoters and alternative investment funds, as applicable, pay to the issuer the difference between the price at which the specified securities are offered in the initial public offer and the price at which the specified securities had been acquired; (*ii*) if such specified securities are acquired in terms of the approved scheme merger or amalgamation, etc. by the promoters in lieu of business and invested capital that had been in existence for a period of more than one year prior to such approval; (*iii*) to an initial public offer by a Government company, statutory authority or corporation or any special purpose vehicle set up by any of them, which is engaged in the infrastructure sector.

However, specified securities, allotted to the promoters against the capital existing in such firms for a period of more than one year on a continuous basis, shall be eligible.

(*d*) Specified securities pledged with any creditor.

(2) Specified securities referred to in clauses (*a*) and (*c*) of sub-regulation (1) shall be eligible for the computation of promoters' contribution if such securities are acquired pursuant to an approved scheme of merger or amalgamation, etc.

Lock-in and Restrictions on Transferability of Promoters' Contribution

The specified securities held by the promoters shall not be transferable (hereinafter referred to as "lock-in") for the periods as stipulated hereunder:

(*a*) Minimum promoters' contribution including contribution made by alternative investment funds or foreign venture capital investors or scheduled commercial banks or public financial institutions or insurance companies registered with Insurance Regulatory and Development Authority of India as stated above, shall be ***locked-in for a period of three years from the date of commencement of commercial production or date of allotment in the initial public offer, whichever is later***;

(*b*) *Promoters' holding in excess of minimum promoters' contribution shall be locked-in for a period of one year from the date of allotment in the initial public offer.*

Lock-in of specified securities held by persons other than the promoters

The entire pre-issue capital held by persons other than the promoters shall be locked-in for a period of one year from the date of allotment in the initial public offer.

Exceptions

Nothing contained in this regulation shall apply to:

(*a*) equity shares allotted to employees, whether currently an employee or not, under an employee stock option or employee stock purchase scheme of the issuer prior to the initial public offer, if the issuer has made full disclosures with respect to such options or scheme;

(*b*) equity shares held by an employee stock option trust or transferred to the employees by an employee stock option trust pursuant to exercise of options by the employees, whether currently employees or not, in accordance with the employee stock option plan or employee stock purchase scheme.

However, the equity shares allotted to the employees shall be subject to the provisions of lock-in as specified under the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014.

(*c*) equity shares held by a venture capital fund or alternative investment fund of category I or Category II or a foreign venture capital investor.

However, such equity shares shall be locked-in for a period of at least one year from the date of purchase by the venture capital fund or alternative investment fund or foreign venture capital investor.

Lock-in of party-paid securities

If the specified securities which are subject to lock-in are partly paid-up and the amount called-up on such specified securities is less than the amount called-up on the specified securities issued to the public, the lock-in shall end only on the expiry of three years after such specified securities have become *pari passu* with the specified securities issued to the public.

Inscription or recording of non-transferability

The certificates of specified securities which are subject to lock-in shall contain the inscription "non-transferable" and specify the lock-in period and in case such specified securities are dematerialised, the issuer shall ensure that the lock-in is recorded by the depository.

(E) Appointment of lead managers, other intermediaries and compliance officer

(1) The issuer shall appoint one or more merchant bankers, which are registered with the Board, as lead manager(s) to the issue.

(2) Where the issue is managed by more than one lead manager, the rights, obligations and responsibilities, relating *inter alia* to disclosures, allotment, refund and underwriting obligations, if any, of each lead manager shall be predetermined and be disclosed in the draft offer document and the offer document.

(3) The issuer shall, in consultation with the lead manager(s), appoint other intermediaries which are registered with the Board after the lead manager(s) have independently assessed the capability of other intermediaries to carry out their obligations.

(4) The issuer shall, in case of an issue made through the book building process, appoint syndicate member(s) and in the case of any other issue, appoint bankers to issue, at centres in the manner specified in Schedule XII.

(5) The issuer shall appoint a Registrar to the issue, registered with the Board, which has connectivity with all the depositories.

(6) The issuer shall appoint a compliance officer who shall be responsible for monitoring the compliance of the securities laws and for redressal of investors' grievances.

(F) Filing of the draft offer document and offer document

(1) Prior to making an initial public offer, the issuer shall file three copies of the draft offer document with the concerned regional office of the Board under the jurisdiction of which the registered office of the issuer company is located, in accordance with Schedule IV, along with the prescribed fees, through the lead manager(s).

(2) The issuer shall also file the draft offer document with the stock exchange(s) where the specified securities are proposed to be listed, and submit to the stock exchange(s), the Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered, where the promoter is a body corporate.

(3) SEBI may specify changes or issue observations, if any, on the draft offer document within thirty days from the later of the following dates: (*a*) the date of receipt of the draft offer document; or (*b*) the date of receipt of satisfactory reply from the lead manager(s), where the Board has sought any clarification or additional information from them; or (*c*) the date of receipt of clarification or information from any regulator or agency, where the Board has sought any clarification or information from such regulator or agency; or (*d*) the date of receipt of a copy of in-principle approval letter issued by the stock exchange(s).

(4) *If the Board specifies any changes or issues observations on the draft offer document, the issuer and lead manager(s) shall carry out such changes in the draft offer document and shall submit to the Board an updated draft offer document complying with the observations issued by the Board and highlighting all changes made in the draft offer document and before registering or filing the offer documents with the Registrar of Companies or an appropriate authority, as applicable.*

(5) Copy of the offer documents shall also be filed with the SEBI and the stock exchange(s) through the lead manager(s) promptly after registering the offer documents with Registrar of Companies.

(6) The draft offer document and the offer document shall also be furnished to the SEBI in a soft copy.

(7) The lead manager(s) shall submit the following documents to the SEBI after issuance of observations by the Board:

(*a*) a statement certifying that all changes, suggestions and observations made by the Board have been incorporated in the offer document;

(*b*) a copy of the resolution passed by the Board of Directors of the issuer for allotting specified securities to promoter(s) towards amount received against promoters' contribution, before opening of the issue;

(*c*) a certificate from a statutory auditor, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid and credited to the issuer's bank account by each of them towards such contribution.

Draft offer document and offer document to be available to the public

(1) The draft offer document filed with the Board shall be made public for comments, if any, *for a period of at least twenty one days* from the date of filing, by hosting it on the websites of the Board, stock exchanges where specified securities are proposed to be listed and lead manager(s) associated with the issue.

(2) The issuer shall, within two days of filing the draft offer document with the Board, make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at

the place where the registered office of the issuer is situated, disclosing the fact of filing of the draft offer document with the Board and inviting the public to provide their comments to the Board, the issuer or the lead manager(s) in respect of the disclosures made in the draft offer document.

(3) The lead manager(s) shall, after expiry of the period stipulated in sub-regulation (1), file with the Board, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.

(4) The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, Board and the stock exchanges, as applicable.

(5) The lead manager(s) and the stock exchanges shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

(G) Pricing

Face value of equity shares

The disclosure about the face value of equity shares shall be made in the draft offer document, offer document, advertisements and application forms, along with the price band or the issue price in identical font size.

Pricing

(1) The issuer may determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book building process, as the case may be.

(2) The issuer shall undertake the book building process in the manner specified in Schedule XIII.

Price and price band

(1) The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book built issue) and determine the price at a later date before registering the prospectus with the Registrar of Companies. But, the prospectus registered with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be.

(2) The cap on the price band, and the coupon rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty per cent of the floor price.

(3) The floor price or the final price shall not be less than the face value of the specified securities.

(4) Where the issuer opts not to make the disclosure of the floor price or price band in the red herring prospectus, the issuer shall announce the floor price or the price band at least two working days before the opening of the issue

in the same newspapers in which the pre-issue advertisement was released or together with the pre-issue advertisement in the prescribed format.

(5) The announcement referred to in sub-regulation (4) shall contain relevant financial ratios computed for both upper and lower end of the price band and also a statement drawing attention of the investors to the section titled "basis of issue price" of the offer document.

(6) The announcement referred to in sub-regulation (4) and the relevant financial ratios referred to in sub-regulation (5) shall be disclosed on the websites of the stock exchange(s) and shall also be pre-filled in the application forms to be made available on the websites of the stock exchange(s).

Differential pricing

(1) The issuer may offer its specified securities at different prices, subject to the following:

(*a*) Retail individual investors or retail individual shareholders or employees entitled for reservation may be offered specified securities at a price not lower than by more than ten per cent of the price at which net offer is made to other categories of applicants, excluding anchor investors;

(*b*) In case of a book built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants;

(*c*) In case the issuer opts for the alternate method of book building, the issuer may offer the specified securities to its employees at a price not lower than by more than ten per cent of the floor price.

(2) Discount, if any, shall be expressed in rupee terms in the offer document.

(H) Issuance conditions and procedure

Minimum offer to public

The minimum offer to the public shall be subject to the provisions of clause (*b*) of sub-rule (2) of rule 19 of Securities Contracts (Regulations) Rules, 1957.

In an issue made through the book building process, the issuer may allocate up to sixty per cent of the portion available for allocation to qualified institutional buyers to anchor investors in accordance with the conditions specified in this regard in Schedule XIII.

Reservation on a competitive basis

(1) The issuer may make reservations on a competitive basis out of the issue size excluding promoters' contribution in favour of the following categories of persons:

(*a*) employees;

(*b*) shareholders (other than promoters and promoter group) of listed subsidiaries or listed promoter companies:

Provided that the issuer shall not make any reservation for the lead manager(s), registrar, syndicate member(s), their promoters, directors and employees.

(2) The reservations on a competitive basis shall be subject to the following conditions:

(*a*) the aggregate of reservations for employees shall not exceed five per cent of the post-issue capital of the issuer and the value of allotment to any employee shall not exceed two lakh rupees:

Provided that in the event of under-subscription in the employee reservation portion, the unsubscribed portion may be allotted on a proportionate basis, for a value in excess of two lakh rupees, subject to the total allotment to an employee not exceeding five lakh rupees.

(*b*) reservation for shareholders shall not exceed ten per cent of the issue size;

(*c*) no further application for subscription in the net offer can be made by persons (except an employee and retail individual shareholder) in favour of whom reservation on a competitive basis is made;

(*d*) any unsubscribed portion in any reserved category may be added to any other reserved category and the unsubscribed portion, if any, after such *inter-se* adjustments among the reserved categories shall be added to the net offer category;

(*e*) in case of under-subscription in the net offer category, spill-over to the extent of under-subscription shall be permitted from the reserved category to the net offer.

(3) An applicant in any reserved category may make an application for any number of specified securities, but not exceeding the reserved portion for that category.

(I) Abridged prospectus and ASBA

(1) The abridged prospectus shall contain the disclosures as specified in Part E of Schedule VI and shall not contain any matter extraneous to the contents of the offer document.

(2) Every application form distributed by the issuer or any other person in relation to an issue shall be accompanied by a copy of the abridged prospectus.

Part E of Schedule VI, inter alia *requires the following information to be given in an Abridged Prospectus:*

1. Name of the Issuer Company along with the address of the Registered office and corporate office.
2. Name(s) of promoter(s) of the company
3. Issue details, Listing and Procedure
4. Indicative Time-table regarding Bid opening date, Bid closing date, etc.
5. General Risks
6. Price information of Book Running Lead Manager/s (BRLM's)
7. Names of BRLM/s, Names of Syndicate members
8. Registrars to the issue

9. Business Model/Business Overview and Strategy
10. Objects of Issue
11. Details of means of Finance
12. Name of monitoring agency, if any
13. Restated and Consolidated audited financials
14. Internal Risk Factors
15. Summary of outstanding litigations, claims and Regulatory action

(3) The issuer shall accept bids using only the ASBA facility in the manner specified by the Board.

(J) Prohibition on payment of incentives

Any person connected with the issue shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the initial public offer, except for fees or commission for services rendered in relation to the issue.

(K) IPO grading

The issuer may obtain grading for its initial public offer from one or more credit rating agencies registered with the Board.

(L) Underwriting

(1) If the issuer making an initial public offer, other than through the book building process, desires to have the issue underwritten, it shall appoint underwriters in accordance with the Securities and Exchange Board of India (Underwriters) Regulations, 1993.

(2) If the issuer makes a public issue through the book building process,—

(*a*) the issue shall be underwritten by lead manager(s) and syndicate member(s):

Provided that at least seventy five per cent of the net offer proposed to be compulsorily allotted to qualified institutional buyers for the purpose of compliance of the eligibility conditions specified in sub-regulation (2) of regulation 6, cannot be underwritten.

(*b*) the issuer shall, prior to filing the prospectus, enter into underwriting agreement with the lead manager(s) and syndicate member(s), indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue.

(*c*) if the syndicate member(s) fail to fulfil their underwriting obligations, the lead manager(s) shall fulfil the underwriting obligations.

(*d*) the lead manager(s) and syndicate member(s) shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

(*e*) in case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992.

(*f*) where the issue is required to be underwritten, the underwriting obligations should at least be to the extent of minimum subscription.

(M) Opening of the issue

(1) Subject to the compliance with the provisions of the Companies Act, 2013, a public issue may be opened within twelve months from the date of issuance of the observations by the SEBI;

(2) An issue shall be opened after at least three working days from the date of registering, the red herring prospectus, in case of a book built issue and the prospectus, in case of a fixed price issue, with the Registrar of Companies.

(N) Minimum subscription

(1) The minimum subscription to be received in the issue shall be at least ninety per cent of the offer through the offer document, except in case of an offer for sale of specified securities.

(2) Minimum subscription to be received shall be subject to the allotment of minimum number of specified securities, as prescribed under the Securities Contracts (Regulation) Rules, 1957.

(3) In the event of non-receipt of minimum subscription referred to in sub-regulation (1), all application monies received shall be refunded to the applicants forthwith, but not later than fifteen days from the closure of the issue.

(O) Period of subscription

(1) Except as otherwise provided in these regulations, an initial public offer shall be kept open for at least three working days and not more than ten working days.

(2) In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red herring prospectus, for a minimum period of three working days, subject to the provisions of sub-regulation (1).

(3) In case of *force majeure*, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding (issue) period disclosed in the red herring prospectus (in case of a book built issue) or the issue period disclosed in the prospectus (in case of a fixed price issue), for a minimum period of three working days, subject to the provisions of sub-regulation (1).

(P) Application and minimum application value

(1) A person shall not make an application in the net offer category for a number of specified securities that exceeds the total number of specified securities offered to the public.

(2) The maximum application by non-institutional investors shall not exceed total number of specified securities offered in the issue less total number of specified securities offered in the issue to qualified institutional buyers.

(3) The issuer shall stipulate in the offer document the minimum application size in terms of number of specified securities which shall fall within the range

of minimum application value of ten thousand rupees to fifteen thousand rupees.

(4) The issuer shall invite applications in multiples of the minimum application value, an illustration whereof is given in Part B of Schedule XIV.

(5) The minimum sum payable on application per specified security shall be at least twenty five per cent of the issue price. However, in case of an offer for sale, the full issue price for each specified security shall be payable at the time of application.

Explanation: *For the purpose of this regulation, "minimum application value" shall be with reference to the issue price of the specified securities and not with reference to the amount payable on application.*

(Q) Monitoring agency

If the issue size, *excluding the size of offer for sale by selling shareholders*, exceeds one hundred crore rupees, the issuer shall make arrangements for the use of proceeds of the issue to be monitored by a public financial institution or by a scheduled commercial bank named in the offer document as bankers of the issuer *except in case of an issue of specified securities made by a bank or public financial institution or an insurance company.*

(R) Manner of calls

If the issuer proposes to receive subscription monies in calls, it shall ensure that the outstanding subscription money is called within twelve months from the date of allotment in the issue and if any applicant fails to pay the call money within the said twelve months, the equity shares on which there are calls in arrears along with the subscription money already paid on such shares shall be forfeited. However, it shall not be necessary to call the outstanding subscription money within twelve months, if the issuer has appointed a monitoring agency in terms of regulation 41.

(S) Allotment procedure and basis of allotment

(1) The issuer shall not make an allotment pursuant to a public issue if the number of prospective allottees is less than one thousand.

(2) The issuer shall not make any allotment in excess of the specified securities offered through the offer document except in case of oversubscription for the purpose of rounding off to make allotment, in consultation with the designated stock exchange. However, in case of oversubscription, an allotment of not more than one per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

(3) The allotment of specified securities to applicants other than to the retail individual investors and anchor investors shall be on a proportionate basis within the respective investor categories and the number of securities allotted shall be rounded off to the nearest integer, subject to minimum allotment being equal to the minimum application size as determined and disclosed in the offer document.

(4) The value of specified securities allotted to any person shall not exceed two lakh rupees for retail investors or up to five lakh rupees for eligible employees.

(5) The allotment of specified securities to each retail individual investor shall not be less than the minimum bid lot, subject to the availability of shares in retail individual investor category, and the remaining available shares, if any, shall be allotted on a proportionate basis.

(6) The authorised employees of the designated stock exchange, along with the lead manager(s) and Registrars to the issue, shall ensure that the basis of allotment is finalised in a fair and proper manner in accordance with the procedure as specified in Part A of Schedule XIV.

(T) Allotment, refund and payment of interest

(1) The issuer and lead manager(s) shall ensure that the specified securities are allotted and/or application monies are refunded or unblocked within such period as may be specified by the Board.

(2) The lead manager(s) shall ensure that the allotment, credit of dematerialised securities and refund or unblocking of application monies, as may be applicable, are done electronically.

(3) Where the specified securities are not allotted and/or application monies are not refunded or unblocked within the period stipulated in sub-regulation (1) above, the issuer shall undertake to pay interest at the rate of fifteen per cent per annum to the investors and within such time as disclosed in the offer document and the lead manager(s) shall ensure the same.

(U) Restriction on further capital issues

An issuer shall not make any further issue of specified securities in any manner whether by way of public issue, rights issue, preferential issue, qualified institutions placement, issue of bonus shares or otherwise, *except pursuant to an employee stock option scheme*, during the period between the date of filing the draft offer document and the listing of the specified securities offered through the offer document or refund of application monies, unless full disclosures regarding the total number of specified securities or amount proposed to be raised from such further issue are made in such draft offer document or offer document, as the case may be.

FURTHER PUBLIC OFFER

Eligibility Requirements

Entities not eligible to make a further public offer

An issuer shall not be eligible to make a further public offer:

(*a*) if the issuer, any of its promoters, promoter group or directors, selling shareholders are debarred from accessing the capital market by the Board;

(*b*) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board;

(*c*) if the issuer or any of its promoters or directors is a wilful defaulter ;

(*d*) if any of its promoters or directors is a fugitive economic offender. *The restrictions under* (a) *and* (b) *above shall not apply to the persons or entities*

mentioned therein, who were debarred in the past by the Board and the period of debarment is already over as on the date of filing of the draft offer document with the Board.

Eligibility requirements for further public offer

(1) An issuer may make a further public offer, if it has changed its name within the last one year, at least fifty per cent of the revenue for the preceding one full year has been earned by it from the activity indicated by its new name.

(2) An issuer not satisfying the condition stipulated in sub-regulation (1) may make a further public offer only if the issue is made through the book-building process and the issuer undertakes to allot at least seventy five per cent of the net offer, to qualified institutional buyers and to refund full subscription money if it fails to make the said minimum allotment to qualified institutional buyers.

General conditions

(1) An issuer making a further public offer shall ensure that—

(*a*) it has made an application to one or more stock exchanges to seek an in-principle approval for listing of its specified securities on such stock exchanges and has chosen one of them as the designated stock exchange, in terms of Schedule XIX;

(*b*) it has entered into an agreement with a depository for dematerialisation of specified securities already issued and proposed to be issued;

(*c*) all its existing partly paid-up equity shares have either been fully paid-up or have been forfeited;

(*d*) it has made firm arrangements of finance through verifiable means towards seventy five per cent of the stated means of finance for the specific project proposed to be funded from the issue proceeds, excluding the amount to be raised through the proposed public issue or through existing identifiable internal accruals.

(2) The amount for general corporate purposes, as mentioned in objects of the issue in the draft offer document and the offer document, shall not exceed twenty five per cent of the amount being raised by the issuer.

Green Shoe Option

What is Green Shoe Option?

Companies that want to venture out and start selling their shares to the public have ways to stabilize their initial share prices. One of these ways is through a legal mechanism called the green shoe option. A green shoe is a clause contained in the underwriting agreement of an initial public offering (IPO) that allows underwriters to buy up to an additional 15% of company shares at the offering price. The investment banks and brokerage agencies (the underwriters) that take part in the green shoe process have the ability to exercise this option if public demand for the shares exceeds expectations and the stock trades above the offering price.

The Origin of the Green Shoe

The term "green shoe" came from the Green Shoe Manufacturing Company (now called Stride Rite Corporation), founded in 1919. It was the first company to implement the green shoe clause into their underwriting agreement.

In a company prospectus, the legal term for the greenshoe is "over-allotment option", because in addition to the shares originally offered, shares are set aside for underwriters.

SEBI Regulations, 2018, with respect to green shoe option, provide as follows :

(1) An issuer may provide a green shoe option for stabilising the post listing price of its specified securities, subject to the following:

(*a*) the issuer has been authorized, by a resolution passed in the general meeting of shareholders approving the public issue, to allot specified securities to the stabilising agent, if required, on the expiry of the stabilisation period;

(*b*) the issuer has appointed a lead manager as a stabilising agent, who shall be responsible for the price stabilisation process;

(*c*) prior to filing the draft offer document, the issuer and the stabilising agent have entered into an agreement, stating all the terms and conditions relating to the green shoe option including fees charged and expenses to be incurred by the stabilising agent for discharging its responsibilities;

(*d*) prior to filing the offer document, the stabilising agent has entered into an agreement with the promoters or pre-issue shareholders or both for borrowing specified securities from them in accordance with clause (*g*) of this sub-regulation, specifying therein the maximum number of specified securities that may be borrowed for the purpose of allotment or allocation of specified securities in excess of the issue size (hereinafter referred to as the "overallotment"), which shall not be in excess of fifteen per cent of the issue size;

(*e*) subject to clause (*d*), the lead manager, in consultation with the stabilising agent, shall determine the amount of specified securities to be over-allotted in the public issue;

(*f*) the draft offer document and offer document shall contain all material disclosures about the green shoe option specified in this regard in Part A of Schedule VI;

(*g*) in case of an initial public offer pre-issue shareholders and promoters and in case of a further public offer pre-issue shareholders holding more than five per cent specified securities and promoters, may lend specified securities to the extent of the proposed over-allotment;

(*h*) the specified securities borrowed shall be in dematerialised form and allocation of these securities shall be made *pro rata* to all successful applicants.

(2) For the purpose of stabilisation of post-listing price of the specified securities, the stabilising agent shall determine the relevant aspects including the timing of buying such securities, quantity to be bought and the price at which such securities are to be bought from the market.

(3) The stabilisation process shall be available for a period not exceeding thirty days from the date on which trading permission is given by the stock exchanges in respect of the specified securities allotted in the public issue.

(4) The stabilising agent shall open a special account, distinct from the issue account, with a bank for crediting the monies received from the applicants against the over-allotment and a special account with a depository participant for crediting specified securities to be bought from the market during the stabilisation period out of the monies credited in the special bank account.

(5) The specified securities bought from the market and credited in the special account with the depository participant shall be returned to the promoters or pre-issue shareholders immediately, in any case not later than two working days after the end of the stabilization period.

(6) On expiry of the stabilisation period, if the stabilising agent has not been able to buy specified securities from the market to the extent of such securities over-allotted, the issuer shall allot specified securities at issue price in dematerialised form to the extent of the shortfall to the special account with the depository participant, within five days of the closure of the stabilisation period and such specified securities shall be returned to the promoters or pre-issue shareholders by the stabilising agent in lieu of the specified securities borrowed from them and the account with the depository participant shall be closed thereafter.

(7) The issuer shall make a listing application in respect of the further specified securities allotted under sub-regulation (6), to all the stock exchanges where the specified securities allotted in the public issue are listed and the provisions of Chapter VII shall not be applicable to such allotment.

(8) The stabilising agent shall remit the monies with respect to the specified securities allotted under sub-regulation (6) to the issuer from the special bank account.

(9) Any monies left in the special bank account after remittance of monies to the issuer under sub-regulation (8) and deduction of expenses incurred by the stabilising agent for the stabilisation 28 process shall be transferred to the Investor Protection and Education Fund established by the Board and the special bank account shall be closed soon thereafter.

(10) The stabilising agent shall submit a report to the stock exchange on a daily basis during the stabilisation period and a final report to the Board in the format specified in Schedule XV.

(11) The stabilising agent shall maintain a register for a period of at least three years from the date of the end of the stabilisation period and such register shall contain the following particulars:

(*a*) The names of the promoters or pre-issue shareholders from whom the specified securities were borrowed and the number of specified securities borrowed from each of them;

(*b*) The price, date and time in respect of each transaction effected in the course of the stabilisation process; and

(*c*) The details of allotment made by the issuer on expiry of the stabilisation process.

9.7 Employees' Benefits Schemes

SEBI vide its Notification No. LAD-NRO/GN/2014-15/16/1729, dated 28th October, 2014 has issued Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 [hereafter referred to as 'Regulations, 2014'][13]. These Regulations, *inter alia*, cover:

(*i*) employee stock option schemes;

(*ii*) employee stock purchase schemes; and

(*iii*) stock appreciation rights schemes.

9.7A Employees Stock Option Scheme [ESOS]

'Employee Stock Option Scheme' or [ESOS] means a scheme under which a company grants employee stock option directly or through a trust.

'Employee' for the purpose of the Scheme **means**:

(*i*) a permanent employee of the company who has been working in India or outside India; or

(*ii*) a director of the company, whether a whole time director or not but excluding an independent director; or

(*iii*) an employee as defined in clause (i) or (ii) of a subsidiary, in India or outside India, or of a holding company of the company or of an associate company but does not include—

(a) an employee who is a promoter or a person belonging to the promoter group; or

(b) a director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten per cent of the outstanding equity shares of the company.

In case of a start-up company, clauses (*a*) and (*b*) above shall not apply up to five years from the date of its incorporation or registration.

SEBI Regulations, 2014, in this regard, *inter alia*, provide as follows:

1. **Details of the Scheme:** Subject to the provisions of the Regulations, as aforesaid, the ESOS shall **contain the details of the manner** in which the Scheme will be implemented and operated.

13. These Regulations have been brought into force w.e.f. 16th June, 2015

2. **Implementation of the Scheme:** A company may implement the Scheme either directly or by setting up an irrevocable trust. In case the scheme is to be implemented through a trust, the same shall have to be decided upfront at the time of taking approval of the shareholders for setting up the schemes. But, where the scheme involves secondary acquisition or gift or both, then it is mandatory for the company to implement such scheme through a trust.
3. **Disclosures:** No ESOS shall be offered unless the disclosures, as specified by SEBI in this regard, are made by the company to the prospective option grantees.
4. **Eligibility:** An employee shall be eligible to participate in the Scheme as determined by the Compensation Committee. Where the employee is a director nominated by an institution, it should, *inter alia*, be ensured that the grants by the company under its scheme can be accepted by the said director and the grant shall not be renounced in favour of the nominating institution.
5. **Approval of Shareholders:** The issue of ESOS would be subject to approval by shareholders through a **special resolution**.
6. **Variation in the terms of the Scheme:** The **company shall not vary** the terms of the Scheme in any manner, which may be detrimental to the interests of the employees except to the extent required to meet any regulatory requirements.
7. **Exercise price:** The company granting option to its employees pursuant to ESOS will have the **freedom to determine the exercise price** subject to conforming to the 'Guidance Note on Accounting for employee share-based payments or Accounting Standards as may be prescribed by ICAI from time to time.
8. **Preferential allotment regulations not to apply:** Subject to the aforesaid financial treatment ESOS would **not be covered by the pricing provisions of SEBIs preferential allotment regulations.**
9. **Vesting period:** There shall be a minimum **vesting period of one year**. However, where options are granted in lieu of options held by a person under ESOS in another company which has merged or amalgamated with that company, the period during which the options granted by the transferor company were held by him shall be adjusted.
10. **Lock-in**: The company may specify the lock-in period for the shares issued pursuant to exercise of option.
11. **Right to receive any dividend or to vote:** The employee shall **not have right to receive any dividend or to vote** or in any manner enjoy the benefits of a shareholder in respect of option granted to him, **till shares are issued upon exercise of option.**
12. **Consequences of failure to exercise option:** In case an employee fails to exercise the option, the amount payable by the employee, if any, at the time of grant of option,—

(*a*) may be forfeited by the company if the option is not exercised by the employee within the exercise period; or

(*b*) may be refunded to the employee if the options are not vested due to non-fulfilment of conditions relating to vesting of option as per the ESOS.

13. **Compensation Committee:** The operation of the ESOS scheme would have to be under the administration and superintendence of a Compensation Committee.

14. **Auditors' certificate:** In the case of every company that has passed a resolution for the scheme under these regulations, the board of directors shall at each annual general meeting place before the shareholders a certificate from the auditors of the company that the scheme(s) has been implemented in accordance with these regulations and in accordance with the resolution of the company in the general meeting.

9.7B Employee Stock Purchase Scheme [ESPS]

"Employee stock purchase scheme or ESPS" means a scheme under which a company offers shares to employees, as part of public issue or otherwise, or through a trust where the trust may undertake secondary acquisition for the purposes of the scheme.

Eligibility and other conditions applicable to the Scheme are similar to the Employees' Stock Option Scheme.

9.7C Stock Appreciation Rights Scheme (SARS)

"Stock appreciation rights scheme or SAR scheme" means a scheme under which a company grants SAR to employees. This is a new scheme permitted by SEBI for the first time.

Administration and Implementation

(1) Subject to the provisions of these regulations, the SAR scheme shall contain the details of the manner in which the scheme will be implemented and operated.

(2) Subject to the provisions of these regulations, a company shall have the freedom to implement cash settled or equity settled SAR scheme. However, in case of equity settled SAR scheme, if the settlement results in fractional shares, then the consideration for fractional shares should be settled in cash.

(3) No SAR shall be offered unless the disclosures, as specified by Board in this regard, are made by the company to the prospective SAR grantees.

Vesting

There shall be a minimum vesting period of one year in case of SAR scheme. In a case where SAR is granted by a company under a SAR scheme in lieu of SAR held by the same person under a SAR scheme in another company which has merged or amalgamated with the first mentioned company, the period during which the

SAR granted by the transferor company were held by the employee shall be adjusted against the minimum vesting period required under this sub-regulation.

Rights of the SAR holder

The employee shall not have right to receive dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of SAR granted to him.

E. Preferential Allotment

Nothing in these guidelines shall apply to shares issued to employees in compliance with the Securities and Exchange Board of India Guidelines on Preferential Allotment.

F. Listing

In case of listed companies, the shares arising pursuant to an ESOS and shares issued under an ESPS, shall be eligible for listing in any recognized stock exchange only if such scheme (*i.e.,* ESOS or ESPS) is in accordance with these Guidelines.

9.8 Book Building

SEBI has allowed book building as an alternative to firm allotment. Under the process of book building prospective buyers make offers to purchase specified number of shares at a particular price. SEBI Regulations, 2018 define 'book building' to mean a process undertaken to elicit demand and to assess the price for determination of the quantum or value or coupon of specified securities or Indian Depository Receipts, as the case may be. In case the issuer chooses to issue securities through book building, it must follow the SEBI Regulations in this regard.

Offer to Public through Book Building Process

An issuer proposing to issue specified securities through the book building process shall comply with the requirements of Schedule XIII of SEBI Regulations, 2018

(1) **Lead Manager(s)**

(*a*) The issuer shall appoint one or more merchant banker(s) as lead manager(s) and their name(s) shall be disclosed in the draft offer document and the offer document(s).

(*b*) In case there is more than one lead manager(s), the rights, obligations and responsibilities of each shall be delineated in the inter-se allocation of responsibility as specified in Schedule I.

(*c*) Co-ordination of various activities may be allocated to more than one lead manager.

(2) **Syndicate Member(s)**

The issuer may appoint syndicate member(s).

(3) **Underwriting**

(*a*) The lead manager(s) shall compulsorily underwrite the issue and the syndicate member(s) shall sub-underwrite with the lead manager(s).

(*b*) The lead manager(s)/syndicate member(s) shall enter into underwriting/ sub-underwriting agreement on a date prior to filing of the prospectus.

(*c*) The details of the final underwriting arrangement indicating actual numbers of shares underwritten shall be disclosed and printed in the prospectus before it is registered with the Registrar of Companies.

(*d*) In case of an under-subscription in an issue, the shortfall shall be made good by the lead manager(s) and the same shall be incorporated in the *inter se* allocation of responsibility as specified in Schedule I.

(4) **Agreement with the stock exchanges**

(*a*) The issuer shall enter into an agreement with one or more stock exchange(s) which have the facility of book building through the electronic bidding system.

(*b*) The agreement shall specify *inter alia*, the rights, duties, responsibilities and obligations of the issuer and the stock exchange(s) *inter se*.

(*c*) The agreement may also provide for a dispute resolution mechanism between the issuer and the stock exchange.

(5) **Appointment of stock brokers as bidding/collection centres**

(*a*) The lead manager(s)/syndicate member(s) shall appoint stock brokers who are members of the stock exchange(s) and registered with the Board, for the purpose of accepting bids and placing orders with the issuer and ensure that the stock brokers so appointed are financially capable of honouring their commitments arising out of defaults of their clients/investors, if any.

In case of Application Supported by Blocked Amount, the self-certified syndicate banks, registrar and share transfer agents, depository participants and stock brokers shall also be authorised to accept and upload the requisite details in the electronic bidding system of the stock exchange(s).

(*b*) The self-certified syndicate banks, registrar and share transfer agents, depository participants and stock brokers accepting applications and application monies shall be deemed as 'bidding/collection centres'.

(*c*) The issuer shall pay to the SEBI registered intermediaries involved in the above activities a reasonable commission/fee for the services rendered by them. These intermediaries shall not levy service fee on their clients/investors in lieu of their services.

(*d*) The stock exchanges shall ensure that no stock broker levies a service fee on their clients/investors in lieu of their services.

(6) **Price not to be disclosed in the draft red herring prospectus**

The draft red herring prospectus shall contain the total issue size which may be expressed either in terms of the total amount to be raised or the total number of specified securities to be issued.

It shall not contain the price of the specified securities.

In case the offer has an offer for sale and/or a fresh issue, each component of the issue may be expressed in either value terms or number of specified securities.

(7) **Floor price and price band**

Subject to applicable provisions of these regulations and the provisions of this clause, the issuer may mention the floor price or price band in the red-herring prospectus.

(*a*) where the issuer opts not to make the disclosure of the price band or floor price in the red-herring prospectus, the following shall also be disclosed in the red-herring prospectus:

(*i*) a statement that the floor price or price band, as the case may be, shall be disclosed at least two working days (in case of an initial public offer)

and at least one working day (in case of a further public offer) before the opening of the issue;

(*ii*) a statement that the investors may be guided by the secondary market prices (in case of a further public offer);

(*iii*) names and editions of the newspapers where the announcement of the floor price or price band would be made; (iv) website addresses where the announcement is available.

(*b*) where the issuer decides to opts for a price band instead of a floor price, the issuer shall also ensure compliance with the following conditions:

(*i*) The cap of the price band should not be higher by more than 20 per cent of the floor of the band; i.e. cap of the price band shall be less than or equal to 120 per cent of the floor of the price band;

(*ii*) The price band can be revised during the bidding period, provided the maximum revision on either side shall not exceed 20 per cent i.e. floor of price band can move up or down to the extent of 20 per cent of floor of the price band disclosed in the red-herring prospectus and the cap of the revised price band will be fixed in accordance with clause (*i*) above;

(*iii*) Any revision in the price band shall be widely disseminated by informing the stock exchanges, by issuing public notice and also indicating the change on the relevant website and the terminals of the syndicate member(s).

(*iv*) In case the price band is revised, the bidding period will be extended as per the provisions of these regulations. (v) The manner in which the shortfall, if any, in the project financing will be met, arising on account of lowering of the price band shall be disclosed in the red-herring prospectus or the public notice and that the allotment shall not be made unless the financing is tied up.

(8) The manner and contents of the bid-cum-application form and revision form (accompanied with abridged prospectus) shall be as specified by the Board.

(9) **Extension of issue period**

(*i*) In case of a revision in the price band, the issuer shall extend the bidding (issue) period disclosed in the red-herring prospectus, for a minimum period of three working days, subject to the total bidding (issue) period not exceeding ten working days.

(*ii*) in case of force majeure, banking strike or similar circumstances, the issuer may, for reasons to be recorded in writing, extend the bidding/issue period for a minimum period of three working days, subject to the total bidding/ issue period not exceeding ten working days.

(10) **Anchor Investors**

(*a*) An anchor investor shall make an application of a value of at least ten crore rupees in a public issue on the main board made through the book building process or an application for a value of at least two crore rupees in case of a public issue on the SME exchange made in accordance with Chapter IX of these regulations.

(*b*) Up to sixty per cent of the portion available for allocation to qualified institutional buyers shall be available for allocation/allotment ("anchor investor portion") to the anchor investor(s).

(*c*) Allocation to the anchor investors shall be on a discretionary basis, subject to the following:

(*I*) In case of public issue on the main board, through the book building process:

(*i*) maximum of 2 such investors shall be permitted for allocation up to ten crore rupees;

(*ii*) minimum of 2 and maximum of 15 such investors shall be permitted for allocation above ten crore rupees and up to two fifty crore rupees, subject to minimum allotment of five crore rupees per such investor; (i) in case of allocation above two fifty crore rupees; a minimum of 5 such investors and a maximum of 15 such investors for allocation up to two fifty crore rupees and an additional 10 such investors for every additional two fifty crore rupees or part thereof, shall be permitted, subject to a minimum allotment of five crore rupees per such investor.

(*II*) In case of public issue on the SME exchange, through the book building process:

(*i*) maximum of 2 such investors shall be permitted for allocation up to two crore rupees;

(*ii*) minimum of 2 and maximum of 15 such investors shall be permitted for allocation above two crore rupees and up to twenty five crore rupees, subject to minimum allotment of one crore rupees per such investor;

(*iii*) in case of allocation above twenty five crore rupees; a minimum of 5 such investors and a maximum of 15 such investors for allocation up to twenty five crore rupees and an additional 10 such investors for every additional twenty five crore rupees or part thereof, shall be permitted, subject to a minimum allotment of one crore rupees per such investor.

(*d*) One-third of the anchor investor portion shall be reserved for domestic mutual funds.

(*e*) The bidding for anchor investors shall open one day before the issue opening date.

(*f*) The anchor investors shall pay on application the same margin which is payable by other categories of investors and the balance, if any, shall be paid within two days of the date of closure of the issue.

(*g*) The allocation to anchor investors shall be completed on the day of the bidding by the anchor investors.

(*h*) If the price fixed as a result of book building is higher than the price at which the allocation is made to the anchor investors, the anchor investors shall pay the additional amount. However, if the price fixed as a result of book building is lower than the price at which the allocation is made to the anchor investors, the excess amount shall not be refunded to the anchor investors and the anchor investor shall be allotted the securities at the same price at which the allocation was made to it.

(*i*) The number of shares allocated to the anchor investors and the price at which the allocation is made, shall be made available to the stock exchange(s)

by the lead manager(s) for dissemination on the website of the stock exchange(s) before opening of the issue.

(*j*) There shall be a lock-in of 30 days on the shares allotted to the anchor investors from the date of allotment.

(*k*) Neither the (i) lead manager(s) or any associate of the lead managers (other than mutual funds sponsored by entities which are associate of the lead managers or insurance companies promoted by entities which are associate of the lead managers or Alternate Investment Funds (AIFs) sponsored by the entities which are associate of the lead manager or FPIs other than Category III sponsored by the entities which are associate of the lead manager) nor (ii) any person related to the promoter/promoter group/ shall apply under the Anchor Investors category.

Explanation: For the purpose of clause (k) above, a qualified institutional buyer who has any of the following rights shall be deemed to be a person related to the promoters or promoter group of the issuer: (I) rights under a shareholders' agreement or voting agreement entered into with promoters or promoter group of the issuer; (II) veto rights; or (III) right to appoint any nominee director on the board of the issuer. Further, for the purposes of this regulation, an anchor investor shall be deemed to be an "associate of the lead manager" if: (i) either of them controls, directly or indirectly through its subsidiary or holding company, not less than fifteen per cent of the voting rights in the other; or (ii) either of them, directly or indirectly, by itself or in combination with other persons, exercises control over the other; or (iii) there is a common director, excluding nominee director, amongst the anchor investor and the lead manager.

(*l*) Applications made by a qualified institutional buyer under the anchor investor category and under the non-anchor Investor category shall not be considered as multiple applications.

(11) **Margin money**

(*a*) The entire application money shall be payable as margin money by all the applicants.

(*b*) Payment accompanied with any revision of bid, shall be adjusted against the payment made at the time of the original bid or the previously revised bid.

(12) **Bidding process**

(*a*) The bidding process shall only be through an electronically linked transparent bidding facility provided by the stock exchange(s).

(*b*) The lead manager(s) shall ensure the availability of adequate infrastructure with the syndicate member(s) for data entry of the bids in a timely manner.

(*c*) At each of the bidding centres, at least one electronically linked computer terminal shall be available for the purpose of bidding.

(*d*) During the period the issue is open to the public for bidding, the applicants may approach the stock brokers of the stock exchange/s through which the securities are offered under on-line system, self-certified syndicate bank(s), registrar and share transfer agents or depository participants, as the case may be, to place their bids.

(*e*) Every stock broker, self-certified syndicate bank, registrar and share transfer agent and depository participant shall accept applications supported by blocked amount.

(*f*) The qualified institutional buyers shall place their bids only through the stock broker(s) who shall have the right to vet the bids;

(*g*) At the end of each day of the bidding period, the demand, shall be shown graphically on the bidding terminals of the syndicate member(s) and websites of the stock exchanges for information of the public (details in relation to allocation made to anchor investors shall also be disclosed).

(*h*) The retail individual investors may either withdraw or revise their bids until the closure of the issue.

(*i*) The qualified institutional buyers and the non-institutional investors shall not be permitted to withdraw or lower the size of their bids at any stage of the issue.

(*j*) The issuer may decide to close the bidding by the qualified institutional buyers one day prior to the closure of the issue, subject to the following conditions:

(*i*) the bidding period shall be minimum of three days for all categories of applicants;

(*ii*) necessary disclosures are made in the red-herring prospectus regarding the issuer's intent to close the bidding by the qualified institutional buyers one day prior to the closure of the issue.

(*k*) The names of the qualified institutional buyers making the bids shall not be made public.

(*l*) The retail individual investors may bid at the "cut off" price instead of a specific bid price.

(*m*) The stock exchanges shall continue to display on their website, the book building data in a uniform format, *inter alia*, giving category-wise details of the bids received, for a period of at least three days after the closure of the issue. Such display shall be as per the format specified in Part B of this Schedule.

(13) **Determination of price**

(*a*) The issuer shall, in consultation with the lead manager(s), determine the final issue price based on the bids received, and on determination of the same, the number of specified securities to be offered or issue size shall be determined.

(*b*) Once the final issue price is determined, all bidders whose bids have been at and above the final price shall be considered for allotment of specified securities.

(14) **Registering of prospectus with the Registrar of Companies**

A copy of the prospectus, which shall include the price and the number of specified securities, shall be registered by the issuer with the Registrar of Companies.

(15) **Manner of allotment/allocation**

(*a*) The issuer shall make allotments only if the minimum subscription has been received.

(*b*) The allotment/allocation to qualified institutional buyers and non-institutional investors, other than the anchor investors, shall be made on a proportionate basis as illustrated in this Schedule. The allotment to retail individual investors and allotment to employees shall be made in accordance with applicable provisions of these regulations.

(*c*) In case of under-subscription in any category, the under-subscribed portion in that category shall be allocated to such bidders as described in the red-herring prospectus.

The unsubscribed portion in the qualified institutional buyer category shall not be available for subscription to other categories in the case of issues made under sub-regulation (2) of regulation 6 of these regulations.

(16) **Maintenance of records**

(*a*) The final book of the demand showing the result of the allocation process shall be maintained by the lead manager and the registrar to the issue.

(*b*) The lead manager(s) and other intermediaries associated in the book building process shall maintain records of the book building prices.

(*c*) The Board shall have the right to inspect the records, books and documents relating to the book building process and such person shall extend full co-operation.

(17) **Applicability to Fast Track Issues**

Unless the context otherwise requires, in relation to the fast track issues, all references in this Schedule to 'draft prospectus' shall be deemed to have been made to the 'red-herring prospectus'.

9.9 SEBI Regulations for Preferential Issue*

Regulations for Preferential Issue not to apply in certain cases.

(1) The provisions of these regulations shall not apply where the preferential issue of equity shares is made:

(*a*) pursuant to conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of section 62 of the Companies Act, 2013;

(*b*) pursuant to a scheme approved by a Tribunal under sections 230 to 232 of the Companies Act, 2013;

(*c*) in terms of the resolution plan approved by the Tribunal under the Insolvency and Bankruptcy Code, 2016.

However, lock-in provisions of these regulations shall apply to such preferential issue of equity shares.

(2) The provisions of these regulations relating to pricing and lock-in shall not apply to equity shares allotted to any financial institution within the meaning of sub-clauses (*ia)* and (*ii*) of clause (*h*) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993).

(3) The provisions of regulation 73 and regulation 76 shall not apply to a preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, where the Board has granted relaxation to the issuer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, if adequate disclosures about the plan and process proposed to

*As amended upto 14-8-2017.

be followed for identifying the allottees are given in the explanatory statement to notice for the general meeting of shareholders.

(4) The provisions of sub-regulation (2) of regulation 72 and sub-regulation (6) of regulation 78 shall not apply to a preferential issue of specified securities where the proposed allottee is a Mutual Fund registered with the Board or Insurance Company registered with Insurance Regulatory and Development Authority of India or a Scheduled Bank or a Public Financial Institution.

(5) The provisions of this Chapter shall not apply where the preferential issue of specified securities is made to the lenders pursuant to conversion of their debt, as part of a debt restructuring scheme implemented in accordance with the guidelines specified by the Reserve Bank of India, subject to the prescribed conditions.

(6) The provisions of this Chapter shall not apply where the preferential issue, if any, of specified securities is made to person(s) at the time of lenders selling their holding of specified securities or enforcing change in ownership in favour of such person(s) pursuant to a debt restructuring scheme implemented in accordance with the guidelines specified by the Reserve Bank of India, subject to the prescribed conditions.

Relevant date

For the purpose of these regulations, "relevant date" means:

(*a*) in case of preferential issue of equity shares, the date thirty days prior to the date on which the meeting of shareholders is held to consider the proposed preferential issue:

Provided that in case of preferential issue of equity shares pursuant to a scheme approved under the Corporate Debt Restructuring Framework of Reserve Bank of India, the date of approval of the Corporate Debt Restructuring Package shall be the relevant date.

(*b*) in case of preferential issue of convertible securities, either the relevant date referred to in clause (*a*) of this regulation or a date thirty days prior to the date on which the holders of the convertible securities become entitled to apply for the equity shares.

Explanation: Where the relevant date falls on a weekend/holiday, the day preceding the weekend/holiday will be reckoned to be the relevant date.

Conditions for Preferential Issue

(1) A listed issuer may make a preferential issue of specified securities, if:

(*a*) a special resolution has been passed by its shareholders;

(*b*) all the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;

(*c*) the issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed;

(*d*) the issuer has obtained the Permanent Account Number of the proposed allottees.

(2) The issuer shall not make preferential issue of specified securities to any person who has sold any equity shares of the issuer during the six months preceding the relevant date:

Provided that in respect of the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, the Board may grant relaxation from the requirements of this sub-regulation, if the Board has granted relaxation under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 to such preferential allotment.

Disclosures

(1) The issuer shall, in addition to the disclosures required under section 102 of the Companies Act, 2013 or any other applicable law, disclose the following in the explanatory statement to the notice for the general meeting proposed for passing special resolution :

(*a*) the objects of the preferential issue;

(*b*) the proposal of the promoters, directors or key management personnel of the issuer to subscribe to the offer;

(*c*) the shareholding pattern of the issuer before and after the preferential issue;

(*d*) the time within which the preferential issue shall be completed;

(*e*) the identity of the proposed allottees, the percentage of post preferential issue capital that may be held by them and change in control, if any, in the issuer consequent to the preferential issue;

(*f*) an undertaking that the issuer shall re-compute the price of the specified securities in terms of the provision of these regulations where it is required to do so;

(*g*) an undertaking that if the amount payable on account of the re-computation of price is not paid within the time stipulated in these regulations, the specified securities shall continue to be locked-in till the time such amount is paid by the allottees.

(2) The issuer shall place a copy of the certificate of its statutory auditor before the general meeting of the shareholders, considering the proposed preferential issue, certifying that the issue is being made in accordance with the requirements of these regulations.

(3) Where specified securities are issued on a preferential basis to promoters, their relatives, associates and related entities for consideration other than cash, the valuation of the assets in consideration for which the equity shares are issued shall be done by an independent qualified valuer, which shall be submitted to the recognised stock exchanges where the equity shares of the issuer are listed:

Provided that if the recognised stock exchange is not satisfied with the appropriateness of the valuation, it may get the valuation done by any other valuer and for this purpose it may obtain any information, as deemed necessary, from the issuer.

(4) The special resolution shall specify the relevant date on the basis of which price of the equity shares to be allotted on conversion or exchange of convertible securities shall be calculated.

Explanation : For the purpose of sub-regulation (3), the term 'valuer' has the same meaning as is assigned to it under clause (*r*) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Sweat Equity) Regulations, 2002.

Allotment pursuant to Special Resolution

(1) Allotment pursuant to the special resolution shall be completed within a period of fifteen days from the date of passing of such resolution.

Where any application for exemption from the applicability of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or any approval or permission by any regulatory authority or the Central Government for allotment is pending, the period of fifteen days shall be counted from the date of order on such application or the date of approval or permission, as the case may be. However, where the Board has granted relaxation to the issuer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the preferential issue of equity shares and compulsorily convertible debt instruments, whether fully or partly, shall be made by it within such time as may be specified by the Board in its order granting the relaxation.

Again, requirement of allotment within fifteen days shall not apply to allotment of specified securities on preferential basis pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India.

(2) If the allotment of specified securities is not completed within fifteen days from the date of special resolution, a fresh special resolution shall be passed and the relevant date for determining the price of specified securities under these regulations will be taken with reference to the date of latter special resolution.

Tenure of Convertible Securities

The tenure of the convertible securities of the issuer shall not exceed eighteen months from the date of their allotment.

Pricing of Equity Shares

(1) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of twenty six weeks or more as on the relevant date, the equity shares shall be allotted at a price not less than higher of the following:

(*a*) The average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the twenty six weeks preceding the relevant date; or

(*b*) The average of the weekly high and low of the closing prices[14] of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(2) If the equity shares of the issuer have been listed on a recognised stock exchange for a period of less than twenty six weeks as on the relevant date, the equity shares shall be allotted at a price not less than the higher of the following:

(*a*) the price at which equity shares were issued by the issuer in its initial public offer or the value per share arrived at in a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013, pursuant to which the equity shares of the issuer were listed, as the case may be;

or

(*b*) the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during the period shares have been listed preceding the relevant date; or

(*c*) the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

(3) Where the price of the equity shares is determined in terms of sub-regulation (2), such price shall be recomputed by the issuer on completion of twenty six weeks from the date of listing on a recognised stock exchange with reference to the average of the weekly high and low of the closing prices of the related equity shares quoted on the recognised stock exchange during these twenty six weeks and if such recomputed price is higher than the price paid on allotment, the difference shall be paid by the allottees to the issuer.

(4) Any preferential issue of specified securities, to qualified institutional buyers not exceeding five in number, shall be made at a price not less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a recognised stock exchange during the two weeks preceding the relevant date.

Explanation : For the purpose of this regulation, 'stock exchange' means any of the recognised stock exchanges in which the equity shares are listed and in which the highest trading volume in respect of the equity shares of the issuer has been recorded during the preceding six months prior to the relevant date.

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14. In order to bring consistency between various regulations and to clarify certain regulations governing the preferential issue norms, SEBI in its Board meeting approved the following:
    (*i*) Replace 'closing price' with 'volume weighted average price' in the pricing formula for preferential issues.
    (*ii*) The regulations concerning pricing of QIPs take into account the effect of stock split, bonus, etc. However, this has not been explicitly provided for in the regulations concerning preferential issues. SEBI has decided to extend the same treatment to preferential issues also.
    (*iii*) The regulations concerning preferential issues do not provide specifically for pricing of infrequently traded shares. However, SEBI (SAST) Regulations explicitly specifies the pricing methodology in case of infrequently traded shares. It has been decided to extend similar treatment to preferential issues also. [Press Release No. 63/2014, dated 19-6-2014]

Payment of consideration

(1) Full consideration of specified securities other than warrants issued under these regulations shall be paid by the allottees at the time of allotment of such specified securities :

Provided that in case of a preferential issue of specified securities pursuant to a scheme of corporate debt restructuring as per the corporate debt restructuring framework specified by the Reserve Bank of India, the allottee may pay the consideration in terms of such scheme.

(2) An amount equivalent to at least twenty five per cent of the consideration determined in terms of regulation 76 shall be paid against each warrant on the date of allotment of warrants.

(3) The balance seventy five per cent of the consideration shall be paid at the time of allotment of equity shares pursuant to exercise of option against each such warrant by the warrant holder.

(4) In case the warrant holder does not exercise the option to take equity shares against any of the warrants held by him, the consideration paid in respect of such warrant in terms of sub-regulation (2) shall be forfeited by the issuer.

Lock-in of specified securities

(1) The specified securities allotted on preferential basis to promoter or promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to promoter or promoter group, shall be locked-in for a period of three years from the date of allotment of the specified securities or equity shares allotted pursuant to exercise of the option attached to warrant, as the case may be:

Provided that not more than twenty per cent of the total capital of the issuer shall be locked-in for three years from the date of allotment:

Provided further that equity shares allotted in excess of the twenty per cent shall be locked-in for one year from the date of their allotment pursuant to exercise of options or otherwise, as the case may be.

(2) The specified securities allotted on preferential basis to persons other than promoter and promoter group and the equity shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to such persons shall be locked in for a period of one year from the date of their allotment.

(3) The lock-in of equity shares allotted pursuant to conversion of convertible securities other than warrants, issued on preferential basis shall be reduced to the extent the convertible securities have already been locked-in.

(4) The equity shares issued on preferential basis pursuant to a scheme of corporate debt restructuring as per the Corporate Debt Restructuring Framework specified by the Reserve Bank of India shall be locked-in for a period of one year from the date of allotment:

Provided that partly paid-up equity shares, if any, shall be locked-in from the date of allotment and the lock-in shall end on the expiry of one year from the date when such equity shares become fully paid-up.

(5) If the amount payable by the allottee, in case of re-calculation of price under sub-regulation (3) of regulation 76 is not paid till the expiry of lock-in period, the equity shares shall continue to be locked in till such amount is paid by the allottee.

(6) The entire pre-preferential allotment shareholding of the allottees, if any, shall be locked-in from the relevant date up to a period of six months from the date of preferential allotment.

Explanation : For the purpose of this regulation:

(I) The expression "total capital of the issuer" means:

(*a*) equity share capital issued by way of public issue or rights issue including equity shares issued pursuant to conversion of specified securities which are convertible; and

(*b*) specified securities issued on a preferential basis to promoter or promoter group.

(II) (*a*) For the computation of twenty per cent of the total capital of the issuer, the amount of minimum promoters' contribution held and locked-in, in the past in terms of Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2009 *or* these regulations shall be taken into account.

(*b*) The minimum promoters' contribution shall not again be put under fresh lock-in, even though it is considered for computing the requirement of twenty per cent of the total capital of the issuer, in case the said minimum promoters' contribution is free of lock-in at the time of the preferential issue.

Transferability of locked-in specified securities and warrants issued on Preferential Basis

Subject to the provisions of Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, specified securities held by promoters and locked-in in terms of sub-regulation (1) of regulation 78 may be transferred among promoters or promoter group or to a new promoter or persons in control of the issuer:

Provided that lock-in on such specified securities shall continue for the remaining period with the transferee.

9.10 Allotment of shares

9.10-1 Meaning of allotment

Offer for shares are made on application forms supplied by the company. When an application is accepted, it amounts to an allotment. The expression allotment is not defined under the Companies Act. It means and implies a division of the share capital into defined shares of a particular value or of different classes and

assignment of such shares to different persons (Re. *Calcutta Stock Exchange Association Ltd.* [1957] 27 Comp. Cas. 559). The Supreme Court in *Sri Gopal Jalan and Co.* v. *Calcutta Stock Exchange Association Ltd.* AIR 1964 SC 250 defined allotment as "the appropriation out of the previously unappropriated capital of the company of a certain number of shares to a person."

Since re-issue of forfeited shares does not constitute appropriation out of unappropriated capital, it does not constitute allotment.

What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares - per *Chetty, J.* In *Re Florence Land & Public Works Ltd.* [1955] 29 Ch. D 421.

9.10-2 General principles regarding allotment

With regard to the allotment of shares, the following general principles should be observed in addition to the provisions of the Companies Act.

9.10-2[1] Proper authority

The allotment should be made by proper authority, *i.e.,* the Board of Directors of the company or a committee authorised to allot shares on behalf of the Board. An allotment made without proper authority will be invalid.

In *P.V. Damodara Reddy* v. *Indian National Agencies Ltd.* [1945] 15 Comp. Cas. 148 (Mad.), R&N applied to the company for allotment of shares. Their applications were considered by the Board and accepted and their names entered in the register. The Articles of the Company however provided that the shares could not be allotted to outsiders without the consent of the company in general meeting. Eight months later, on the objection of the Auditor, the allotment was cancelled and the names of R&N removed from the register. The contention of the company was that acceptance of the applicants' offers by the directors alone was entirely inoperative and accordingly there were no allotments and that the applicants must be deemed to have contracted on the footing of the Articles of Association.

Held, that applying the rule laid down in *Royal British Bank* v. *Turquand* [1856] 6E & B37, applicants were entitled to assume that the directors were acting regularly and that the sanction of the company in general meeting had in fact been obtained. That being so, allotments could not be avoided by the company.

However, allotment of shares in a joint stock company made by an irregularly constituted Board of directors shall *prima facie* be invalid - *Changa Mal* v. *Provincial Bank* [1914] ILR 36 All. 412.

9.10-2[2] Allotment against application only

No valid allotment can be made on an oral request. Section 2(55) provides that for becoming a member, a person should agree in writing. Thus, no allotment can be made without a written application for allotment [*H.H. Manabendra Shah* v. *Official Liquidator* [1977] 47 Comp. Cas. 356. In practice, application is to be made on the form supplied by the company in this regard.

Where there was no application in writing for allotment of shares and allotment was made in blank, company was rightly directed by the Special Court to return money

paid for shares. [*Rahul Subodh Windoors Ltd.* v. *A.K. Menon* [1999] 96 Comp. Cas. 597 (SC)].

9.10-2[3] Allotment not to be in contravention of any other law

If shares are issued in a manner prohibited by foreign exchange regulations, the issue would be invalid and void and confer on the allottee no title whatsoever to the shares - *Re Trans Atlantic Life Assurance Co. Ltd.* [1979] 3 All ER 352.

Similarly, an allotment of shares made for any improper motive is bad and can be struck down - *Unit Trust of India* v. *Om Prakash Berlia* [1983] 54 Comp. Cas. 723 (Bom.).

If shares are allotted on the application of a minor, the allotment will be void.

9.10-2[4] Reasonable time

Allotment must be made within a reasonable period of time; otherwise, the application lapses. What is reasonable time must remain a question of fact in each case. The interval of about 6 months between application and allotment has been held to be not reasonable - *Ramsgate Victoria Hotel Company* v. *Montefiore* [1866] LRI Ex. 109. On the expiry of reasonable time, section 6 of the Contract Act becomes applicable and the applications must be deemed to have been revoked. In *Karachi Oil Products Ltd.* v. *Kumar Shree Narendrasinghji* [1948] 18 Comp. Cas. 215 (Bom.), it was held that an allotment of shares made almost a year after the date of application was ineffective. However, if there is unreasonable delay in allotment of shares but shares are accepted by applicant and are not repudiated he cannot plead that his offer had lapsed because of delay. - *St. M.R.V.R. Murugappa Chettiar* v. *Pudukottai Ceramics Ltd.* [1955] 25 Comp. Cas. 78 (Mad.).

9.10-2[5] Communication

The allotment must be communicated to the applicant. A contract of allotment of shares is like any other contract. There is no fallacy in likening the contract, between a company and a person who makes an application to become a member, to an ordinary contract; the circumstances are different but the principles are identical. There must be the consent of the two parties. There must be acceptance of the offer by words or conduct to the knowledge of the person who made the offer. That is required in the case of an application for shares, just as in the case of any other contract.

In *Universal Banking Corporation, In re* [1867] LR 3 CH APP 40 (CA), one gentleman applied for the shares and remitted the application money; but he never received a certificate or a notice of allotment nor any information that shares had been allotted to him, nor was any demand made on him for remittance of the money on allotment, as was stipulated in the prospectus letter. When he enquired about the allotment, he was told that it would be looked into. However, it was recorded in the Minute Book that it has been resolved to allot shares to G; his name had already been entered in the register of shareholders. But as the company had been ordered to be wound up, the question was whether G's name had been properly put on the list of contributories. *Held,* that, in the circumstances, it was impossible to hold that any

contract had been entered into or that any knowledge of registration was given to G. It was not his duty to search the register; his name was, therefore, to be deleted from the list of contributories.

Similarly, in *Changa Mal* v. *Provincial Bank* [1914] 36 ILR 412 (All.), it was held that a person cannot be treated as a shareholder unless a notice of allotment has been sent to him.

However, once allotment is made and communicated, the directors shall have no power to release the shareholder by cancelling the allotment; not even on the ground that the shares had been taken under a mistake - *Karachi Oil Products Ltd.* v. *Kumar Shree Narendra Singh Ji* (*supra*).

Posting of a properly addressed and stamped letter of allotment is a sufficient communication even if the letter is delayed or lost in the course of post. *Household Fire and Carriage Accident Insurance Co.* v. *Grant*[15] is the leading authority in this regard. The defendant 'Grant' applied for some shares in the plaintiff company. His application was sent by post and a letter of allotment was dispatched by the company soon after. But the letter never reached the applicant. He was nevertheless held liable as a shareholder.

9.10-2[6] Absolute and unconditional

The allotment must be absolute and unconditional, *i.e.,* must be made on the same terms as stated in the application. *Thus,* where a person applied for 500 shares, he is not bound to accept an allotment of, say, 100 shares[16].

Where an applicant applied for shares in a company on the condition that he should be appointed a branch manager of the company; shares were allotted to him but he was not appointed the branch manager. *Held,* he was not bound by the allotment - *Ramanbhai* v. *Ghasi Ram* [1918] Bom. LR 595.

Likewise, no condition should be attached to the acceptance of an offer to purchase shares. If the acceptance introduced a new term, it will be a new offer by a company and it shall not be effective unless it is accepted by the applicant - *Gackson* v. *Turquand* [1869] LR 4 HL 305.

9.10-3 Statutory provisions regarding allotment

9.10-3[1] Registration of prospectus [Section 26(4)]

A copy of the prospectus signed by every person who is named therein as a director or proposed director of the company or by his duly authorized attorney shall be duly filed with the Registrar for registration on or before the date of its publication.

In case of contravention, the company shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and every person who is knowingly a party to the issue of such prospectus shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both.

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15. [1874-80] All ER 919 (CA)
16. To avoid this eventuality, the application form includes a clause whereby the applicant agrees to accept lesser number of shares in case of over-subscription.

9.10-3[2] Application money [Section 39(2)]

An amount payable on application on each share shall not be less than 5% of the nominal amount of the share or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf. However, as per SEBI Regulations, 2009, application money must not be less than 25% of the nominal amount of the share[17].

9.10-3[3] Minimum subscription [Section 39(1 &3)]

No allotment of any securities of a company offered to the public for subscription shall be made unless the amount stated in the prospectus as the minimum amount has been subscribed and the sums payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.

If the stated minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board[18], the amount received under sub-section (1) shall be returned within such time and manner as may be prescribed.

As per Rule 11 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 the application money shall be repaid within a period of 15 days from the closure of the issue. In case of failure to repay, 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 per cent per annum.

The application money to be refunded shall be credited only to the bank account from which the subscription was remitted.

In case of company's failure to return the amount, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less [Section 39(5)].

Where minimum prescribed subscription was not received for a public issue floated by petitioner-company and SEBI had advised petitioner-company to refund application monies to share applicants, the High Court of Delhi held that it was duty of petitioner-company to have made available adequate funds to respondent banks to issue refund warrants, irrespective of legal proceedings, if any, initiated by petitioner-company against respondent banks - *A P L Industries Ltd.* v. *Securities Exchange Board of India* [2016] 76 taxmann.com 133 (Delhi)

Minimum subscription would have to be calculated after excluding account requests made for withdrawal of share application- In SEBI v. A.P.L. Industries Ltd. [2013] 30 taxmann.com 384 (Delhi), on date of closure, public issue was over-subscribed by almost 1.71 times. However, when rejected share applications and request for withdrawal of share applications were taken into account, subscription to public issue fell to 83 per cent of total public issue made by respondent company. SEBI directed respondent to refund monies received from applicants against public issue. SAT, however, reversed order of SEBI. The question before the High Court was whether minimum subscription would have to be calculated by taking into account factum of number of withdrawal request, made qua share application

17. For details, see para 9.6-2.
18. For relevant SEBI Regulations, see para 9.6-2.

received. The Court held in the affirmative and observed that since minimum subscription amount was not reached, no allotment could be made and, therefore, order of SEBI would have to be sustained.

In *Rich Paints Ltd.* v. *Vadodara Stock Exchange Ltd.* [1998] 15 SCL 128/92 Comp. Cas. 282, the Gujarat High Court held that the application money cannot be said to have been paid to or received by the company which might have been physically received by the company, but which is not deposited in a separate bank account with the Scheduled Bank(s) which are bankers to the issue. *Thus*, where stockinvestments were made in the bank other than the banker to issue and if the stockinvests were excluded, minimum subscription of 90 per cent of the public issue was not fulfilled, it would be said that the amount relating to the stockinvests was not paid to and received by the company and, therefore, the provisions of section 69 (now section 39) were not complied with and the allotment of the shares was illegal and invalid.

9.10-3[4] Closing of the subscription list

Although Companies Act is silent as to the time for which the subscription list must be kept open, SEBI's Regulations, 2018 provide that the subscription list for public issue must be kept open for at least 3 working days and for not more than 10 working days. In case of revision of price bond, the issuer shall extend the bidding (issue) period for a minimum period of three working days.

In case of rights issue, the issue shall remain open for a minimum period of 15 days and cannot remain open beyond 30 days.

9.10-3[5] Permission to deal on a stock exchange [Section 40]

Every company making public offer shall, before making such offer, make an application to one or more recognised stock exchange or exchanges and obtain permission for the securities to be dealt with in such stock exchange or exchanges.

Where a prospectus states that an application under sub-section (1) has been made, such prospectus shall also state the name or names of the stock exchange in which the securities shall be dealt with.

Unless permission is granted by each or every one of all the stock exchanges named in the prospectus for listing of shares to which application is made by the company the consequence is to render the entire allotment void. *In other words*, if permission has not been granted by any one of the several stock exchanges named in the prospectus for listing of shares, the consequence is to render the entire allotment void and the grant of permission by one or more of them is inconsequential. **[Supreme Court in *Rishyashringa Jewellery Ltd.* v. *Stock Exchange* (1995); *Smt. Urmila Bharuka* v. *Coventry Spring and Engineering Co. Ltd. & Ors.* [1997]].**

However, where an appeal is preferred against the decision of the stock exchange, the allotment shall not be void till the appeal has been disposed off.

All monies received on application from the public for subscription to the securities shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than—

(*a*) for adjustment against allotment of securities where the securities have been permitted to be dealt with in the stock exchange or stock exchanges specified in the prospectus; or

(*b*) for the repayment of monies within the time specified by the Securities and Exchange Board, received from applicants in pursuance of the prospectus, where the company is for any other reason unable to allot securities.

If a default is made in complying with the aforesaid provisions, the company shall be punishable with a fine which shall not be less than five lakh rupees but which may extend to fifty lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees, or with both [Section 40(5)].

9.10-3[6] Basis of allotment

Allotment will be on proportionate basis within the specified categories rounded off to the nearest integer. Minimum allotment will be equal to the minimum application size as fixed and disclosed by the issuer. For details, *see under para 9.6-1.*

9.10-3[7] Over-subscription

As per SEBI Regulations, 2018, no allotment shall be made by the issuer in excess of the specified securities offered through the offer document. However, in case of oversubscription, an allotment of not more than ten per cent of the net offer to public may be made for the purpose of making allotment in minimum lots.

9.11 Jurisdictions of the Court

In terms of the decision in *Harikumar Rajah* v. *Ashok R. Thakkar* [2004] 51 SCL 735 (Mad.), the Court having jurisdiction on the place where the registered office is located will be the proper Court for admitting a case questioning allotment of shares, irrespective of the residence of the company's directors or any majority of them.

9.11A Allotment of shares for consideration other than cash

In *Sajal Dutta* v. *Ruby General Hospital Ltd.* [2015] 56 taxmann.com 93 (CLB - New Delhi), it was held that where directors of company had an arrangement of allotment of shares against value of medical equipment supplied at the inception stage of the company, allotment of shares was perfectly valid.

9.11B Allotment of shares in contravention of Established Procedure

In *Babu Khandelwal* v. *Andhra Ferro Alloys Ltd.* [2015] 129 SCL 719/53 taxmann.com 99 (CLB-Chennai), Petitioner contended that respondents 2 and 3 allotted shares of R1 company to themselves without offering to petitioners on proportionate basis. Main grievance of petitioners was that by virtue of said allotment, petitioners' shareholding got diluted and respondents' shareholding was enhanced to detriment of interest of petitioners. It was contended that no notice was sent to petitioners and no proof of service was produced by respondents with regard to meetings in which the said allotments had taken place. Since the respondents failed to establish that shares had been offered to petitioners who were major shareholders at the time of allotment, CLB (now Tribunal) held the allotment made only to respondents as illegal and hence was set aside.

9.12 Allotment of shares to a charitable institution by way of donation - Whether allowed

A public limited company has no power to issue any shares without consideration except the bonus shares. The shares can be issued for consideration payable in money or in the form of some valuable assets or against some service rendered to the company. If there is no payment in money or monies worth for the shares, the allotment would be *ultra vires*. In case of allotment for consideration other than cash a company is required to disclose in the return of allotment the number of shares allotted by it for consideration otherwise than in cash. The company is also required to produce for inspection and examination of the Registrar the actual contracts in writing constituting the title of the allottee in the shares together with relevant contracts of sales or service. The copies certified in the prescribed manner of all such contracts must also be filed with the Registrar.

From the above, it is amply clear that allotment of shares by the company as fully paid up shares to a charitable trust by way of donation shall not be valid. This position is based on the law of contract.

9.12A Shares held in Trust - Disclosure of Beneficial Interest (Sections 89 and 90)

Section 89 identifies two types of interests. One is legal interest vested with the registered holders of the shares, who is also referred as the 'registered or ostensible member'. Another is a beneficial interest vested with the beneficial owner or the beneficial member.

Meaning of Beneficial Interest (Section 89)

As per the Companies (Amendment) Act, 2017, Beneficial interest in a share includes the right or entitlement of a person alone or together with any other person to—

(*i*) exercise or cause to be exercised any or all of the rights attached to such share; or

(*ii*) receive or participate in any dividend or other distribution in respect of such share.

The aforesaid right might be conferred, directly or indirectly or through any contract, arrangement or otherwise*.

Disclosure of Beneficial Interest (Section 90)

The following provisions of Section 90, as amended by the Companies (Amendment) Act, 2017 may be noted with respect to disclosure of beneficial interest:

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*As per the Companies (Significant Beneficial Owners) Amendment Rules, 2019, "significant beneficial owner" in relation to a reporting company means an individual referred to in sub-section (1) of section 90, who acting alone or together, or through one or more persons or trust, possesses one or more of the following rights or entitlements in such reporting company, namely:- (*i*) holds indirectly, or together with any direct holdings, not less than ten per cent of the shares; (*ii*) holds indirectly, or together with any direct holdings, not less than ten per cent of the voting rights in the shares; (*iii*) has right to receive or participate in not less than ten per cent of the total distributable dividend, or any other distribution, in a financial year through indirect holdings alone, or together with any direct holdings; (iv) has right to exercise, or actually exercises, significant influence or control, in any manner other than through direct holdings alone.

(1) Every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, ***of not less than twenty-five per cent or such other percentage as may be prescribed***, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (*27*) of section 2, over the company (herein referred to as ***"significant beneficial owner"***), shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed.

However, the Central Government may prescribe a class or classes of persons who shall not be required to make declaration under this sub-section.

(2) Every company shall maintain a register of the interest declared by individuals under sub-section (1) and changes therein which shall include the name of individual, his date of birth, address, details of ownership in the company and such other details as may be prescribed.

(3) The register maintained under sub-section (2) shall be open to inspection by any member of the company on payment of such fees as may be prescribed.

(4) Every company shall file a return of significant beneficial owners of the company and changes therein with the Registrar containing names, addresses and other details as may be prescribed within such time, in such form and manner as may be prescribed.

(5) A company shall give notice, in the prescribed manner, to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe- (*a*) to be a significant beneficial owner of the company; (*b*) to be having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or (*c*) to have been a significant beneficial owner of the company at any time during the three years immediately preceding the date on which the notice is issued, and who is not registered as a significant beneficial owner with the company as required under this section.

(6) The information required by the notice under sub-section (5) shall be given by the concerned person within a period not exceeding thirty days of the date of the notice.

(7) The company shall,- (a) where that person fails to give the company the information required by the notice within the time specified therein; or (b) where the information given is not satisfactory, apply to the Tribunal within a period of fifteen days of the expiry of the period specified in the notice, for an order directing that the shares in question be subject to restrictions with regard to transfer of interest, suspension of all rights attached to the shares and such other matters as may be prescribed.

(8) On any application made under sub-section (7), the Tribunal may, after giving an opportunity of being heard to the parties concerned, make such order restricting the rights attached with the shares within a period of sixty days of receipt of application or such other period as may be prescribed.

(9) The company or the person aggrieved by the order of the Tribunal may make an application to the Tribunal for relaxation or lifting of the restrictions placed under sub-section (8). The company or the person aggrieved by the order of the Tribunal may make an application to the Tribunal for relaxation or lifting of the restrictions placed under sub-section (8), within a period of one year from the date of such order:

Provided that if no such application has been filed within a period of one year from the date of the order under sub-section (8), such shares shall be transferred, without any restrictions, to the authority constituted under sub-section (5) of section 125, in such manner as may be prescribed [Sub-section (9) inserted by the Companies (Amendment) Act, 2019]

(10) If any person fails to make a declaration as required under sub-section (1), he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees or both and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues*.

(11) If a company, required to maintain register under sub-section (2) and file the information under sub-section (4), fails to do so or denies inspection as provided therein, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than ten lakh rupees but which may extend to fifty lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the failure continues.

(12) If any person wilfully furnishes any false or incorrect information or suppresses any material information of which he is aware in the declaration made under this section, he shall be liable to action under section 447.

9.13 Return as to allotment

Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed [Section 39(4)].

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

Re-issue of forfeited shares : No return of allotment is required to be filed with regard to the re-issue of forfeited shares because re-issue of such shares does not amount to allotment. It is only the re-issue of existing shares.

9.14 Underwriting

9.14-1 Meaning of underwriting

According to Palmer**, underwriting is an expression used in company matters signifying a contract by which a person (known as the underwriter) agrees (usually for a commission) that if the shares, debentures, or debenture stock about to be

*Sub-section (10) as amended by the Companies (Amendment) Act, 2019.

**Company Precedents, Part I, 17th Edition, page 175.

offered for subscription or some specified proportions thereof, are not, within a specified time, taken up by the public, or by that Section of the public to which they are to be offered, he will himself take them up and pay for what the public do not take up or some specified proportions thereof.

SEBI Regulations, 2009 define underwriting to mean an agreement with or without conditions to subscribe to the securities of a body corporate when the existing shareholders of such body corporate or the public do not subscribe to the securities offered to them.

Underwriting is thus in the nature of an insurance against the possibility of inadequate subscription - *Nani Gopal Lahiri* v. *State of U.P.* [1965]

Section 26 of the Companies Act, 2013 read along with **Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014** require a prospectus to state the details about underwriting of the issue including the names, addresses, telephone numbers, fax numbers and e-mail addresses of the underwriters and the amount underwritten by them. Further, **Rule 13** provides that a company may pay commission to any person in connection with the subscription or procurement of subscription to its securities, whether absolute or conditional, subject to the following conditions, namely:—

(*a*) the payment of such commission shall be authorized in the company's articles of association;

(*b*) the commission may be paid out of proceeds of the issue or the profit of the company or both;

(*c*) the rate of commission paid or agreed to be paid shall not exceed, in case of shares, five per cent of the price at which the shares are issued or a rate authorised by the articles, whichever is less, and in case of debentures, shall not exceed two and a half per cent of the price at which the debentures are issued, or as specified in the company's articles, whichever is less;

(*d*) the prospectus of the company shall disclose—

(*i*) the name of the underwriters;

(*ii*) the rate and amount of the commission payable to the underwriter; and

(*iii*) the number of securities which is to be underwritten or subscribed by the underwriter absolutely or conditionally.

(*e*) there shall not be paid commission to any underwriter on securities which are not offered to the public for subscription;

(*f*) a copy of the contract for the payment of commission is delivered to the Registrar at the time of delivery of the prospectus for registration.

Section 36 (1) provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or deliberately conceals any material facts, to induce another person to enter into, or to offer to enter into any agreement for underwriting securities shall be liable for action under section 447*.

*As per section 447, any person who is found to be guilty of fraud, shall be punishable 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.

Again, section 40(6) allows a company to pay commission to any person in connection with the subscription to its securities subject to such conditions as may be prescribed. ***Companies (Meetings of Board and its Powers) Rules, 2014*** provide that a company having a paid-up share capital of ten crore rupees or more shall not pay underwriting commission of more than one per cent except with the prior approval of the company by a special resolution.

9.14-2 Sub-underwriting

The underwriter usually chooses to spread his risk by using sub-underwriters who agree to take certain number of shares for which they receive a commission. The liability of sub-underwriter is contingent upon :

(*a*) the number of shares subscribed by the public ;

(*b*) the intimation by the underwriter to the sub-underwriter that the latter shall subscribe or procure subscriptions [*Dena Bank* v. *K. Motiram Vakil* AIR 1989 Bom. 264].

A sub-underwriting letter authorising an underwriter to apply for shares for a valuable consideration, if the offer is accepted by the underwriter, amounts to an authority coupled with interest and is irrevocable [*Olympic Fire and General Re-Insurance Company Ltd.* [1902] 2 CH. 341].

In case of discrepancy between an underwriting agreement and sub-underwriting, say, where the sub-underwriting mentions the shares at par whereas it was a premium issue, it was held that the sub-underwriter was bound by the allotment at premium [*Greater Britain Insurance Corporation Ltd.* [1920] 124 L.T. 194].

9.15 Brokerage

Brokerage is the reward paid to a middle man (called broker) who brings about a bargain between the seller and a purchaser of shares or debentures. Brokerage is different from the underwriting commission because the underwriter undertakes to subscribe for shares in case public defaults but the broker does not incur any such liability. If he brings a bargain between the company and the allottee, he gets the brokerage, and otherwise not.

The word used in section 40(6) as well as in **Rule13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014** is 'commission'. Thus, Section 40 as well as Rule 13 does not limit its scope to 'underwriting commission'. **Companies (Meetings of Board and its Powers) Rules, 2014** restrict the powers of Board of directors in respect of 'underwriting commission' only. The restriction, therefore, does not appear to extend to payment of lawful brokerage.

The amount of brokerage paid or payable should be disclosed in the prospectus. However, brokerage can be paid only to professional brokers and not to a person who has casually induced others to subscribe. In ***Andrew* vs. *Zinc Mines of Great Britain (supra)***, the company agreed to pay commission for sale of shares to an allottee that was not carrying on any business. ***Held***, it cannot be suggested that what was to be paid to the plaintiff was brokerage. She was in no sense a broker. She did not carry on business as broker and it was a mere accident that she came into the company's office and was consulted in this matter.

The provisions as noted above, apply to all companies, private as well as public.

9.16 Buy-back/Purchase of its own shares by a company

Section 67(1) of the Companies Act, 2013 provides that a company limited by shares or a company limited by guarantee having a share capital cannot buy its own shares. The restriction is applicable to all companies having share capital, whether public or private*.

However, Section 68 allows a company to purchase its own shares or other securities subject to certain conditions. The provisions of Section 68 are as follows:

9.16-1 Sources to Buy-Back

A company can buy its own shares and other specified securities out of :

(*i*) its free reserves; or

(*ii*) the securities premium account; or

(*iii*) the proceeds of any shares or other specified securities. However, no buy-back shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

In case shares are bought back out of free reserves then Section 69 stipulates that a sum equal to the nominal value of shares bought back shall be transferred to a reserve account to be called the 'Capital Redemption Reserve Account' and details of such transfer shall be disclosed in the balance-sheet. This account may be applied by the company for issue of fully paid bonus shares.

9.16-2 Conditions for buy-back

A. Section 68(2) provides that no company shall purchase its own shares or other specified securities unless :

(*a*) the buy-back is authorised by its articles;

(*b*) a special resolution has been passed at a general meeting of the company authorising the buy-back. However, buy-back up to ten per cent of the total paid-up equity capital and free reserves of the company may be affected by passing a resolution at a meeting of the Board of directors of the company;

SEBI regulations, as amended up to 1-8-2014, provide that the resolution of the Board of directors must be filed with SEBI and the stock exchanges where the shares or other specified securities of the company are listed, within two working days of the date of the passing of the resolution. '*Working day*' means any working day of SEBI.

(*c*) the buy-back is twenty-five per cent or less of the aggregate of paid-up capital and free reserves of the company.

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*The prohibition to buy back its own shares shall not apply to a private company:

(*a*) In whose share capital no other body corporate has invested any money;

(*b*) If the borrowings of such a company from banks or financial institutions or any body corporate is less than twice its paid up share capital or 50 crore rupees, whichever is lower; and

(*c*) Such a company is not in default in repayment of such borrowings subsisting at the time of making transactions under this section. – *Vide MCA Notification dated 5-6-2015*

In case of buy-back of equity shares in any financial year, buy-back cannot exceed 25% of its total paid-up equity capital in that financial year.

However, there cannot be more than one such buy-back within a period of one year reckoned from the date of the closure of the preceding offer of buy-back.

(*d*) the ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies;

(*e*) all the shares or other specified securities for buy-back are fully paid-up;

(*f*) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by the Securities and Exchange Board in this behalf; and

(*g*) the buy-back in respect of shares or other specified securities other than those specified in clause (*f*) is in accordance with such rules as may be prescribed.*

B. The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement containing specified particulars.

C. Every buy-back shall be completed *within a period of one year* from the date of passing the Special resolution /Board's resolution under sub-section (2) of Section 68.

D. Buy-back shall be permissible :

(*a*) from the existing shareholders or security holders on a proportionate basis;

(*b*) from the open market;

(*c*) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

E. Where a company proposes to buy-back its own shares or other specified securities under this section in pursuance of a special resolution/Directors' resolution, it shall, before making such buy-back, file with the Registrar and the Securities and Exchange Board, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, in such form as may be prescribed and verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board.

No declaration of solvency shall be required to be filed with the Securities and Exchange Board by a company whose shares are not listed on any recognised stock exchange. It may be noted that exemption in this regard shall be available for only those companies whose shares are not listed irrespective of any of its other security being listed.

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*Rule 17 of the Companies (Share capital and Debentures) Rules, 2014 (as amended) contain the relevant requirements w.r.t. unlisted companies.

F. Where a company buys-back its own securities, it shall extinguish and physically destroy the securities so bought-back *within seven days* of the last date of completion of buy-back.

G. Where a company completes a buy-back of its shares and other specified securities under this Section, it shall not make further issue of the same kind of shares including by way of rights or other specified securities within a period of *six months* except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option scheme, sweat equity or conversion of preference shares or debentures into equity shares.

H. Where a company buys-back its securities under this Section, it shall maintain a register of the securities so bought, the consideration paid for the securities bought-back, the date of cancellation of securities, the date of extinguishing and physically destroying of securities and such other particulars as may be prescribed.

I. A company shall after the completion of the buy-back file with the ROC and SEBI a return containing such particulars relating to the buy-back within 30 days of such completion, as may be prescribed.

However, the aforesaid return shall not be required to be filed with SEBI if the company's shares are not listed on any recognized stock exchange.

9.16-3 Benefits/Objectives underlying buy-back of shares

Buy-back, as such, is a recent corporate phenomenon in our country. The provisions of sections 68, 69 and 70 allow buy-back. The objectives underlying the introduction of buy-back provisions may be any or a combination of following motives—

(*i*) return of surplus cash to the shareholders, when paid up share capital appears to be more than necessary,

(*ii*) increase of current share price of the company,

(*iii*) support to share price when company activities are on a reduced scale,

(*iv*) maintaining a revised capital structure,

(*v*) discourage unwelcome takeover bids,

(*vi*) increase in dividend rate,

(*vii*) increase in earning per share,

(*viii*) more efficient use of the corporate resources, and

(*ix*) increase in promoters'/controlling shareholders' stake in the company by resorting to open market purchase or selective buy-back.

Section 77A [Now section 68] is intended to provide certain checks on the company which desires to buy-back its shares; but this section will have no application when buy-back is otherwise occasioned *e.g.* under section 402 [Now section 242] of the Act - *Gurmeet Singh* v. *Polymer Papers Ltd.* [2003] 45 SCL 251 (CLB).

In *D. Link (India) Ltd.* v. *SEBI* [2008] SCL 385 (SAT - Mum.), it has been held by the Appellate Tribunal that a special resolution passed by shareholders of a listed company is only an enabling act and not binding on the company to make the offer of buy-back.

9.16-4 SEBI Regulations : SEBI (Buy-back of Securities)

Regulations, stipulate as follows :

1. Buy-back shall be permissible :[19]

(*a*) from the existing shareholders or security holders on a proportionate basis:

Provided that 15% of the number of securities which the company proposes to buy back or number of securities entitled as per their shareholding, whichever is higher, shall be reserved for small shareholders. A 'small shareholder' means a shareholder the market value of whose shares is not more than two lakh rupees;

(*b*) from the open market through—

(*i*) book-building process,

(*ii*) stock exchange;

(*c*) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

SEBI *vide* its Notification No. SO 263(E), dated 16-4-1999 has allowed the foreign institutional investors to sell the securities held by them to a company intended to buy-back its securities subject to SEBI regulations in this regard.

Accordingly, the company may buy-back its securities from any foreign institutional investor.

Where the company proposes to buy-back its shares, it shall, after passing of the special resolution or a resolution of the Board of directors at its meeting, make a public announcement within two working days from the date of resolution in at least one English National Daily, one Hindi National Daily and a Regional language Daily all with wide circulation, at the place where the registered office of the company is situated and shall contain all the material information as specified in Schedule II, Part A of SEBI Regulations on buy-back. A copy of the public announcement alongwith the soft copy, shall also be submitted to SEBI simultaneously through a Merchant banker.

The company shall within 5 working days of the public announcement file with SEBI a draft letter of offer alongwith soft copy containing disclosures as specified in Schedule III through a merchant banker who is not associated with the company. The aforesaid draft letter of offer should be accompanied with the prescribed fee as per Schedule IV.

The Board may give its comments on the draft letter of offer not later than seven working days of the receipt of the draft letter of offer:

Provided that in the event the Board has sought clarifications or additional information from the merchant banker to the buyback offer, the period of issuance of comments shall be extended to the seventh working day from the date of receipt of satisfactory reply to the clarification or additional information sought:

Provided further that in the event the Board specifies any changes, the merchant banker to the buyback offer and the company shall carryout such changes in the letter of offer before it is dispatched to the shareholders.

19. As per SEBI Regulations and section 68(5) read together.

A copy of the resolution, passed by the Board of directors at its meeting, authorising buy-back of its securities, shall be filed with the SEBI and the stock exchanges where the securities of the company are listed, within two working days of the date of the passing of the resolution. 'Working day' means any working day of SEBI.

It may, however, be noted that where a company decides to buy-back through the public offer or tender route, it shall have to open an escrow account on the same lines as the one in the take-over code.

2. Buy-back through negotiated deals, spot transactions and private placement will not be permitted. Further, any person or an insider shall not deal in securities of the company on the basis of unpublished information relating to buy-back of shares of the company.

3. Maximum price at which shares shall be bought back shall be determined either by shareholders through a special resolution or through the resolution passed by the Board of directors at its meeting. A copy of the special resolution or the Board's resolution, as the case may be, shall be filed with SEBI as well as the stock exchange(s) where the shares of the company are listed within 7 days and 2 working days respectively from the date of passing of such resolution.

4. Companies buying back *via* stock exchanges must disclose purchases daily.

5. In case of buy-back of shares through the stock market route, the purchases shall not be made from the promoters or persons in control of the company.

6. Promoters would be required to declare upfront the 'pre' and 'post' buy-back holding in order to prevent manipulation.

(7) (*i*) "A company making a buyback offer shall announce a record date for the purpose of determining the entitlement and the names of the security holders, who are eligible to participate in the proposed buyback offer.

(*ii*) The letter of offer alongwith the tender form shall be dispatched to the security holders who are eligible to participate in the buyback offer, not later than five working days from the receipt of communication of comments from the Board.

(*iii*) The date of the opening of the offer shall be not later than five working days from the date of dispatch of letter of offer.

(*iv*) The offer for buy back shall remain open for a period of ten working days.

(*v*) The company shall accept shares or other specified securities from the security holders on the basis of their entitlement as on record date.

(*vi*) The shares proposed to be bought back shall be divided into two categories; (*a*) reserved category for small shareholders, and (*b*) the general category for other shareholders, and the entitlement of a shareholder in each category shall be calculated accordingly.

(*vii*) After accepting the shares or other specified securities tendered on the basis of entitlement, shares or other specified securities left to be bought back, if any, in one category shall first be accepted, in proportion to the shares or other specified securities tendered over and above their entitlement in the offer by security holders in that category and thereafter from security

holders who have tendered over and above their entitlement in other category."

8. Onus of compliance of SEBI regulations shall be on the merchant banker who shall be required to file a 'due diligence certificate' with the SEBI.

9. Obligations of the company :

(*a*) The company shall ensure that :

(*i*) the letter of offer, the public announcement of the offer or any other advertisement, circular, brochure, publicity material shall contain true, factual and material information and shall not contain any misleading information and must state that the directors of the company accept the responsibility for the information contained in such documents;

(*ii*) the company shall not issue any shares including by way of bonus till the date of closure of the offer;

(*iii*) the company shall complete the verifications of offers received and make payment of consideration to those security holders whose offers have been accepted or return the shares or other specified securities to the security holders within 7 working days of the closure of the offer.

(*iv*) the company shall pay the consideration only by way of cash;

(*v*) the company shall not withdraw the offer to buy-back after the draft letter of offer is filed with the SEBI or public announcement of the offer to buy-back is made;

(*vi*) the promoter or the person in control of the company shall not deal in the shares of the company in the stock exchange during the period of the buy-back offer.

(*b*) No public announcement of buy-back shall be made during the pendency of any scheme of amalgamation or compromise or arrangement pursuant to the provisions of the Companies Act.

(*c*) The company shall nominate a compliance officer and investors service centre for compliance with the buy-back regulations and to redress the grievances of the investors.

(*d*) The company shall not buy-back the locked in shares and non-transferable shares till the pendency of the lock-in or till the shares become transferable.

(*e*) The company shall *within 2 days* of the completion of buy-back issue a public advertisement in a national daily, *inter alia,* disclosing:

(*i*) number of shares bought; (*ii*) price at which bought; (*iii*) total amount invested in buy back; (*iv*) details of shareholders from whom shares exceeding 1% of the total shares bought back; and (*v*) the consequent changes in the capital structure and the shareholding pattern after and before the buy-back.

(*f*) A company shall, after the completion of the buy-back under this section, file with the Registrar and the Securities and Exchange Board of India, a return containing such particulars relating to the buy-back within thirty days of such completion, as may be prescribed. However, no such return should be filed with the SEBI if its shares are not listed.

9.16-5 Penalty

If a company makes default in complying with the provisions of Section 68 or any rules and regulations made thereunder, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

9.16-6 Prohibition for buy-back in certain circumstances [Sec. 70]

No company shall, directly or indirectly, purchase its own shares or other specified securities:

(*a*) through any subsidiary company including its own subsidiary companies;

(*b*) through any investment company or group of investment companies; or

(*c*) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of the Companies Act, 2013, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. However, the buy-back shall be permissible after a period of three years from the date such default ceased to subsist.

Again, No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of Sections 92, 123, 127 and Section 129.

In the following cases, however, a company is not taken to have purchased its own shares:—

(*a*) where it redeems its preference shares;

(*b*) forfeits its shares for non-payment of calls;

(*c*) accepts a valid surrender of shares.

Although a company cannot purchase or hold its own shares, a bequest (transfer through 'Will') of its shares by a shareholder to the company is not illegal.[20]

Also, a company may have the shares transferred to a nominee in trust for itself, the nominee being a person qualified to hold shares under a company's Articles of Association [*In re, Indian Iron & Steel Co. Ltd.* AIR 1957 Cal. 234].

Similarly, receiving of shares by way of gift cannot be said to be prohibited under this section.

9.16-7 Giving of Loan/Financial Assistance Prohibited

Sub-section (2) of Section 67 further disallows a public company and a private subsidiary of a public company to give loan or provide financial assistance (directly or indirectly) to any person to enable him to purchase or subscribe company's own shares or shares of its holding company.

20. Costiglion's Will Trusts, In re [1958].

However, the aforesaid provisions regarding the prohibition to buy its own shares or give loans or provide financial assistance shall not affect :

(*a*) The lending of money by a banking company in the ordinary course of its business. However, loans deliberately made by a banking company for the direct purpose of financing the purchase of its own shares cannot come within the exemptions - *Louis Steen* v. *Charles Allen Law* [1963].

(*b*) the provision by a company of money in accordance with any scheme approved by company through special resolution and in accordance with such requirements as may be prescribed, for the purchase of, or subscription for, fully paid-up shares in the company or its holding company, if the purchase of, or the subscription is for, the shares held by trustees for the benefit of the employees or such shares are held by the employees of the company;

(*c*) the giving of loans by a company to persons in the employment of the company other than its directors or key managerial personnel, with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership. However, the amount so advanced must not exceed their salary or wages for a period of six months.

(*d*) A company may buy its own shares from any member for prevention of oppression and mismanagement in pursuance of the Tribunal order under Section 242 of the Act.

(*e*) A private company not being a subsidiary of a public company though not allowed to buy its own shares may advance loan or financial assistance for purchase of its shares or shares of its holding company.

(*f*) The Section does not apply to the case of any holding company purchasing the shares of or lending money to any person for purchasing shares of its subsidiary.

(*g*) The Section would also not include the lending of money in accordance with the company's memorandum and articles to shareholder on the security of company's shares. It creates only a lien on the shares.

Penalty: If a company contravenes the provisions of section 67, it shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

9.17 Issue of securities at a premium

A company may issue securities at a premium when it is able to sell them at a price above par or above face value, for example, Rs. 100 per share at a price of Rs. 120, thereby earning a premium of Rs. 20 per share. The Companies Act, 2013 does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium. However, the Companies Act does impose conditions

regarding the utilisation of the amount of premium collected on securities. *Firstly,* the premium cannot be treated as profit and, therefore, cannot be distributed as dividend. However, the same can be capitalised and distributed in the form of bonus shares. *Secondly,* the amount of premium, whether received in cash or in kind, must be recorded in a separate account, known as the "Securities Premium A/c". *Thirdly,* the amount of securities premium is to be maintained with the same sanctity as the share capital. *Fourthly,* the securities premium amount cannot be treated as free reserves as it is in the nature of capital reserve.

According to Section 52(2), the share premium can be utilised only for:

(*a*) issuing fully paid bonus shares to members.

(*b*) writing off the balance of the preliminary expenses of the company;

(*c*) writing off the commission paid or discount allowed, or expenses incurred on issue of shares or debentures of the company;

(*d*) providing for the premium payable on redemption of any redeemable preference shares or debentures of the company.

(*e*) for the purchase of its own shares or other securities under section 68.

Sub-section (3) of Section 52 further provides that the securities premium account may be used in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,—

(*a*) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or

(*b*) in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company; or

(*c*) for the purchase of its own shares or other securities under section 68.

Unless articles of association of company permit utilization of share premium account for purpose other than mentioned in section 78(2) [Now section 52(2)], company court cannot approve resolution to that effect - *Hyderabad Industries Ltd., In re* [2004] 53 SCL 376 (AP).

However, Rajasthan High Court has held that a company can utilize credit balance in securities premium account for purpose of meeting deferred tax liability - *Mangalam Cement Ltd., In re* [2008] 86 SCL 153 (Raj.). In a scheme of arrangement, where, *inter alia,* the credit balance in Security Premium Account is sought to be transferred to 'Business Reconstruction Reserve', the same can be allowed by the Court considering the scheme, inspite of the express provisions of section 78(2) - *DSM Anti Infectives (I) Ltd., In re* [2010] 104 SCL 384 (Punj. & Har.). Also *see, Sintex Industries Ltd., In re* [2011] 105 SCL 572 (Guj.).

Further, unless and until there is diminution of the share capital and corresponding reduction of the share premium account (now securities premium account), no company can be allowed to write off or adjust the loss against share premium account (now securities premium account) - *Hyderabad Industries Ltd., In re* [2004] 53 SCL 376 (AP). Similar decision was given in *Global Trust Bank Ltd., In re* [2005] 57 SCL 164 (AP). Also *see, Hill Crest Realty Sdn. Bhd.* v. *Ram Parshotam Mittal* [2010] 103 SCL 80 (Delhi)

Where decision to adjust consolidated loss with surplus in Securities Premium Account was purely a commercial decision with approval by shareholders with required majority by way of a special resolution and same was in consonance with Articles of Association of petitioner company, reduction of petitioner company's share capital (Securities Premium Account) against accumulated losses was to be allowed - *Vaibhav Global Ltd., In re* [2016] 76 taxmann.com 249 (Rajasthan)

The rate of premium will be decided by the Board of directors.

SEBI vide its Regulations, 2009 has allowed every company which is entitled to make a public issue, to offer its shares either at par or premium subject only to stating justification for premium.

For utilization of the share premium account for purposes mentioned in section 78(2) [Now section 52(2)], no approval or sanction of the Court is required - *Hyderabad Industries Ltd., In re* [2004] 53 SCL 376 (AP).

Securities Premium Account and Reduction of Share Capital - Section 52 of the Act, in sub-section (1), *inter alia,* provides that Securities Premium Account is to be treated as paid-up share capital and provisions of the Act relating to reduction of share capital shall apply. Regulation 38 of Table F to Schedule I of the Act allows share premium account to be reduced by passing special resolution and with consent as may be required by law. It is, therefore, clear that share premium account (Securities Premium Account) can be made subject to reduction provided the Articles authorize such reduction and members have passed a special resolution. The above is apart from the utilization of Securities Premium Account mentioned above (*vide* section 52(2) of the Act). In this regard, cases of *Parry Confectionery Ltd., In re* [2004] 56 SCL 34 (Mad.), *Hyderabad Industries Ltd., In re* [2004] 53 SCL 376 (AP) and *Zee Tele Films Ltd. In re* [2004] 53 SCL 387 (Bom.) can be cited. In each of these cases permanent loss of paid-up capital was allowed to be set off against Securities Premium Account, in light of provisions in respective Articles of Association and provisions of section 78(1) [Now section 52] read along with section 100(1)(*b*) [Now section 66] of the Act.

Again, in *Hill Crest Realty Sdn. Bhd.* v. *Ram Parshotam Mittal* [2010] 103 SCL 80 (Delhi), High Court of Delhi held that the proposals for upgrading the business, and purchase of various equipments, renovations, etc., may not fall within the description of section 78(2) [Now section 52(2)]. In this case, the plaintiff-company issued right shares at premium. The share premium account was to be utilized by it for purpose of upgrading the business and purchase of various equipments, renovations, etc. The defendants filed temporary injunction application contending that the proposed expenditure of the amounts received from the rights issue, was impermissible, having regard to section 78 [Now section 52(2)].

The court held that the provisions of, and procedure prescribed for under sections 100 to 102 [Now section 66], for reduction of share capital would apply, wherever a company proposes to utilize amounts from the securities premium account, for any purpose, other than what is provided for under section 78 [Now section 52(2)]. Upgrading the business and purchase of various equipments, renovations, etc. does not fall within the permissible uses of the securities premium amount under section 78(2) [Now section 52(2)].

In the circumstances, the plaintiff was, therefore, advised to approach and seek approval under sections 100 and 101 [Now section 66].

9.18 Issue of shares at a discount [Section 53]

If the buyer of shares is required to pay less than face value of the share, for example, Rs. 9 on a share of Rs. 10, then the share is said to be issued or sold at a discount. The issue of shares at a discount is regulated by law and Section 53 provides that except as provided in section 54, a company shall not issue shares at a discount. Section 54 allows only 'sweat equity shares' to be issued at a discount and that too subject to compliance of the specified conditions.

Any share issued by a company at a discount shall be void.

However, as per the Companies (Amendment) Act, 2017, a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Where a company contravenes the provisions of section 53, sub-section (3), as amended by the Companies (Amendment) Act, 2019, lays down that the company and every officer-in-default shall pay a penalty which may extend to an amount raised through issue of shares at discount or Rs. 5 lakhs, whichever is less and the company shall also be liable to refund the amount with interest at the rate of 12% p.a. from the date of issue of shares to the respective persons to whom the shares were issued.

9.19 Issue of sweat equity shares [Section 54]

"Sweat equity shares" means such equity shares as are issued by a company to its directors[21] or employees[22] at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called [Section 2(88)].

Sweat equity shares are thus issued to employees or directors, as aforesaid. These are issued at a discount (to market price) or for providing knowhow or making available rights in the nature of intellectual property rights or value additions.

A company can issue sweat equity shares only of a class of shares already issued.

Besides, for issue of sweat equity shares, Section 54, inter alia, *requires to ensure that:*

(*a*) The issue is authorized by a special resolution passed by the company. As per **Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014,** the special resolution authorizing the issue of sweat equity shares shall be valid

21. A director of the company includes a whole time director as well as other directors of the company as well as its subsidiary or holding company, in India or outside India

22. As per Rule 8 of *the Companies (Share Capital and Debentures) Rules, 2014,* 'employee' means a permanent employee of the company who has been working in India or outside India, for at least last one year. Further, it includes an employee, as aforesaid, of a subsidiary, in India or outside India, or of a holding company of the company.

for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

(*b*) *

(*c*) In case of a listed company, the sweat equity shares are issued in accordance with the SEBI regulations made in this behalf and in case of an unlisted company, the sweat equity shares are issued in accordance with such rules as may be prescribed.

Rule 8 provides that a company shall not issue sweat equity shares for more than 15% of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. In no case the issuance of sweat equity shares in the company can exceed 25% of the paid up equity capital of the company at any time.

However, a startup company, as defined in notification number GSR 180(E) dated 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding 50% of its paid up capital up to five years from the date of its incorporation or registration.

(5) Sweat equity shares issued to directors or employees shall be locked in/non transferable for a period of three years from the date of allotment. The fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

(6) The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.

(7) The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the Board of directors with justification for such valuation.

(8) The rights, limitations, restrictions applicable to the sweat equity shares shall be the same as applicable to equity shares.

9.19-1 SEBI Regulations with respect to Sweat Equity

These regulations, *inter alia*, provide for the following :

1. *Issue of Sweat Equity Shares to promoters*
   - (*i*) In case of issue of sweat equity shares to promoters, the same must also be approved by simple majority of the shareholders in general meeting. Voting for the purpose should be through postal ballot and the allottee promoters should not participate in voting for such resolution.
   - (*ii*) Each transaction of issue of sweat equity shall be voted by a separate resolution.
   - (*iii*) Resolution for issue of sweat equity shares shall be valid for not more than 12 months from the date of its passing.

*Under the 2013 Act, sweat equity shares could not be issued within 1 year of commencement of business of the company. *The Amendment Act, 2017 has removed this restriction.*

(*iv*) The explanatory statement shall contain details of disclosures as specified in the schedule.

2. *Pricing of Sweat Equity Shares* - The pricing of sweat equity shares has been brought at par with pricing in respect of allotment on preferential basis, *viz.*, the price shall not be less than the higher of the following:

   (*a*) the average of the weekly high and low of the closing prices of the related equity shares during last 6 months preceding the relevant date; or

   (*b*) the average of the weekly high and low of the closing prices of the related equity shares during the two weeks preceding the relevant date.

   'Relevant date' for this purpose means the date which is 30 days prior to the date on which the meeting of the general body of the shareholders is convened in terms of section 79(1)(*a*).

   If the shares are listed on more than one stock exchange, but quoted only on one stock exchange on the given date, then the price on that stock exchange shall be considered. But, if the share price is quoted on more than one stock exchange, then the stock exchange where there is highest trading volume during that date shall be considered.

   If shares are not quoted on the given date, then the share price on the next trading day shall be considered.

3. *Valuation of intellectual property* - The valuation of the intellectual property rights or of the know-how provided or other value addition shall be carried out by a merchant banker. The merchant banker may consult such experts and valuers, as he may deem fit having regard to the nature of the industry and the nature of the property or other value addition.

   The merchant banker shall obtain a certificate from an independent chartered accountant that the valuation of the intellectual property or other value addition is in accordance with the relevant accounting standards.

4. *Accounting Treatment* - Where the sweat equity shares are issued for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company:

   (*a*) Where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance-sheet of the company as per the relevant accounting standards; or

   (*b*) Where clause (*a*) is not applicable, it shall be expensed as per the relevant accounting standards.

5. *Placing of Auditor's Certificate before AGM* - In the AGM subsequent to the issue of sweat equity shares, the Board of Directors shall place before the shareholders, a certificate from the auditors of the company that the issue of sweat equity shares has been made in accordance with the Regulations and in accordance with the resolution passed by the company authorising the issue of such sweat equity shares.

6. *Ceiling on Managerial Remuneration* - The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 198, 309, 310, 311 and 387, if the following conditions are satisfied:

(*i*) the sweat equity shares are issued to any director or manager; and

(*ii*) they are issued for non-cash consideration, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the relevant accounting standards.

7. *Lock-in of sweat equity shares*

(*i*) The sweat equity shares shall be looked in for a period of 3 years from the date of allotment.

(*ii*) SEBI (Disclosure and Investor Protection) Guidelines, 2000 on public issue in terms of lock-in and computation of promoters' contribution shall apply if a company makes a public issue after it has issued sweat equity shares.

8. *Listing* - The sweat equity shares issued by a listed company shall be eligible for listing only if such issue is in accordance with these regulations.

9. *Applicability of Takeover Code* - Any acquisition of sweat equity shares shall be subject to the provisions of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.

10. *Obligations of the company* - The company shall ensure that —

(*a*) Explanatory statement to the notice of the general meeting shall contain specified details.

(*b*) Auditors' certificate, as stated above, shall be placed in the general meeting.

(*c*) Within 7 days of the issue of sweat equity shares, a statement is sent to the recognized stock exchange disclosing:

(*i*) number of sweat equity shares;

(*ii*) price at which issued;

(*iii*) total amount invested;

(*iv*) details of persons to whom issued; and

(*v*) consequent changes in the capital structure and the shareholding pattern after and before the issue of sweat equity shares.

11. *Action against Intermediaries* - SEBI may, on failure of the merchant banker to comply with the obligations under these regulations or failing to observe due diligence in respect of valuation of intellectual property or value addition, initiate action against the merchant banker as per SEBI (Merchant Bankers) Regulations, 1992.

12. *Powers of SEBI to order inspection or investigations* - SEBI, may, *suo motu* or upon information received by it, cause an inspection to be made of the books of account or other books to be made in respect of conduct and affairs of any person associated with the process of sweat equity shares, by appointing of its officer.

The inspection or investigation can be made for any of the following purposes:

(*a*) To ascertain whether there are circumstances which would render any person guilty of having contravened any of these regulations or directions issued thereunder.

(*b*) To investigate into any complaint of any contravention of the regulations, received from any investor, or any other person.

Every person in respect of whom inspection or investigation has been ordered shall produce before the Inspector/Investigating Officer such books, accounts and other documents and information in his custody or control as the said officer may require.

The Inspector/Investigating Officer shall have full powers:

(*a*) of summoning and enforcing the attendance of persons;

(*b*) to examine orally and to record on oath the statement of the persons concerned, any director, partner, member, or employee of such persons.

On the report of the Inspector/Investigating Officer, SEBI may initiate such action as it may deem fit in the interests of investors and the securities market. The directions, besides initiating criminal prosecution, may include:

(*a*) directing the person not to further deal in securities in a particular manner;

(*b*) directing the person concerned to sell or divest the sweat equity shares acquired in violation of these regulations/any other law or regulations;

(*c*) prohibiting the persons concerned from accessing the securities market;

(*d*) directing the disgorgement of any ill-gotten gains or profit or avoidance of loss;

(*e*) restraining the company from making a further offer for sweat equity shares.

9.20 Share certificate [Section 56]

An allottee of shares is entitled to have from the company a document, called share certificate, certifying that he is the holder of the specified number of shares in the company.

9.20-1 Time of issue of share certificate (Section 56)

Section 56 (4) provides that every company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates of all securities allotted, transferred or transmitted—

(*a*) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;

(*b*) within a period of two months from the date of allotment, in the case of allotment of any of its shares;

(*c*) within a period of one month from the date of receipt by the company of the instrument of transfer, or of the intimation of transmission.

Where the securities are dealt within a depository, the company shall intimate the details, of allotment of securities to depository immediately on allotment of such securities.

Signing of Share Certificate

Rule 3 of the Companies (Share Capital and Debentures) Rules, 2014, as amended by the Companies (Share Capital and Debentures) Amendment Rules, 2018 provides that every certificate shall specify the shares to which it relates and the

amount paid-up thereon and shall be signed by two directors or by a director and the company secretary, wherever the company has appointed company secretary However, in case the company has a common seal it shall be affixed in the presence of persons required to sign the certificate.

In case of an One Person Company, it shall be sufficient if the certificate is signed by a director and the company secretary or any other person authorised by the Board for the purpose.

A director shall be deemed to have signed the share certificate if his signature is printed thereon as facsimile signature by means of any machine, equipment or other mechanical means such as engraving in metal or lithography or digitally signed, but not by means of rubber stamp, provided that the director shall be personally responsible for permitting the affixation of his signature thus and the safe custody of any machine, equipment or other material used for the purpose.

Penalty

In case of default, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees.

A petition under section 113(3) of the 1956 Act [corresponding to section 56 of the 2013 Act] could be filed only if there is a subsisting default on the part of the company in delivering the share certificate, as on date of filing the petition [*Harish Kr. Agarwal* v. *Punjab Communications Ltd.* [1998] 15 SCL 418 (CLB - New Delhi)].

Further, no loss of profits can be awarded, section 113(3) [now section 56] contemplates only for costs incurred by an applicant but not for any hypothetical loss of profits suffered by the applicant.

In case of the company failing to deliver the shares certificate within the stipulated period, it was held by the Supreme Court in *H.V. Jayaram* v. *ICICI Ltd.* [2000] 23 SCL 64 that the complaint shall be filed only where the registered office of the company is situated. The effect of aforesaid decision has been to confirm the decision of the Karnataka High Court in *ICICI* v. *H.V. Jayaram* [1998] 18 SCL 68 and to over-rule the decision of the Rajasthan High Court in the case of *Ranbaxy Laboratories Limited* v. *Smt. Indra Kala* [1997] 12 SCL 288.

In case Letter of Allotment is lost or destroyed, the Board may impose such reasonable conditions as to evidence and indemnity in the payment of actual expenses incurred by the company in investigating evidence, as the Board thinks fit.

9.20-2 Object and effect of share certificate (Section 46)

Section 46 gives the object of the share certificate. It reads, "a share certificate under the Common Seal of the company[23], specifying any shares held by any member, shall be *prima facie* evidence of the title of the member to such shares". Thus, the share certificate being *prima facie* evidence of title, it gives the share-holder the facility of dealing more easily with the share in the market. It enables him

23. In case a company does not have a common seal, the share certificate shall be signed by two directors or by a director and the company secretary, if any - MCA Notification dated 29-5-2015.

to sell at once a marketable title. Cockburn, C.J. in *Bahia & San Francisco Railway Co.* [1868] LR 3 QB 584.

9.20-2a ESTOPPEL AS TO TITLE - A share certificate once issued binds the company. It is a declaration by the company to all the world that the person in whose name the certificate is made out, and to whom it is given, is a shareholder in the company.

Suppose, 'X' by fraudulent means, obtains a share certificate of a company in his name as the holder of some shares. He then sells them to 'Y' who purchases them in good faith and applies to the company for registration of those shares in his name. The company, having discovered the fraud, refuses. The company must compensate 'Y' for the loss he has sustained by acting on the faith of the share certificate. The measure of damages would be the market price of the shares at that time. In *Dixon* v. *Kennaway* [1900] 1 Ch. 833, Mrs. Dixon applied for 300 shares in a company. A clerk in the company who owned no shares executed a transfer in favour of Mrs. Dixon. The company without requiring the clerk to produce a certificate registered the transfer and issued a new certificate to Mrs. Dixon. The company was held liable to Mrs. Dixon, in damages.

In case of dispute as to membership *prima facie* evidence through share certificate under section 84 [Now section 46] shall get precedence over the *prima facie* evidence of register of members under section 164 for the reason that the register of members, being under the control of the company, is susceptible to manipulations [*Satish Chand Sanwalka* v. *Tinplate Dealers Assn. (P.) Ltd.* [1998] 16 SCL 172].

However, the certificate must be issued by the company or on its behalf by someone having the authority. Thus, where a secretary forged the signatures of the directors to a certificate, and fraudulently affixed the Company's Seal, the company could refuse to register the holder - *Rubben* v. *Great Fingall Consolidated Co.* [1906] AC 439.

9.20-2b ESTOPPEL AS TO PAYMENT - If the certificate states that on each of the shares full amount has been paid, the company is estopped, as against a *bona fide* purchaser of the shares, from alleging that they are not fully paid. Thus, in *Bloomenthal* v. *Ford* [1897] AC 156, B lent 1000 pounds to the company on the security of 10000 shares which were issued to him as fully paid. In fact, nothing had been paid on them. In winding-up of the company, it was held that neither the company nor the liquidator could deny that the shares were fully paid and, therefore, B could not be placed on the list of contributories.

But, where a person knows that the statements in a certificate are not true, he cannot claim an estoppel against the company - *Crickmer's* case [1875] 10 Ch. 614.

A certificate, however, does not certify anything as to the equitable interest in the shares and therefore the company shall not be liable to a person who holds such interest.

9.21 Issue of duplicate share certificate (Section 46)

Section 46 (2) provides that a duplicate certificate of shares may be issued, if such certificate —

(*a*) is proved to have been lost or destroyed; or

(*b*) has been defaced, mutilated or torn and is surrendered to the company.

As per **the Companies (Share Capital and Debentures) Rules, 2014, w**here a duplicate certificate is issued, it shall be stated prominently on the face of it and be recorded in the Register maintained for the purpose, that it is "duplicate issued in lieu of share certificate No…." and the word "duplicate" shall be stamped or printed prominently on the face of the share certificate.

If a company with intent to defraud issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447.

If any person impersonates or obtains certificate fraudulently, he may be liable for punishment with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees (Section 57).

In case of dispute about the transfer of shares, duplicate shares cannot be ordered to be issued in favour of the transferee - *S. Sundaram Pillai* v. *P. Govindaswami* [1987].

A company can issue duplicate share certificate only to a registered shareholder.

9.22 Rights shares/Further issue of capital [Section 62]

A company limited by shares can increase its share capital by issuing new shares provided it is authorised by the Articles. The companies generally do not issue the whole of its authorised capital at once. When the directors feel the need for additional funds for expansion, diversification or modernisation, they may issue further shares. However, the power to issue further shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers, or to enable it to comply with statutory requirements - *Needle Industries (India) Ltd.* v. *Needle Industries Newey (India) Holding Ltd.* [1981] 51 Comp. Cas. 743. But, the directors cannot issue the new shares at their discretion. Because, if allowed, they may allot the new shares to their relations, friends or their nominees. In order to overcome such a misuse, section 62 of the Act lays down certain conditions for further issue of shares. Since section 62 provides for the further issue of shares to be first offered to the existing members of the company, such shares are known as 'right shares' and the right of the members to be so offered is called the 'right of pre-emption'.

Section 62 of the Companies Act, 2013 provides that where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital on those shares.

The offer shall be made by sending a 'letter of offer' subject to the following conditions, namely:—

(*i*) the offer shall be made by notice specifying the number of shares offered and limiting a **time not being less than fifteen days* and not exceeding thirty days** from the date of the offer. If the offer is not accepted within the specified time, it shall be deemed to have been declined;

(*ii*) unless the articles of the company otherwise provide, the existing shareholder shall have a right to renounce the shares offered to him in favour of any other person.

The notice, as aforesaid, shall be dispatched through registered post or speed post or through electronic mode **[or courier or any other mode having proof of delivery] to all the existing shareholders at least three days before the opening of the issue.

The notice must contain a statement with respect to the right of a member to renounce the shares offered to him.

After the expiry of the time specified in the notice aforesaid, or on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered, the Board of Directors may dispose of those shares in such manner which is not dis-advantageous to the shareholders and the company.

If a member did not respond to offers made by company, it has to be necessarily held that he was not inclined to subscribe to additional shares, thereby impliedly consenting for allotment of shares to others - *R. Khemka* v. *Deccan Enterprises (P.) Ltd.* [1998] 16 SCL 1 (A.P.).

However, where some shareholders of a company were not given notice to apply for allotment of additional shares, subsequent allotment of shares to other shareholders at a meeting was invalid - *M.S. Madhusoodanan* v. *Kerala Kaumudi (P.) Ltd.* [2003] 46 SCL 695 (SC).

Alternatively, by passing a special resolution, shares may be offered to:

(*a*) employees under a scheme of employees' stock option†; or

(*b*) to any persons, whether for cash or for a consideration other than cash.

In case of (b) above, the price of such shares shall be determined by the valuation report of a registered valuer subject to such conditions as may be prescribed.

Exceptions - In the following circumstances, a company need not offer further issue of shares to the existing shareholders or to employees under a scheme of employees' stock option.

1. Where a special resolution is passed in the general meeting.
2. In case of issue of shares against conversion of loans or debentures, if relevant conditions are satisfied‡.

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*In case 90% of the members of a private company have given their consent in writing or in electronic mode then the offer may be closed before 15 days—*Vide MCA Notification dated 5-6-2015.*

** *Vide* Companies (Amendment) Act, 2017.

†In case of a private company employees can be offered shares under ESOP by passing an ordinary resolution—*Vide MCA Notification dated 5-6-2015.*

‡For details, *see* the discussion under 'Conversion of loans or debentures into shares'.

3. Section 62 (earlier Section 81) does not come into play when the company proposes to make allotment of shares to its creditors - *Sree Ayyanar Spg. & Wvg. Mills Ltd.* v. *V.V.V. Rajendran* [1973].

9.22-1 Further allotment out of unsubscribed portion of capital

Any allotment of unsubscribed portion of issued shares as and when applications are received will not amount to an increase in the subscribed capital of the company by issuing new shares and every allotment of shares within the issued capital is the first allotment so far as those shares are concerned. Section 81(1) [Now section 62] is not, therefore, applicable to the remaining shares which were issued already. The said section is also not applicable to the sale of forfeited shares for which no allotment is necessary [Letter No. 2(27)/56-PR, dated 4-10-1976 issued by the Department of Company Affairs].

9.22-2 SEBI regulations regarding rights issues [w.e.f. 26-8-2009 as amended up to May, 2017] :

APPLICABILITY

1. These guidelines apply to the rights issues made by existing listed companies (*i.e.,* companies whose equity capital is listed). Therefore, a company whose debentures/ bonds are listed but not the equity (*i.e.,* shares) will not be governed by these guidelines.

These guidelines apply only to the rights issues where the aggregate value of the specified securities offered is Rs. 50 lakh or more.

RECORD DATE

(1) A listed issuer making a rights issue shall announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue.

(2) The issuer shall not withdraw rights issue after announcement of the record date.

(3) If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date announced under sub-regulation (1):

Provided that the issuer may seek listing of its equity shares allotted pursuant to conversion or exchange of convertible securities issued prior to the announcement of the record date, on the recognised stock exchange where its securities are listed.

RESTRICTION ON RIGHTS ISSUE

(1) No issuer shall make a rights issue of equity shares unless it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments, if any, in proportion to the convertible part thereof.

(2) The equity shares so reserved for the holders of fully or partially compulsorily convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms at which the equity shares offered in the rights issue were issued.

LETTER OF OFFER, ABRIDGED LETTER OF OFFER, PRICING AND PERIOD OF SUBSCRIPTION

(1) The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue:

Provided that the letter of offer shall be given by the issuer or lead merchant banker to any existing shareholder who has made a request in this regard.

(1A) The abridged letter of off shall not contain any matter extraneous to the contents of the offer document.

(2) The shareholders who have not received the application form may apply in writing on a plain paper, along with the requisite application money.

(3) The shareholders making application otherwise than on the application form shall not renounce their rights and shall not utilise the application form for any purpose including renunciation even if it is received subsequently.

(4) Where any shareholder makes an application on application form as well as on plain paper, the application is liable to be rejected.

(5) The issue price shall be decided before determining the record date which shall be determined in consultation with the designated stock exchange.

(6) A rights issue shall be open for subscription for a minimum period of fifteen days and for a maximum period of thirty days.

(7) The issuer shall give only one payment option out of the following to all the investors—

(*a*) part payment on application with balance money to be paid in calls; or

(*b*) full payment on application :

Provided that where the issuer has given the part payment option to investors, the part payment on application shall not be less than 25 per cent of the issue price* and such issuer shall obtain the necessary approvals to facilitate the same.

In all rights issues, where not more than one payment option is given, the issuer shall provide the facility of ASBA in accordance with the procedure and eligibility criteria specified by SEBI. However, in case of QIBs and non-institutional investors, the issuer shall accept bids using ASBA facility only[24].

PRE-ISSUE ADVERTISEMENT FOR RIGHTS ISSUE

(1) The issuer shall issue an advertisement for rights issue disclosing the following:

(*a*) the date of completion of despatch of abridged letter of offer and the application form;

(*b*) the centres other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlements may obtain duplicate copies of the application forms in case they do not receive the application form within a reasonable time after opening of the rights issue;

(*c*) a statement that if the shareholders entitled to receive the rights entitlements have neither received the original application forms nor they are in a position

*W.e.f. 24-3-2015.

24. W.e.f. 1-1-2016.

to obtain the duplicate forms, they may make application in writing on a plain paper to subscribe to the rights issue;

(*d*) a format to enable the shareholders entitled to apply against their rights entitlements, to make the application on a plain paper specifying therein necessary particulars such as name, address, ratio of rights issue, issue price, number of equity shares held, ledger folio numbers, depository participant ID, client ID, number of equity shares entitled and applied for, additional shares if any, amount to be paid along with application, and particulars of cheque, etc. to be drawn in favour of the issuer's account;

(*e*) a statement that the applications can be directly sent by the shareholders entitled to apply against rights entitlements through registered post together with the application moneys to the issuer's designated official at the address given in the advertisement;

(*f*) a statement to the effect that if the shareholder makes an application on plain paper and also on application form both his applications shall be liable to be rejected at the option of the issuer.

(2) The advertisement shall be made in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where registered office of the issuer is situated, at least three days before the date of opening of the issue.

Reservation for employees alongwith rights issue

Subject to other applicable provisions of these regulations, the issuer may make reservation for employees along with right issue subject to the condition that value of allotment to any employee shall not exceed two lakh rupees.

UTILISATION OF FUNDS RAISED IN RIGHTS ISSUE

The issuer shall utilise funds collected in rights issues after the finalisation of the basis of allotment.

Post- Issue Reports

In rights issue the lead merchant banker shall submit post- issue reports as follows:

(*a*) Initial post-issue report within three days of the closure of the issue;

(*b*) Final post-issue report within fifteen days of the date of finalization of basis of allotment or within fifteen days of refund of money in case of failure of issue.[25]

9.22-3 Duty of transferor to transferee in respect of rights shares

There may be pending transfers at the time when a rights issue takes place. This raises the question whether the transferor of an unregistered transfer is under any obligation towards his transferee to apply for the rights shares for the benefit of the transferee. The Bombay High Court in *Dinge Venkatarama Reddy* v. *Padampat Singhania* AIR 1950 Bom. 76 held that it was the duty of the transferor to apply for the new shares and to hold them in trust for the transferee. But, the Supreme Court in *R. Mathalone* v. *Bombay Life Assurance Co. Ltd.* AIR 1953 SC 385 has upheld a contrary view. The Supreme Court, in this case, observed that after the transfer

25. W.e.f. 1.1.2016.

form has been executed, the transferor cannot be held to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

9.22-4 Allotment to renouncee

As per section 62[26], unless the Articles of the company otherwise provide, the letter of offer of rights shall be deemed to include a right to renounce the shares offered to a member in favour of any other person; and the notice sent to him must contain a statement to this effect. When a shareholder renounces any of the rights shares offered to him, in favour of a third person, it is not in the nature of transfer of such shares. The Board of directors, therefore, cannot refuse to allot the shares to the renouncee unless the Articles so provide - *Re Simo Securities Trust Ltd.* [1972] 42 Comp. Cas. 457.

In the case of shares registered in joint names, any of the joint holders may lodge a letter of renunciation.

9.22-5 Procedure for issue of rights shares

For issue of rights shares, a company is required to follow the procedure as laid down in section 62 of the Companies Act and also the regulations issued by SEBI in this regard[27].

The various steps involved for issue of rights shares may be noted as follows:

1. See that the rights issue is within the authorised share capital of the company. If not, steps should be taken to increase the same.
2. If the rights shares are to be issued out of 'unclassified shares', take steps to amend the capital clause to classify 'unclassified shares' as equity/preference shares proposed to be issued.[28]
3. Notify the stock exchange concerned the date of the Board meeting at which the rights issue is proposed to be considered.
4. Where the issue size exceeds Rs. 50 lakhs, take steps for the appointment of eligible merchant banker since, as per SEBI regulations, the appointment of an eligible merchant banker in case of rights issue of listed companies exceeding Rs. 50 lakhs is mandatory.
5. In case the issue is proposed to be made at a premium, fix the premium in consultation with the lead manager to the issue. Differential premium may, however, be charged, *e.g.*, a higher premium may be charged from foreign investor as compared to the other existing shareholders.
6. Appoint registrars and the underwriters. Appointment of underwriters, as per SEBI regulations, is, however, optional.

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26. Section 62 corresponds to section 81 of the Companies Act, 1956.
27. SEBI regulations apply to rights issues of existing listed companies. They do not apply to issue of rights shares of any amount by existing private companies/closely held or other unlisted companies.
28. M.C. Bhandari, Guide to Company Law Procedures, 12th Edition, page 793

7. Note that there can be no preferential allotment in respect of the rights issue except in favour of employees provided the value of allotment does not exceed Rs. 2 lakh.
8. In consultation with the stock exchange(s), fix the record date for the proposed issue.
9. If it is proposed to offer shares to persons other than the existing members, a general meeting be convened and a special resolution or an ordinary resolution in lieu of special resolution passed for the purpose in terms of section 62(1)(c).
10. If issue is to be offered to NRIs, file the requisite form and declarations with RBI. No prior approval of the RBI is required for offer of shares to NRIs on non-repatriation basis.
11. Forward six sets of letter of offer to the concerned stock exchange.
12. Note that in case the rights issue is withdrawn after the announcement of the record date, the regional stock exchange will not permit the making of application for listing of shares for a minimum period of 12 months from the record date.
13. Make arrangements with bankers for acceptance of share application forms.
14. Make arrangements for despatch of letters of offer to shareholders containing details as per section 62 of the Companies Act, 2013 as well as SEBI regulations.
15. Ensure that the issue is kept open for a minimum period of 15 days but not beyond 30 days.
16. Open a specific bank account for keeping subscription received against rights issue. Note that the money deposited in this account cannot be utilised until and unless the company has received from the concerned regional stock exchange(s) approval for utilisation of this money.
17. In case the company does not receive 90% of the issue amount including accepted devolvement from underwriters within 60 days from the date of the closure of the issue, the amount of subscription received shall be required to be refunded.

    In respect of underwriters' devolvement, lead merchant banker must ensure that the underwriters honour their commitments within 70 days of the closure of the issue.
18. Prepare a scheme of allotment in consultation with stock exchange(s).
19. Convene Board meeting and make allotment of shares.
20. File return of allotment in the prescribed Form with Registrar of Companies within 30 days of allotment.
21. Complete other formalities such as refund of excess application money, issue of allotment letters, making of entries in various registers, etc.
22. Forward a report in the prescribed form to the SEBI within 15 days of the date of finalisation of allotment or within 15 days of refund or money in case of failure of issue.

23. Note that if the instrument of transfer of shares has been delivered to the company but the same has not been registered till the date of closure of register of members, keep in abeyance the offer of rights shares relating to the shares involved in the transfer - section 126 of the Companies Act, 2013.

9.23 Conversion of loans or debentures into shares

A company may issue shares to its lenders or debenture holders who have been given the option to convert their loans or debentures into shares. The increase of subscribed capital caused thereby shall not amount to the violation of the provisions of section 62 as shares having not been offered to the existing members because section 62 specifically permits this. As per sub-section (3), the provisions of section 62 (1) shall not apply to the increase of the subscribed capital of a public company caused by the exercise of an option attached to the debentures issued or loans raised by the company - (*i*) to convert such debentures or loans into shares in the company; or (*ii*) to subscribe for shares in the company. However, the company can do so only if such conversion has been approved before the issue of debentures or raising of the loan by a special resolution and also by the Central Government.

In *Raj Singh Chopra* v. *Jagat Singh Chopra* [2018] 90 taxmann.com 156 (NCLAT), it was held that when question of issue of further share capital is taken up, conversion of loan into share capital would be permissible provided there was special resolution passed by company in General Meeting which granted option as a term attached to loan raised by company permitting conversion of such loan into shares of company. Thus, where no special resolution had been passed at time of raising loan, purported allotment of 26000 equity shares in favour of appellant in lieu of loan was to be cancelled.

Further, sub-sections (4) to (7) of Section 62 provide that where a company has taken any loans from the Central Government by issuing any debentures or otherwise, the Government may, in the public interest, convert such debentures or loans into shares in the company. The conversion shall be on such terms and conditions as appear to the Government to be reasonable in the circumstances of a particular case.

However, where the terms and conditions of such conversion are not acceptable to the company, it may, **within sixty days** from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

Tribunal shall, after hearing the company and the Government, pass such order as it deems fit.

9.23-1 Share Capital to Stand Increased

Where the Government has, by an order, directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under sub-section (4) or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into.

9.24 Bonus shares

The provisions with respect to issue of bonus shares are contained in section 63 of the Companies Act, 2013. Besides, in case of listed companies SEBI Regulations, 2018 shall also be required to be complied with[29]. Section 63 provides that:

(*1*) A company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of—

(*i*) its free reserves;

(*ii*) the securities premium account; or

(*iii*) the capital redemption reserve account:

However, no issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

(*2*) No company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares under sub-section (1), unless—

(*a*) it is authorised by its articles;

(*b*) it has, on the recommendation of the Board, been authorised in the general meeting of the company;

(*c*) it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(*d*) it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus;

(*e*) the partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up;

(*f*) it complies with such conditions as may be prescribed.

(*3*) The bonus shares shall not be issued in lieu of dividend.

9.24-1 SEBI Regulations, 2018 for issue of bonus shares—

Conditions for a bonus issue

Only a listed issuer shall be eligible to issue bonus shares to its members if:

(*a*) It is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc.

If there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;

(*b*) It has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

(*c*) It has not defaulted in respect of the payment of statutory dues of the employees such as contribution to provident fund, gratuity and bonus;

(*d*) Any outstanding partly paid shares on the date of the allotment of the bonus shares, are made fully paid-up;

(*e*) Any of its promoters or directors is not a fugitive economic offender.

29. It may be noted that prior to the Companies Act, 2013, Bonus issues were governed by SEBI guidelines/regulations only.

Restrictions on a bonus issue

(1) An issuer shall make a bonus issue of equity shares only if it has made reservation of equity shares of the same class in favour of the holders of outstanding compulsorily convertible debt instruments if any, in proportion to the convertible part thereof.

(2) The equity shares so reserved for the holders of fully or partly compulsorily convertible debt instruments, shall be issued to the holder of such convertible debt instruments or warrants at the time of conversion of such convertible debt instruments, optionally convertible instruments, warrants, as the case may be, on the same terms or same proportion at which the bonus shares were issued.

(3) A bonus issue shall be made only out of free reserves, securities premium account or capital redemption reserve account and built out of the genuine profits or securities premium collected in cash and reserves created by revaluation of fixed assets shall not be capitalised for this purpose.

(4) Without prejudice to the provisions of sub-regulation (3), bonus shares shall not be issued in lieu of dividends.

Completion of a bonus issue

(1) An issuer, announcing a bonus issue after approval by its Board of Directors and not requiring shareholders' approval for capitalisation of profits or reserves for making the bonus issue, shall implement the bonus issue within fifteen days from the date of approval of the issue by its Board of Directors:

Provided that where the issuer is required to seek shareholders' approval for capitalisation of profits or reserves for making the bonus issue, the bonus issue shall be implemented within two months from the date of the meeting of its Board of Directors wherein the decision to announce the bonus issue was taken subject to shareholders' approval.

(2) A bonus issue, once announced, shall not be withdrawn.

9.25 Distinction between bonus shares and rights shares

Rights Shares	*Bonus Shares*
1. *To be paid for* - It only confers a privilege on the existing shareholders to have a claim on the shares offered after the first public issue.	1. Bonus shares are issued to the existing members *free of charge.*
2. *Partly paid*- The existing shareholding of the members as well as rights shares may be partly paid.	2. Bonus shares are always fully paid.

Rights Shares	*Bonus Shares*
3. Minimum subscription- In the event of a company failing to receive a minimum of 90% subscription, the company shall have to return the entire money received.	3. There is no such requirement.
4. Right to renounce- Right shares may be renounced in favour of his nominee.	4. No such facility is available in case of bonus shares.

9.26 Reduction of share capital

Section 66 contains provisions with respect to reduction of share capital. The section provides that subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in particular, may :

(*a*) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up, *e.g.*, where a share of Rs. 10 on which Rs. 5 has been paid is treated as a share of Rs. 5 fully paid up. In this way the shareholder is relieved from liability on the uncalled capital; or

(*b*) either with or without extinguishing or reducing liability on any of its shares,—

(*i*) cancel any paid-up share capital which is lost or is unrepresented by available assets; or

(*ii*) pay off any paid-up share capital which is in excess of the wants of the company.

For example, *e.g.*, where there is a share of Rs. 10 fully paid up, reduce it, say, Rs. 5 and pay back Rs. 5 to the shareholder.

In *Tamil Nadu Newsprint and Papers Ltd.* vs. *Registrar of Companies* [1995], the Madras High Court allowed the company to reduce its capital which was found to be in excess of its needs by permitting it to pay the same partly in cash and partly in the form of non-convertible debentures.

In a scheme for reduction of capital, it is permissible for a company to reduce its share capital in a disproportionate manner and consideration payable to different shareholders at different rates - *RS Livemedia (P.) Ltd., In re* [2014] 45 taxmann.com 551 (Delhi).

Where a company affects reduction of its capital, as aforesaid, it may alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

You may note that no reduction of capital shall be allowed if the company is in arrears in the repayment of any deposits accepted by it, either before or after the commencement of this Act, or the interest payable thereon.

9.26-1 Procedure for reduction of capital

The procedure, as laid down in section 66 of the Companies Act, may be summed up as follows:

1. Pass a special resolution for the reduction of capital.
2. Apply to the Tribunal by way of petition to confirm the resolution*.
3. The Tribunal shall give notice of the application to the Central Government, Registrar and to SEBI, in the case of listed companies, and the creditors of the company.
4. Government, Registrar, SEBI and the creditors must make their representation, if any, within a period of **three months** from the date of receipt of the notice failing which; it shall be presumed that they have no objection to the reduction.
5. The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit.
6. No application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.
7. The order of confirmation of the reduction of share capital by the Tribunal under Sub-section (3) shall be published by the company in such manner as the Tribunal may direct.

***Rules 2 and 3 of the National Company Law Tribunal (Procedure for Reduction of Share Capital of Company) Rules, 2016** provide that the application to the Tribunal to confirm a reduction of share capital of a company shall be filed in Form No. RSC-1 along with the prescribed fee and shall be accompanied with:

(*a*) the list of creditors duly certified by the Managing Director, or in his absence, by two directors, as true and correct, which is made as on a date not earlier than fifteen days prior to the date of filing of an application showing the details of the creditors of the company, class-wise, indicating their names, addresses and amounts owed to them;

(*b*) a certificate from the auditor of the company to the effect that the list of creditors referred to in clause (*a*) is correct as per the records of the company verified by the auditor;

(*c*) a certificate by the auditor and declaration by a director of the company that the company is not, as on the date of filing of the application, in arrears in the repayment of the deposits or the interest thereon; and

(*d*) a certificate by the company's auditor to the effect that the accounting treatment proposed by the company for the reduction of share capital is in conformity with the accounting standards specified in section 133 or any other provisions of Act.

Copies of the list of creditors shall be kept at the registered office of the company and any person desirous of inspecting the same may, at any time during the ordinary hours of business, inspect and take extracts from the same on payment of the sum of rupees fifty for inspection and for taking extracts on payment of the sum of rupees ten per page to the company.

8. The company shall deliver to the Registrar a certified copy of the order of the Tribunal under sub-section (3) and of a minute approved by the Tribunal showing—

   (*a*) the amount of share capital;

   (*b*) the number of shares into which it is to be divided;

   (*c*) the amount of each share; and

   (*d*) the amount, if any, at the date of registration deemed to be paid-up on each share.

   Copy of the order as aforesaid shall be delivered to the Registrar **within thirty days** of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

9. A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

10. Where the name of any creditor entitled to object to the reduction of share capital under this section is, by reason of his ignorance of the proceedings for reduction or of their nature and effect with respect to his debt or claim, not entered on the list of creditors, and after such reduction, the company is unable to pay the amount of his debt or claim,—

    (*a*) every person, who was a member of the company on the date of the registration of the order for reduction by the Registrar, shall be liable to contribute to the payment of that debt or claim, an amount not exceeding the amount which he would have been liable to contribute if the company had commenced winding up on the day immediately before the said date; and

    (*b*) if the company is wound up, the Tribunal may, on the application of any such creditor and proof of his ignorance as aforesaid, if it thinks fit, settle a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

    (*c*) The rights of the contributories among themselves shall not be affected.

11. If any officer of the company—

    (*a*) knowingly conceals the name of any creditor entitled to object to the reduction;

    (*b*) knowingly misrepresents the nature or amount of the debt or claim of any creditor; or

    (*c*) abets or is privy to any such concealment or misrepresentation as aforesaid, he shall be liable under section 447.

12. The company must publish the order of confirmation of the reduction of share capital by the Tribunal in the manner as directed by the Tribunal failing which it shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees.

9.26-2 Reduction of share capital without the sanction of the Tribunal

There are some cases in which there is reduction of share capital and no confirmation by the Tribunal is necessary. These are:

(*i*) *Buy-back of its shares* by a company under Section 68.

(*ii*) *Forfeiture of shares* - A company may, in pursuance of its articles, forfeit shares for non-payment of calls.

(*iii*) *Surrender of shares* - It is a short cut to forfeiture. It may be accepted by the company under circumstances where its forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from liability on shares.

(*iv*) *Diminution of capital* - This has already been explained. Section 61 (2) clearly states that diminution of capital does not amount to reduction of capital.

(*v*) *Redemption of redeemable preference shares* - This has already been explained as provided by section 55.

Purchase of shares of a member by the company under section 242 - The Tribunal may order the purchase of shares of any member by the company, under certain circumstances.

9.26-3 Reduction of Capital v. Diminution of Capital

Reduction of capital involves writing off past losses against capital, cancellation of the uncalled capital or repayment of surplus capital. It may involve reduction of subscribed or paid up share capital. Diminution of capital denotes cancellation of the unsubscribed part of the issued capital. Diminution of capital does not constitute a reduction of capital within the meaning of the Act.

DISTINCTION

1. *Diminution of capital* is the reduction of the issued capital. *Reduction of capital* involves reduction of subscribed or paid up capital; there is no reduction of issued capital.
2. Both require authorization by Articles but whereas 'diminution' can be effected by an ordinary resolution (if so authorised by Articles), *reduction of capital* cannot be effected without passing a special resolution.
3. *'Reduction'* requires confirmation by Tribunal (Section 66) but 'diminution' needs no confirmation by the Tribunal (Section 61).

9.27 Calls on shares

When shares[30] are issued, the terms of issue may specify the instalments by which the issue price shall be payable. Instalments other than those payable by way of

30. Also debentures. For detailed discussion on debentures, please refer to Chapter 12

application and allotment money are generally referred to as calls. A call, in the strict sense, is a demand by the company for payment of part of the issue price of shares or debentures which has not been paid, and the date on which payment was to be made was not specified in the terms of the issue. The amount payable on application on each share must not be less than 5% of the nominal amount of the share (section 39). The balance may be payable as and when called for by the Board of directors in one or more instalments. A call may also be made by the liquidator in the course of winding-up of the company.

9.27-1 Requisites of a valid call

1. *Resolution at a meeting of the Board* - The power to make calls is exercised by the Board in its meeting by means of a resolution [section 179(3)(*a*)]. The Board, in making a call, must observe the provisions of the Articles, otherwise the call will be invalid, and the shareholders not bound to pay.

   In making a call, care must be taken that :

   (*i*) the directors making it are duly appointed and duly qualified;

   (*ii*) the meeting of the Board of directors has been duly convened;

   (*iii*) the proper quorum is present;

   (*iv*) the resolution making the call is duly passed and specifies the amount of the call, and the time and place of payment;

   (*v*) A proper entry is made in the minutes.

   Unless the aforesaid matters are attended to, the call may be invalid. However, every small irregularity may not render a call invalid, particularly where the articles contain a clause to the effect that 'the acts of directors would be valid notwithstanding that it should be afterwards discovered that there was some defect in the appointment or qualifications, etc. of the directors. Accordingly, in *Shiromani Sugar Mills Ltd.* v. *Debi Prasad* AIR 1950 All. 508 where a clause of this kind existed, it was held that a call made by a resolution of the directors who had by not paying allotment and call moneys disqualified themselves was valid.

2. *Calls on shares of same class must be made on uniform basis [Sec. 49]* - For the purpose of this section, shares of the same nominal value on which different amounts have been paid-up shall not be deemed to fall under the same class (*Explanation* to section 49).

3. *Call to be made* bona fide *in the interest of the company* - Directors are the trustees of the capital of a company. Accordingly, the amount called up has to be used for the benefit of the company, and it should also be called only in the interest of the company. Thus, where the company was in difficult circumstances and the directors made a call only to enable them to draw their own remuneration, the call was held to be an abuse of power and the directors were bound to refund the remuneration drawn by them - *Alexander* v. *Automatic Telephone Co.* [1900] 2 Ch. 56 (CA).

4. *Time within which shares are to be made fully paid-up* - Any company offering shares to the public must ensure that the shares issued are made

fully paid-up within 12 months of the date of allotment, where the size of the issue is up to 500 crores. Where the size of issue exceeds Rs. 500 crores, the amount to be called up on application, allotment and on various calls should not in each case exceed 25% of the total quantum of issue.

5. *Notice of call* - A call must be made by serving upon members a notice of payment in accordance with the provisions of section 20. It should be a formal notice and not mere demand or request for payment. Every shareholder is under a statutory obligation to pay the full amount of his shares. Section 10 (2) of the Companies Act, 2013 declares that all money payable by any member to the company on the shares held by him under the Memorandum or Articles is a debt due from him to the company. But the liability to pay this debt arises only when a valid call has been made. Thus, where a company acquired the rights of another company in respect of its uncalled capital and demanded payments from members, it was held that such a demand could not take the place of a formal call notice - *Pabna Dhana Bhandar Co. Ltd.* v. *Foyezudin Mia* AIR 1932 Cal. 716.

The notice must specify the exact amount and the time of payment - *E and W Insurance Co. Ltd.* v. *Kamala Mehta (supra).* However, if the contents of the notice are certain in terms of money demanded and time allowed for payment, the notice will be valid even if its form is inaccurate - *Shackleford, Ford & Co.* v. *Dangerfield* [1868] LR 3 CP 407.

A call notice which does not specify time of payment is not valid but in case of directors who were present in the meeting where resolution for call was adopted, plea of want of notice shall not be available. In *Major Teja Singh* v. *Liquidator, Hindustan Petroleum Co. Ltd.* [1961] 31 Comp. Cas. 573 (Punj.), the Court observed that the fixation of time of payment of the call is imperative and if that is not done, the call is not valid. However, in the case of directors who were present in the meeting and decided on the call, there was the fixation of the immediate time for payment and this objection cannot thus be available to them. They cannot say that they have had no notice of the time when their liability to pay arose. They had known this all the time and knew this immediately when the resolution was passed. However, knowledge of happenings at a Board meeting cannot be imputed to an absentee director.

The liability of the joint shareholders shall be joint and several (section 43 of the Indian Contract Act).

9.27-2 Payment of calls otherwise than in cash

Shares may be paid for in cash or in kind or in any manner that has the effect of actual cash being received by the company. A payment is an effective payment in money's worth if the consideration given by way of payment is something which is *bona fide* recorded by the parties to the payment as fairly representing the sum which the payment is to discharge - *White Star Line Ltd., In re* [1939] 9 Comp. Cas. 85 (CA). Thus, a company purchased a paper mill for thirty-five thousand dollars payable in cash. Subsequently, however, the vendors purchased shares in the company and allowed it to retain a part of the sale proceeds in payment of the shares. It was held that the effect of the agreement was that the shares had been paid

in full in cash as it was not necessary that the company should first receive the share money and then hand it back to the vendor in payment of its debt - *Lavocque* v. *Beauchemin* [1897] AC 358. However, the consideration which is given by way of satisfaction must not be mere blind or clearly colourable or illusory. If, in a contract, for payment to be in money's worth, a money value less than the face value of the sum to be paid-up be placed on the consideration, the fact that the shares were not fully paid-up in money or money's worth would be apparent on the face of the contract. Thus, where in satisfaction of the debt of calls, the shareholder issued deferred creditors certificates, which admittedly were worth less than their nominal value, it was held that the calls had not been satisfied. But, in the absence of a fraud in violation, the court may not interfere only on the ground of inadequacy of consideration. In *Alote Estate* v. *R.B. Seth Hiralal Kalyanmal* [1970] 1 SCC 425, shares were allotted in return for sugar cane growing land transferred to the company. In the winding-up of the company, it was alleged that the value of the land was *ten times less* than the value of the shares allotted. The Supreme Court refused to interfere. The learned judge said that there was no allegation of fraud. The facts stated related more to inadequacy of price or consideration and not to it (*i.e.,* consideration) being illusory.

A debt due and owing by a banking company to a shareholder can be set off against outstanding calls so long as banking company is a going concern - *Hind Iran Bank Ltd.* v. *Raizada Jagan Nath Bali* [1959] 29 Comp. Cas. 418 (Punj.). This is in accordance with the principle set in *Spargo's* case referred earlier.

9.27-3 Payment of calls in advance

Section 50 of the Act provides that the directors may, if authorised by the Articles, allow shareholders to pay the whole or a part of the amount remaining unpaid on any shares held by them, although no part of that amount has been called up.

According to Section 50(2) a member of a limited liability company having share capital shall not be entitled to any voting rights in respect of the moneys so paid in advance by him until the same becomes payable.

However, Section 51 provides that dividends may be paid on advance calls, if so authorised by the Articles.

Regulation 18 of Table 'F' allows payment of interest not exceeding 12% p.a. on calls paid in advance, as may be agreed between the Board of directors and the member paying the sum in advance.

9.27-4 Interest on calls due but not paid

A member is generally made liable to pay interest on the calls made but not paid. The rate of interest to be charged is as specified in the Articles. Regulation 16 of Table F provides for interest at the rate of 10% per annum or at such lower rate, if any, as the Board may determine. The Board shall, however, be at liberty to waive payment of any such interest wholly or in part.

9.27-5 Quantum and Interval between two calls

Proviso to Reg. 13(1) to the Table 'F' of the Companies Act provides that no call shall exceed 25% of the nominal value of the share or be payable at less than one month from the date fixed for the payment of the last preceding call.

9.28 Forfeiture of shares

A company's articles usually contain a power for it to forfeit the shares of a member who fails to pay calls or instalments of the issue price of his shares within a certain time after they fall due. Companies normally adopt Regulations 28 to 34 of Table F with regard to forfeiture of shares.[31] Such a power is valid, even though in the case of shares it involves a reduction of the company's unpaid share capital - *Trevor* v. *Whitworth* [1887] 12 App. Cas. 409. Forfeiture of shares does not vest the property in the shares in the company, and it is not an asset of the company and, therefore, there is no reduction of capital because of forfeiture.[32] Forfeiture is a serious step since it involves depriving a person of his property as a penalty of some act or omission. Accordingly, shares of a member cannot be forfeited unless the Articles confer such a power on the directors.

The *following rules* may be noted in connection with forfeiture of shares :

1. *In accordance with the Articles* - The forfeiture to be valid must be in accordance with the provisions contained in the Articles. As per Regulation 28 of Table F, shares can be forfeited only against non-payment of any call, or instalments of a call. The Articles of a company may, however, lawfully incorporate any other grounds of forfeiture - *per Shah J. in Naresh Chandra Sanyal* v. *Calcutta Stock Exchange Assn. Ltd.* AIR 1971 SC 422. But, it cannot be for the non-payment of the other debts; that would amount to unauthorised reduction of share capital - *Hopkinson* v. *Mortimer Harley & Co.* (1917) 1 Ch. 646. Thus, where the articles authorise the directors to forfeit the shares of a shareholder, who commences an action against the company or the directors, by making a payment of the full market value of his shares, it was held that such a clause was invalid as it was against the rights of a shareholder - *Hope* v. *International Finance Society* (1876) 4 Ch. D. 598. *Similarly,* in *Kotah Transport Ltd.* v. *State of Rajasthan* [1967] 37 Comp. Cas. 288, it was held that where shares are once registered in the name of a person, the company has no power to forfeit the shares on the ground of failure of consideration. Its remedy is only to obtain appropriate relief by suit. Again, where two directors were allotted qualification shares, without any payment, and these shares were forfeited by a Board resolution passed at the request of those two directors, the forfeiture was held to be invalid and the directors were held liable to pay the nominal value of the shares - *Re Esparto Trading Co.* [1879] 12 Ch. D 191.
2. *Proper Notice* - Before the shares of a member are forfeited, a proper notice to that effect must have been served. Regulation 29 of Table F provides that a notice requiring payment of the amount due together with any interest accrued must be served mentioning a further day (not less than 14 days from the date of service of the notice) on or before which the payment is to be made. The notice must also mention that in the event of non-payment, the shares will be liable to be forfeited. The object of the notice is to give the shareholder an opportunity for payment of the call money, interest and

31. In England, however, the English Companies Act, 1985 vide section 143(3)(d) confers the power of forfeiture upon the company.
32. A. Ramaiya, Guide to Companies Act, 12th edn. Page 2246

expenses. It must, therefore, disclose sufficient information with particulars of the amounts due. A proper notice is a condition precedent to the forfeiture, and even the slightest defect in the notice will invalidate the forfeiture - *Public Passenger Services Ltd.* v. *M.A. Khader* [1966] 1 Comp. LJ 1.

Thus, where the notice on which the forfeiture was founded was inaccurate in requiring payment of interest from the date of the call instead of the date when the call was payable, the forfeiture was held invalid - *Johnson* v. *Lyttle's Iron Agency* [1877] Ch.D 687. Again where a notice for the forfeiture was sent by registered AD post and was returned unserved, the forfeiture was held invalid— *Promilla Bansal* v. *Wearwell Cycle Co. (India) Ltd.* [1978] 48 Comp. Cas. 202 (Delhi). However, the accidental non-receipt of notice of forfeiture by the defaulter is not a ground for relief against forfeiture regularly effected - *Sparks* v. *Liverpool Water Works Co.* [1807] 13 Ves 428. Notice sent to the holder of partly paid share after his death, is not a proper notice. Notice in that situation is to be sent to the legal heir - *George Mathai Noorani* v. *Federal Bank Ltd.* [2007] 76 SCL 528 (CLB).

3. *Resolution for Forfeiture* - If the defaulting shareholder does not pay the amount within the specified time as required by the notice, the directors may pass a resolution forfeiting the shares (Regulation 30 of Table F). In the absence of such a resolution, the forfeiture shall be invalid unless the notice of forfeiture incorporates the resolution of forfeiture as well, *e.g.*, it may state that in the event of default, the shares shall be deemed to have been forfeited.
4. *Power of forfeiture must be exercised* bona fide *and in good faith* - The power to forfeit is in the nature of the trust and must therefore be exercised *bona fide* and for the benefit of the company. The power must be used in order to coerce reluctant shareholders into paying their calls, or in order to deprive shareholders of their shares if they cannot pay for them. The power cannot be exercised so that shareholders who can pay their calls may be released from liability merely because they are unwilling to pay.[33] Thus, the power cannot be used at the request of shareholder to relieve him of liability. Such a forfeiture amounts to an abuse of power to forfeit and is a fraud on other shareholders.[34] If shares are forfeited for this reason, the forfeiture is void and the shareholder continues to be responsible for the unpaid part of the issue price. Furthermore, the power of forfeiture cannot be used to relieve a shareholder of shares which he has a right to repudiate because he was induced to subscribe for them by misrepresentation (*Re-London and Provincial Starch Co., Gower's* case [1868] LR 6 Eq 77). The proper course in such a case shall be for the directors to strike the shareholder's name off the register of members, thereby recognising that, because he has chosen to rescind, he must be treated as though he had never been a member of the company - *Reese River Silver Mining Co.* v. *Smith* [1869] LR 4 HL 64.

Since forfeiture may result in the permanent reduction of the capital of the company, it is not merely the person whose shares are being forfeited who is entitled

33. Re Athenaeum Life Assurance Society, Richmond's case [1858] 4 K & J 305.
34. Esparto Trading Co. [1857] 12 Ch. D. 79.

to insist on the strict fulfilment of the conditions prescribed for forfeiture by the Articles - *Premila Devi* v. *The Peoples Bank of Northern India Ltd.* 41 Bom. I.R. 147.

Even a slight irregularity in effecting a forfeiture would be fatal and render the forfeiture null and void. The aggrieved shareholder may bring an action for setting aside the forfeiture as well as for damages. His demand for damages can be proved even in a winding-up - *Re New Chili, etc. Co.* [1890] 45 Ch. D. 598. Mere waiver or acquiescence, not amounting to an abandonment of his right (or an estoppel against him) would not deprive him of his rights against an invalid forfeiture of his shares - *Sha Mulchand & Co.* v. *Jawahar Mills Ltd.* [1953] 23 Comp. Cas. 1 (SC).

After shares have been forfeited, a further notice intimating forfeiture is not necessary to complete the forfeiture of shares [*Sha Mulchand & Co.* v. *Jawahar Mills Ltd.* (*supra*).]

9.28-1 Forfeiture of fully paid shares[35]

Fully paid-up shares can also be forfeited in cases like default in fulfilling any engagement between the members or expulsion of members, where the articles specifically provide therefor - *Shyam Chand* v. *Calcutta Stock Exchange Assn.* [1945] 2 I.L.R. Cal. 313.

Though it may be unusual, but if it so happens that neither the clauses of Table F on forfeiture apply nor any express provision exists in the Articles and the company feels the need for effecting forfeiture on any permissible ground, it has to seek Court's permission before effecting any forfeiture.

In *K.Md. Farooq Ahmed* v. *Fortan Cirkit Electronics (P.) Ltd.* [1997] 2 CLJ 234, the issue related to a company's right of forfeiture on shares issued as fully paid to a promoter-*cum*-subscriber to the Memorandum, without receiving any money on such shares, after 9 years of issue. The CLB (now Tribunal) held that the right of recovery of call money expires three years after the date of allotment. Therefore, forfeiture was held invalid.

9.28-2 Effect of forfeiture

The effect of forfeiture of shares is as follows :

1. *Cessation of membership* - A person whose shares have been forfeited ceases to be a member in respect of the forfeited shares [*Regulation 32(1) of Table F*].
2. *Cessation of liability* - The liability of the person whose shares have been forfeited ceases if and when the company receives payment in full of all such money in respect of the shares forfeited [*Regulation 32(2) of Table F*]. However, notwithstanding the forfeiture, he remains liable to pay to the company all moneys which, at the date of forfeiture, were payable by him to the company in respect of the shares forfeited [*Regulation 32(1) of Table F*]. Thus, liability for unpaid calls remains even after forfeiture of shares.
3. *Liability as past member* - The former holder shall remain liable as a past member to pay calls if liquidation takes place within one year of the forfeiture.

35. For details, *see* under Para 10.10

4. On forfeiture, the forfeited shares become the property of the company. Accordingly, these may be re-issued or otherwise disposed of on such terms and in such manner as the Board thinks fit [*Regulation 31(1) of Table F*]. However, at any time before a sale or disposal of the forfeited shares, the Board may cancel the forfeiture on such terms as it thinks fit [*Regulation 31(2) of Table F*].

The right of the company upon forfeiture is only to dispose of the share and use the proceeds for discharging the liability for which the forfeiture was effected, and if there is any balance it belongs to the defaulter and, cannot be appropriated by the company - *Naresh Chandra Sanyal* v. *Calcutta Stock Exchange Assn. Ltd.* AIR 1971 SC 422.

9.28-3 Re-issue of forfeited shares

Normally, a company re-issues forfeited shares. However, in *Bishambhar Nath* v. *Agra Electric Stores Ltd.* [1932] 2 Comp. Cas. 242 (All.), it was held that the directors are not bound to sell shares forfeited for non-payment of calls. This reduction of capital would not require sanction of the court (now Tribunal). From this decision, it may be inferred that if the shares are forfeited for reasons other than the non-payment of calls, re-issue of such shares shall be obligatory.

The forfeited shares may be re-issued at any price provided that the total sum paid by the former holder of the shares, together with the amount paid on re-issue and the amount remaining unpaid on shares is not less than the par (face) value because if it were this would amount to an issue at a discount. In other words, the discount on re-issue should not exceed the amount forfeited on those shares.

If the shares are re-issued at a price more than the face value, the excess of the proceeds of sale is not payable to the former owner if the articles so provide (*Calcutta Stock Exchange Assn. Ltd., Re.* AIR 1957 Cal. 438). The excess of the proceeds so retained shall constitute a premium and must therefore be transferred to the securities premium account. But, as stated earlier, where the articles are silent with regard to such surplus, it was held by Supreme Court in *Naresh Chandra Sanyal* v. *Calcutta Stock Exchange Assn. Ltd.* AIR 1971 SC 422 that the right of a company upon the forfeiture and sale of forfeited shares is to use the proceeds for discharging the liability for which the forfeiture was effected. If there is any balance, it belongs to the defaulter and cannot be appropriated by the company.

Where shares are sold for non-payment of calls, the purchaser is liable to a fresh call in respect of the total amount of the prior calls. But, if any amount is recovered from the ex-holder in respect of the calls, the purchaser will be entitled to the benefit of any amount so recovered. Likewise, any payments by the purchaser will reduce the liability of the ex-holder.[36]

Where the forfeited shares are re-allotted while credit will be given for money already received in respect of them, the new allottee will not only be liable for the balance amount remaining on the shares but he will also be not entitled to voting rights so long as calls payable by the original shareholder remain unpaid, if the company's articles so provide, as stated in section 48.[37] *No return of allotment in*

36. *See* Palmer's Company Precedents, 16th Edition, Part I, page 498.
37. *See* A. Ramaiya's Guide to the Companies Act, 12th Edition, page 2247.

respect of re-issue of forfeited shares: No return of allotment of the shares re-issued need be filed with the Registrar under section 39(4). Such re-issue, in fact, cannot be called allotment. - *Sri Gopal Jalan & Co.* v. *Calcutta Stock Exchange Assn. Ltd.* AIR 1964 SC 250.

9.28-4 Annulment of forfeiture

The Board of directors may, if the former shareholder so requests annual (cancel) the forfeiture. *Regulation 31 of Table A,* in this regard, provides that at any time before a sale or disposal of forfeited shares, the Board may cancel the forfeiture on such terms as it thinks fit. The directors must, however, act, *bona fide* and must pass a suitable resolution to that effect. On cancellation of the forfeiture, the former holder is required to pay all calls due with interest and then his name is restored in the register of members.

9.29 Surrender of shares

Surrender of shares means voluntary return of shares by the shareholder to the company for cancellation. There is no provision for surrender of shares either in the Companies Act or in Table A. In *Bellerby* v. *Rowland & Marwood Steamship Co. Ltd.* [1902] 2 Ch. 14, it was observed that a company cannot accept a surrender of its shares, "as every surrender of shares, whether fully paid-up or not involves a reduction of capital which is unlawful.... forfeiture is a statutory exception and is the only exception". However, the articles of some companies may allow surrender of shares as a short cut to the long procedure of forfeiture, where their forfeiture is otherwise justified - *Trevor* v. *Whitworth* [1887] 12 App. Cas. 409.

In any other circumstance, surrender of shares cannot be accepted without sanction of the Court, as this would amount to a reduction of capital. In *Mangal Sain* v. *Indian Merchants Bank Authority* AIR 1920 Lah. 240, the objector, who had been placed in the list of contributories contended that he had surrendered his shares and the directors had under a clear power in the Articles, accepted the same. *Held,* that a company can only accept a surrender under conditions and limitations under which shares can be forfeited, which did not exist in the present case.

Mere handing over of share certificates cannot constitute surrender of shares - *Vasant Investment Corpn. Ltd., In re* [1982] 52 Comp. Cas. 139 (Bom.).

Since shares can be surrendered only where their forfeiture is justified, a company can accept surrender of partly paid-up shares only. The only exception where fully paid-up shares may be accepted is when shares are surrendered in exchange for new shares of the same nominal value (but with different rights). It is because, in such a case, the capital is not reduced but only replaced.

Surrendered shares may be re-issued in the same way as forfeited shares. If this is done, no reduction in capital occurs. Notice that, no consideration can be paid by the company in exchange of surrendered shares since it would amount to purchase of its own shares, which is specifically prohibited under section 67 of the Act. Thus, where the surrender was accepted in consideration of the discharge of registered holder from his liability in respect of them, it was held that it amounted to purchase of its own shares by the company and was thus ineffective - *Bellerby* v. *Rowland & Marwood Steamship Co. (supra).*

9.30 Transfer of shares

One of the most important features of a company is that its shares are transferable. Section 44 empowers every shareholder to transfer his shares in the manner laid down in the Articles and in accordance with the various provisions of law. However, a private company is statutorily under obligation to place certain restrictions on the right of its members to transfer shares. One of the most common restrictions on transfer of shares in a *private company* is the "Pre-emption clause", which states that the intending transferor must offer his shares to the existing members of the company, before offering them to non-members, so long as a member can be found to purchase them at a fair price to be determined in accordance with the Articles.

In the case of *public companies* also, there may be some restrictions on the right of members to transfer shares. *Regulation 20 (Table F)* provides that the Board of directors may refuse to register the transfer of partly paid shares to a person of whom they do not approve. *Further,* the Board of directors may refuse to register the transfer of any share on which the company has a lien. *Regulation 21* also envisages certain conditions which may be introduced by a company in its Articles to restrict transfer of shares. It provides that the Board may also decline to recognise any instrument of transfer unless: (*a*) the instrument of transfer is in the form as prescribed in rules made under sub-section (1) of section 56; (*b*) the instrument of transfer is accompanied by the certificate of the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transferor to make the transfer; and (*c*) the instrument of transfer is in respect of only one class of shares.

Right of a shareholder to transfer his share is always subject to provisions in Articles of Association - *Mathrubhumi Printing and Publishing Co. Ltd.* v. *Vardhaman Publishers Ltd.* [1992] 73 Comp. Cas. 150 (Ker.).

An already existing restriction on right to transfer of shares continues to exist even after Court sale and a Court sale does not stand on a higher pedestal than a private sale in this regard - *S.A. Padmanabha Rao* v. *Union Theatres (P.) Ltd.* [2002] 36 SCL 353 (Kar.).

Merely an agreement to sell shares does not extinguish the rights of the shareholder - *Martin Castelino* v. *Alpha Omega Shipmanagement (P.) Ltd.* [2001] 33 SCL 210 (CLB).

Where under a loan agreement, plaintiff transferred certain shares in favour of first defendant and first defendant without disbursing loan to plaintiff, transferred said shares to other defendants, it was held that merely because the consideration failed, it could not be said that the transfer of shares in favour of the first defendant was not a transfer and that sale by the first defendant of the shares was sale by a person who was not an owner thereof - *Jay Investments Private Limited* v. *Deccan Leafine Services Ltd.* [2004] 121 Comp. Cas. 12 (Bom.).

9.30-1 Time within which transfer must be registered

As per Section 56, a company is required, within one month after the application of transfer, to deliver the share certificates duly transferred.

In re, Reliance Industries Ltd. [1997] 25 CLA 29 (CLB), the company failed to deliver 77.40 lakhs shares in one case and 10,950 shares in another case within the prescribed period of 2 months (now 1 month) . The total delay was as long as 2371 days in the first case and 300 days in the second case, CLB (now Tribunal) allowed compounding of the offence under section 621A (now section 441) and fined the company and share transfer agents Rs. 10 lakhs each; directors who were officers in default were ordered to pay Rs. 1 lakh each from their personal account and secretary and vice-president were ordered to pay Rs. 10,000 each from personal account.

The default under section 56[38] is a continuing offence and, therefore, shall not be subject to limitation [*Herdillia* v. *Ms. Aparajita Chauhan* [2000] 26 SCL 320 (Raj.)].

Complaint under section 56 may also be filed by the Registrar of Companies; the shareholder is not the only aggrieved person contemplated under the section - Supreme Court in *Registrar of Companies* v. *Rajshree Sugar & Chemicals Ltd.* [2000] 25 SCL 510 (SC).

9.30-2 Power of the Board of directors to refuse registration of transfer of shares

Where the Articles of association of a company give power to the Board to refuse registration of a transfer of shares such power must be exercised by a resolution of the Board. The Board may refuse to register the transfer as long as they are acting in the interests of the company, but if they exercise their discretion to refuse *mala fide, i.e.,* they act oppressively, or corruptly, Tribunal will interfere and order registration. The Articles may, of course, be specific and empower the Board of directors to refuse to register transfers on certain specific grounds. Thus, where the Articles of Association of a private company contain a provision to the effect that "no share shall be transferred to an outsider if any member of the company was willing to purchase the same at fair price to be determined by the directors, and transfer to an outsider shall be allowed only when the Board of directors was unable to find a willing member within a stipulated period", the directors having offered to purchase those shares, the question of registering shares in favour of an outsider would not arise - *Satyanarayana Rathi* v. *Annamalaiar Textiles (P.) Ltd.* [1999] 93 Comp. Cas. 386 (CLB - Chennai).

Again in *Pawan Gupta* v. *Hicks Thermometers (India) Ltd.* [1999] 21 SCL 90 (CLB - New Delhi), it was held that the refusal to register transfer of shares of the company in the name of son of one of the collaborators of the company on the ground that under an agreement the three collaborators had the pre-emptive right to acquire each other's shares in the event of any of them deciding to part with his holding, would not be permissible under the provisions of the Securities Contracts (Regulation) Act, 1956.

Similarly, the refusal to register transfer of shares on the ground that the transferor had been indulging in acts which were against the interests of the company shall not be tenable - *Pawan Gupta* v. *Hicks Thermometers (India) Ltd.* (*supra*).

38. Section 56 corresponds to section 113 of the Companies Act, 1956.

Can refusal to effect transfer be made on grounds other than those stated in the Articles ?

In *Hemangini Finance & Leasing (P.) Ltd.* v. *Tamilnad Mercantile Bank Ltd.* [1996] 8 SCL 237 the CLB (now Tribunal) held that there is no blanket authority available to a company to refuse registration of transfer, even if the articles provide absolute discretion. When the articles do not provide for any powers for refusal, the company cannot refuse. If it has restrictive powers as per articles, the powers could be exercised only in regard to those matters.

Where company gives reason for its refusal to register transfer of shares, that reason alone will have to be examined as good or bad [*Karnataka Theatres Ltd.* v. *S. Venkatesan* [1998] 93 Comp. Cas. 433 (Kar.)].

A director present at meeting approving transfers cannot seek injunction to restrain transferee's rights [*J.K. Puri* v. *H.P. State Industrial Development Corpn.* [1998] 93 Comp. Cas. 491/18 SCL 387 (HP)].

Merely because, with registration of transfer of shares, total holdings of transferee would become dangerously close to 25 per cent, company cannot refuse to transfer [*Bajaj Auto Ltd.* v. *CLB* [1998] 17 SCL 223 (SC)].

9.30-3 Procedure of transfer

Section 56 has laid down the following procedure for effecting transfer of shares:

1. A company shall not register a transfer of securities of the company unless a proper instrument of transfer, in such form as may be prescribed, duly stamped, dated and executed by or on behalf of the transferor and the transferee and specifying the name, address and occupation, if any, of the transferee has been delivered to the company by the transferor or the transferee*.

2. The instrument of transfer, as aforesaid, must have been delivered to the company within a period of sixty days from the date of execution.

3. The instrument of transfer must be accompanied by the certificate relating to the securities, or if no such certificate is in existence, along with the letter of allotment of securities.

However, where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period, the company may register the transfer on such terms as to indemnity as the Board may think fit.

In *Sanjay Mukim v. Thermax Ltd.* [2014] 45 taxmann.com 22 (CLB - Mumbai), Petitioner purchased 100 shares of respondent company R-1 as held by two registered holders (R-3 and R-4). Transfer deed for said shares was lost, so he wrote to Registrar of R-1 regarding same and requested him to send procedure for transfer which would allow transfer without transfer deed. On not receiving any reply from Registrar, he wrote to R-3 and R-4 requesting them to execute fresh transfer deed as well as to provide other documents to enable him to get shares transferred in his name. However, Registrar rejected transfer due to mismatch of signatures of R-3 and R-4. On rejection petitioner again approached R-3 and R-4

*In case of transfer of bonds issued by a Government company, duly stamped instrument of transfer executed by the transferor and the transferee shall not be required to be filed provided an intimation by the transferee specifying his name, address and occupation, if any, has been delivered to the company along with the certificate/letter of allotment relating to the bond.

who in turn executed a fresh transfer deed. Petitioner thus re-lodged all these documents with Registrar of R-1 for registration of transfer in his favour. However, Registrar once again rejected transfer. Petitioner wrote to Registrar giving him all necessary details to effect transfer in his name and a copy of the said letter was also sent to R-1's Chairperson, director and company secretary. However, company secretary and Registrar rejected request of transfer again and advised petitioner to obtain an order from competent court. Hence petitioner by way of this petition sought a direction from R-1 to transfer shares in question in his name and also to rectify its Register of Members by inserting name of petitioner with respect to shares in question. R-1, however, sought dismissal of petition *inter alia* on ground that petition was time barred; that this forum had no jurisdiction and petitioner was not lawful owner of shares-in-question. R-1 had failed to show as to how CLB did not enjoy jurisdiction with respect to transfer of shares and rectification of Register of Members. Moreover, since R-3 and R-4 had filed their affidavits before instant Bench supporting claim of petitioner and petitioner had filed sufficient documentary evidence to prove title of shares-in-question which had not been controverted by R-1, reasons attributed by R-1 could not be held as a sufficient cause for refusal of transfer of shares in favour of petitioner[39].

A reading of Section 56 of the Companies Act, 2013 and Section 12 of the Indian Stamp Act, 1899, clearly shows that the instrument of transfer of shares should bear the requisite stamps and the adhesive stamps should be cancelled at the time of affixation of such stamps and execution of the document. If these requirements are not complied with, then the instrument, although bearing an adhesive stamp but not cancelled, cannot be said to be an instrument 'duly stamped'. Accordingly, transfer shall not be valid - *Nuddea Tea Co. Ltd.* v. *Ashok Kumar Saha* [1988]. Similarly view was held in *Kothari Industrial Corpn. Ltd.* v. *Lazor Detergent (P.) Ltd.* [1993].

Again, in *Arvind Parasramka* v. *Minwool Rock Fibres Ltd.* [2018] 90 taxmann.com 319 (NCLT - Mum.), since adhesive stamps were not cancelled, instrument of transfer was deemed to be unstamped and, therefore, shares were rightly not transferred in favour of petitioners due to non-compliance of provisions of section 56.

Cancellation of the stamps by the staff of the company does not make the transfer instrument duly stamped. The contention of the company that stamps were cancelled by them (the company) before the Board of directors considered the transfer shall not be upheld as valid - *Subhash Chander* v. *Vardhaman Spg. & Gen. Mills Ltd.* [1993].

4. The company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates within a period of one month from the date of receipt by the company of the instrument of transfer.

Inordinate and unexplained delay in lodging the transfer - In *Dinesh Sud v. Stitchwell Qualitex (P.) Ltd.* [2013] 38 taxmann.com 223 (Delhi), Delhi High Court held that inordinate and unexplained delay of 16 years on the part of appellant in raising his claim as regards shareholding in respondent company would result in dismissal of his petition for rectification of register of members.

39. You may note that Section 58 has now created specific provision in the event of loss of transfer deeds.

9.31 Blank transfer

Where a shareholder signs a share transfer form without filling in the name of the transferee and hands it over along with the share certificate to the transferee thereby enabling him to deal with the shares, he is said to have made a transfer 'in blank' or a 'blank transfer'. Blank transfer facilitates purchase and sale of shares by mere delivery of the share certificates along with the said blank transfer form. Because of the convenience associated with blank transfers, the shares are usually sold and purchased through blank transfer. Besides easy transferability, blank transfers result in saving on stamp duty. Stamp duty is to be affixed only by the last transferee who lodges the shares with the company for the purpose of registration of transfer. Thus, all the intermediate transferees save stamp duty.

A blank transfer deed is not a negotiable instrument merely because it may be transferred by mere delivery. Accordingly, the title of the transferee acquiring shares through a blank transfer shall invariably be subject to the title of the transferor. Thus, a *bona fide* transferee from a person who has acquired a blank transfer deed by fraud does not acquire good title to the shares included in the deed.

A transfer in blank, when accompanied by a share certificate, carries to the transferee both the legal and equitable rights to the shares and also the right to call upon the company to register the transfer - *Colonial Bank* v. *Cady* [1980] 15 App. Cas. 267. This right to get himself registered as a member is available to the transferee even after the death of the transferor - *Bengal Silk Mills Co., In re* [1942] 12 Comp. Cas. 206 (Cal.).

9.31-1 Ills associated with blank transfers

1. *Loss of stamp duty* - The saving in stamp duty by the intermediate transferees is, in effect, a loss to the exchequer - the State Government (Stamp duty being a State subject).
2. *Loss of income-tax* - The facility of blank transfer enables any number of transfers till a transferee decides to become the registered shareholder of the company. Such a transferee shall fill up his name and other particulars before lodging the same with the company. From the entries in the transfer form, it will now appear as if the last transferee has purchased the shares directly from the registered shareholder. As a consequence the intermediate transferors who might have sold the shares for a gain may not report the same as a part of their income. Since the transaction has not been recorded, it may provide a convenient route to avoid the income-tax liability, thus, resulting in a loss to the exchequer.

9.32 Transfer of partly-paid shares

Where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice of the application, in such manner as may be prescribed, to the transferee and the transferee gives no objection to the transfer within two weeks from the receipt of notice [Section 56(3)].

9.33 Transfer of shares held in joint names

In the case of shares held in joint names, the transfer form must be signed by all of them, unless a specific authorisation is made in favour of any or some of them. Thus, is *Shanta G. Pommerat* v. *Sakal Papers (P.) Ltd.* [1990] 69 Comp. Cas. 65 (Bom.), where four persons were shown as transferors of shares and only three had signed the share transfer form and fourth had not authorised the others to sign on his behalf, it was held that transfer of shares was not valid.

9.34 Transfer when complete

Transfer becomes complete and the transferee becomes a shareholder, only when the transfer is registered in the company's register - *Mathrubhumi Printing & Publishing Co. Ltd.* v. *Vardhaman Publishers Ltd.* [1992] 73 Comp. Cas. 80 (Ker.).

In a plea that the names of certain persons entered in the Register of Members were done without following the complete procedure prescribed under section 108 [Now section 56], the Delhi High Court held that the onus of proof will lie on the party making such allegation [*Radhey Shyam Gupta* v. *Kamal Oil & Allied Industries Ltd.* [1999] 19 SCL 271 (Delhi).

9.35 Right of transferees pending registration of transfer [Sec. 126]

For transferring the ownership rights in shares it is necessary that the company must register the transfer and make new entries in its register of members. But, as we know, the transfer of shares is not registered immediately on delivering the instrument of transfer to the company. In fact, the company is given one month time under section 56 to either register the transfer or refuse it. Now the question arises as to what shall be the position of the respective parties during this period? The matter may be of interest inasmuch as the company during this period may issue bonus shares or make offer of rights. Till the company has registered the transfer, the name of the transferor continues to appear in the register of members. Technically, therefore, the transferor continues to be a lawful owner and the member of the company, but the transferee is the beneficial owner. In order to protect the interest of transferees in such a situation, section 126 provides that where any instrument of transfer of shares has been delivered to the company for registration and transfer has not been registered, the right to dividend, rights shares and bonus shares shall be kept in abeyance. The dividend in relation to such shares shall be transferred to the special account called "Unpaid Dividend Account" as per section 124 of the Act unless the company is authorised by the registered holder of such share in writing to pay such dividend to the transferee specified in such instrument of transfer.

In *G.R. Desai* v. *Registrar of Companies* [1998] 18 SCL 55 (AP), the Andhra Pradesh High Court held that it is possible to take the view that section 206A (now section 126) applies in all cases where the instrument of transfer of shares has been delivered to a company but the transfer has not been registered by the company for any reason whatsoever, but if the Court finds that the company *mala fide* or lacking *bona fides,* did not transfer the shares in the name of the transferee then such act

of non-registration will not be covered by the provisions of section 206A (now section 126). In such case the company would be liable to pay the dividend not to the transferor but to the transferee, due to absence of *bona fides* on its part. Nobody can take advantage of his own wrong.

Transfer of shares not duly substantiated with transfer form/letter of allotment-Whether maintainable?

In *Suhas Chakma* v. *South Asia Human Rights Documentation Centre (P.) Ltd.* [2017] 80 taxmann.com 18 (NCLT - New Delhi), an ex-director of company alleged that his shares in company were fraudulently transferred to others and company and its existing directors failed to substantiate their claim of transfer of shares with production of share transfer forms, letter of allotment, NCLT, New Delhi held the transfer being fraudulent should be declared to be null and void.

9.36 Notice of refusal

Where a **private company** refuses to register a transfer, whether in pursuance of any power of the company under its Articles or otherwise, it shall, within 30 days from the date on which the instrument of transfer was delivered to the company, send notice of refusal to the transferee and the transferor, giving reasons for such refusal [Sec. 58(1)].

Notice of refusal of transfer of shares is a requirement of section 58 which must be observed even where the shareholder is also a director of the company and therefore aware of the decision of refusal taken in the Board meetings [*Vimal K. Gupta* v. *Auto Lamps Ltd.* [1995] 5 SCL 238 (CLB)].

9.36-1 Returning back the documents

Notice of refusal to register transfer of shares on the grounds mentioned in the Articles, has to be given to the transferor and the transferee. Here, the idea in returning the instruments of the transfer is that the parties may comply with the requirements of the law and resubmit the documents once again to the company for effecting transfer.

9.36-2 Retention of certificates

However, certain companies have adopted a practice of retaining the instruments of transfer or the relevant share certificates so as to delay the procedure of transfer and thereby causing the transferee an unjustified injury. Retention of instruments of transfer is totally against the objective and spirit behind public policy of free transferability of shares. It is an established practice in the corporate sector that the share scrips are to be returned to the person who lodged the instruments of transfer.

Also, in Circular No. F/37/SE-79 dated 29-12-1970, issued by the Department of Economic Affairs, Ministry of Finance, relating to the delay in registering transfer, it is stated that in the interest of investors, documents should be returned without delay. The Ministry has also shown concern over delay/failure in the return of the documents relating to the transfer. The circular further states :

It is equally undesirable to delay the return of a document, when the same is found to be defective or not in order on presentation to the company. The delay of weeks

and at times of months which frequently occurs makes it difficult to rectify the documents in time and creates avoidable difficulties in the collection of dividends as well as right shares. The right of recourse of the contracting parties is prejudiced thereby and delayed receipt of valid documents is detrimental to the interests of *bona fide* investors.

It is clear from the above circular that the share certificates have to be returned forthwith to the parties concerned, otherwise, it will create lot of legal complications and possibilities of third party rights.

The Company Law Board (now Tribunal) in the case of *Jagatjit Industries Ltd.* v. *Mohan Meakin Ltd.* (No. 23/90-CLB etc. decided on 31-5-1991), came down heavily on such practice of retaining instruments of transfer by the companies while sending notice of defects relating to the law in the transfer documents.

In the instant case, the company had objected to register the transfer of shares in the name of other company on the ground that the requirements of law under section 108 [Now section 56] of the Act are not fulfilled and on other grounds, which are covered by clause (*a*) of section 22A(3) of the SCRA, and it had sent the share certificate to the transferors retaining the relevant transfer deeds with itself. The other company objected to such practice of sending the certificates to the transferors and retaining the share transfer deeds. On an appeal by the aggrieved company, the CLB (now Tribunal) held that the first company has chosen to return the share scrips to the transferors, apparently, with a view to harass the transferee company. Such action is against all the cannons of law, justice, equity and fair play, and is not in accordance with sound business principles or prudent commercial practices.

It also held that such practice is neither consistent with the letter nor the spirit behind the above circular and such unhealthy practice should not be allowed.

In *Tirupati Techno Projects Ltd.* v. *Modi Spinning & Weaving Mills Co. Ltd.* [2015] 132 SCL 223 (CLB-New Delhi), Petitioner purchased equity shares of the Respondent company from open market and lodged the same for transfer with the company. The Respondent company rejected the application with the plea that company was not duly constituted and therefore, the resolution passed by the Board of directors was not valid. Further, it submitted that the petitioner company had acquired shares without adopting fair method, i.e., by public offer/announcement violating the provisions of SEBI, RBI, and SICA. CLB (now Tribunal*) held that the Respondent Company, not being a shareholder of Petitioner Company that the Board of Petitioner Company was invalid and that director of Petitioner Company could not file petition on its behalf. Again, it held that neither any statutory authority nor any court had declared that acquisition of shares by the petitioner violated any provisions such as RBI, SEBI and SICA. Besides, there was no public interest involved, nor was there any bar under law to acquire shares. Accordingly, it directed the Respondent Company to register shares in the name of petitioner and also rectify register of members.

9.37 Appeal against refusal to register transfer [Section 58]

The transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent

*W.e.f. 1.6.2016.

by the company, within a period of **sixty days in case of private company** and within a period of **90 days in case of a public company** from the date on which the instrument of transfer or the intimation of transmission, as the case may be, was delivered to the company.

The Tribunal, while dealing with an appeal, whether it relates to a private company or public company may, after hearing the parties, either dismiss the appeal, or by order—

(*a*) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or

(*b*) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved.

Where respondent had furnished succession certificate as well as transfer deed executed in their favour, they were clearly entitled to have rectification made by getting shares registered in their favour - *Jai Mahal Hotels (P.) Ltd.* v. *Rajkumar Devraj* [2015] 62 taxmann.com 241 (SC).

Section 59(1)[40] does not cover a situation of transfer of shares in violation of a private agreement - *Industrial Development Bank of India Ltd.* v. *Parmeshwari Fabrics (P.) Ltd.* [2016] 67 taxmann.com 331 (Bombay).

Penalty: If a person contravenes the order of the Tribunal under this section, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

In case of refusal to register a transfer by the Board of directors, on appeal to the CLB (now Tribunal), it is always for the party assailing the decision of the Board of directors to demonstrate that such decision suffers from unsustainable reasons, *i.e.*, such reasons are not legitimate or that the decision is vitiated by ulterior motive or corrupt motive or arbitrary conduct or *mala fides* of the Board of directors [*Vasant Investment Corpn. Ltd.* v. *CLB* [1999] 19 SCL 502 (Bom.)].

Locus standi *of transferee to complain against non-registration* [*Federal Bank Ltd.* v. *Smt. Sarla Devi Rathi* [1997] CLA 183 (Raj.)].

Smt. Sarla Devi Rathi (Respondent) complained under section 113 (now section 58) of the Act, that the company had neither registered 100 shares she had purchased nor did it return the share certificates to her. The Magistrate found that there was a *prima facie* case against the company and its managing director and summoned them.

It was urged on behalf of the company that section 439[41] of the Act prohibits a Court from taking cognizance of any offence under the Act except on a complaint, among others, of a shareholder of the company and since in this case the respondent had not become a shareholder of the company, no cognizance of the complaint could be taken.

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40. Section 59 provides for rectification of register of members.
41. Corresponding to section 621 of the Companies Act, 1956.

The Rajasthan High Court held that the respondent having purchased the shares by paying the price therefor, had become their owner and no interest in the shares had been left with the person in whose name the shares stood earlier in the company's records. If the interpretation sought to be given by the company on section 439 is accepted, that would defeat the purposes of the provision and enable the company to avoid its liability as the person, after selling the shares, would have no interest whatsoever in coming forward and filing the complaint, alleging the non-transfer of the shares in favour of the purchaser.

The Magistrate, therefore, did not commit any error in summoning the Managing Director on the basis of material on record before him.

The complaint under section 58 should be filed before the court having jurisdiction with respect to the place of registered office of the company and not the place of purchase of shares.

In *Zee Telefilms Ltd.* v. *State of Andhra Pradesh* [2000] 27 SCL 389 (AP), the complainant purchased certain shares of the petitioner-company at Hyderabad. He sent the said shares to the registered office of the petitioner-company for affecting the transfer of the said shares in his name. The company did not deliver the said shares duly transferred in his name in spite of reminders and legal notice. Therefore, the complainant filed complaint before Court at Hyderabad against the petitioner-company and its directors for the offence punishable under section 58.

The High Court of Andhra Pradesh held that the complaint filed before Court at Hyderabad where shares were purchased could not be entertained since the registered office of the company was at Mumbai.

Case Law: *Synthite Industries Ltd. v. Plant Lipids (P.) Ltd.* [2018] 100 taxmann.com 343 (NCL-AT)

Facts of the Case:

Appellant company initially incorporated as a private company became deemed public company. Later on, shareholders of appellant company unanimously resolved to reconvert appellant company into private company and included article 23A in AOA of appellant company which restricted right of transfer of shares by members to non-member. Meanwhile, R-10 transferred shares held by him in appellant company to R1, who was an outsider to company. Appellant company refused to register said transfer in R1's name on basis that same was in violation of article 23A. Respondents submitted that conversion was still pending and on concerned date, company was still a public company. Further, earlier article 23 was deleted when appellant company had become deemed public company and, thus, there was no restriction on transferability of shares. It was found that even with or without article 23A admittedly, article 24 of AoA was existing wherein Board of Directors had option to refuse to register any transfer where Directors were of opinion that it was not desirable to admit proposed transferee to membership. Apart from that, as per section 58, it is open for public company to refuse registration of transfer of securities for a sufficient cause.

Decision:

Held that, in instant case transferee *i.e.* R1 was appellant company's competitor and purported acquisition of shares by way of transfer was with sole intention of causing

prejudice to interests of appellant company by introducing outsiders and thus the appellant company had justifiable reason to refuse to record transfers of shares.

Difference in signatures on Transfer deed

In the case of *LIC of India Ltd.* v. *Tata Steel Ltd.* [2015] 56 taxmann.com 131 (CLB - Mumbai) the Appellant purchased shares of R-1 company through broker. Shares were delivered along with transfer deeds duly signed by authorised signatories of registrar and transferor (R-2) of R-1 company. R-1 company and R-2 raised objection that there being difference in signatures on transfer deeds, transfer would not be effected. Appellant sent several reminders to transferors to sign transfer deeds afresh. However, transferors did not respond to various letters sent to them. Thereafter, R-2 finally advised appellant to approach competent Court. Hence, appellant filed instant appeal seeking declaration that it be declared as owner of shares of R-1 Company.

CLB held that since respondents had not come forward to claim ownership of impugned shares for last 17 years and there being no reason to disbelieve claim of appellant in respect of impugned shares, appellant was to be declared owner of shares of R-1 company and R-1 was directed to rectify register of members to effect transfer of shares in name of appellant.

In *Mathstraman Manufacturers & Traders (P.) Ltd.* v. *Malayalam Industries Ltd.* [2014] 45 taxmann.com 211 (CLB - Chennai), Respondent company agreed to issue shares against sales proceed of land of petitioner. Part payment was received by petitioner. Petitioner alleged that respondent company had not issued shares against balance amount. The issue was, could allotment of shares or enforcement of agreement for allotment of shares be a subject matter of adjudication under sections 111A and 111(4) [Now section 58]? CLB (now Tribunal) held 'No' because the petitioner company under guise of rectification was seeking to enforce a specific performance and was invoking jurisdiction of CLB (now Tribunal) under sections 111A and 111(4) (now section 58), which was a matter to be referred to a civil court. Thus, entertaining the petition would amount to abuse of law.

In State Bank of India v. Kamlesh Kalidas Shah [2019] 102 taxmann.com 321 (NCL-AT, New Delhi), it was held that in case of non-availability/major mismatch in transferor's signature, transferor is required to update his/her signature by submitting bank attested signature along with an affidavit and cancelled cheque to RTA/company - NCLAT relied on the SEBI's Circular No. SEBI/HO/MIRSD/DOS3/CIR/P/2018/139 dated 6-11-2018.

9.38 Transfer of shares on the basis of pre-incorporation transfer deeds

A director of a company, prior to its incorporation, signed a transfer deed, as if the company was in existence at the relevant date. Later, when the shares were submitted to the company for the purpose of registration of the transfer, the company refused to register the same. On an appeal to the CLB [Now Tribunal], it was held that the transfer deed was not properly executed and the company was justified in refusing to register - *Inlec Investment (P.) Ltd.* v. *Dynamatic Hydraulics Ltd.* [1989] 3 Comp. LJ 242 (CLB).

Sale of shares by Tax Recovery Officer - Who should sign the transfer deed **:** In *Swadeshi Polytex Ltd.* v. *Swadeshi Mining & Manufacturing Co. Ltd.* [1987] 62 Comp. Cas. 683 (All.), it was held that when the Tax Recovery Officer is required to transfer shares to a person who has purchased them, the Tax Recovery Officer may execute such documents or make such endorsement as required and in that event the execution and the endorsement made shall have the same effect as an execution/ endorsement made by the party.

Therefore, when shares are acquired from the Tax Recovery Officer, he is competent to execute the document of sale.

9.39 Transfer of shares after winding-up - Whether valid

The question was considered in the case of *H.L. Seth* v. *Wearwell Cycle Co. (India) Ltd. (In Liquidation)* [1988] 64 Comp. Cas. 497 (Delhi). The Delhi High Court held that as between transferor and transferee, a transfer of shares executed after the commencement of winding up is valid, whether it was executed in performance of a contract made before or after that time.

9.40 Transfer of shares under Depository System

The Depositories Act, 1996 provides for an alternate mode of effecting transfer of shares. Investors will, however, have the choice of continuing with the existing share certificates (*i.e.,* in physical form) and adopt the existing mode of effecting their transfer.

The Depositories Act provides for the establishment of one or more depositories. Every depository will be required to be registered with the SEBI and receive a certificate of commencement of business on fulfilment of such conditions as may be prescribed. Investors opting to join the system will be required to be registered with one or more participants who will be agent for depositories. The participants will be custodial agencies like banks, financial institutions as well as large corporate brokerage firms. Upon entry into the system, share certificates belonging to the investor will be dematerialised and their names entered in the books of participants as beneficial owners. The investors' names in register of companies concerned will be replaced by the name of the depository as the registered owner of the securities. The investors will, however, continue to enjoy the economic benefits, from the shares as well as voting rights on the shares concerned.

In the case of fresh issue (IPO), at the time of initial offer, the investor would indicate his choice in the application form, if he opts to hold the security in the depository mode. Shares in the depository mode shall cease to have distinctive numbers.

An investor, who opts for a depository mode may at any time, opt to choose out of it and claim share certificate from the company by substituting his name as the registered owner in the place of the depository.

Ownership changes in the depository system will be made automatically on the basis of delivery *against* payment. There will be a regular, mandatory flow of information about the details of ownership in the depository's record to the company concerned. If the latter has any reservations about the admissibility of share acquisition by any person on the grounds that the transfer of security

conflicts with the provisions pertaining to substantial acquisition of shares and takeovers or conflicts with the provisions of SICA, 1985, the company will be entitled to make an application to the CLB (now Tribunal) for rectification of the ownership records with the depository. During the pendency of company's application with the CLB (now Tribunal) the transferee would be entitled to all the rights and benefits of the shares except voting rights which will be subject to the orders of the CLB (now Tribunal).

Any loss caused by the negligence of the depository or the participant will be required to be indemnified by the depository.

It may be noted that the provisions of section 108 (Now section 56) are inapplicable to transfer where transferee and transferor are entered as beneficial owners in records of depository. [*Finolex Industries Ltd.* v. *Anil Ramchand Chhabria* [2000] 26 SCL 233 (Bom.).]

9.41 Transfer of shares in favour of pledgee

Share pledged by a company against loan could be transferred in favour of the pledgee but subject to the provisions of Takeover Code. - *Andhra Pradesh Mills Ltd.* v. *Pampasar Distilleries Ltd.* [2001] 33 SCL 641 (CLB - Chennai).

9.42 Transfer of shares by way of gift

A gratuitous transfer of shares may sometimes also be effected to transfer an equitable title to the shares. [*see Re Rose,* (1949) Ch 78 : [1948] Ch 78]. It has been held that where a donor of shares has delivered to the donee, or to the company, an executed transfer deed and the relevant share certificate, the gift is complete despite the fact that the directors have a discretion to refuse registration of the transfer. The Supreme Court in *Ramchandra Shelat* v. *Pranlal Jayanand Thakur* [1975] 45 Comp. Cas. 43 : AIR 1974 SC 1728 has held that even where transfer forms signed by the transferor are otherwise in blank and are handed over to the transferee along with the share scrips by way of gift, the transferee's title will be complete even before registration.

9.43 Forged transfer

An instrument on which the signature of the transferor is forged is called a forged transfer. Forgery does not confer any title. It is because in case of forgery there is not merely an absence of free consent but there is no consent at all. Hence a forged transfer can never confer ownership upon the transferee thereof, howsoever genuine the transaction may appear. Thus, if a transfer is forged and the company registers the transfer, the true owner can apply to the company for rectification of the register of members and for his name to be placed back in the register.

9.43-1 Consequences of forged transfer

1. A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder with the consequential rights, *viz.*, the right to receive dividends, right, bonus etc. The company is bound to restore his name in the register of members - *Barton* v. *N. Staffordshire Rly.* [1988] 38 Ch. D 458.

2. If the company has issued a share certificate to the transferee and he has sold the share to an innocent purchaser, it cannot deny his title, for the certificate stops it from doing so. It will, therefore, be under a liability to compensate him if it refuses to register him as a shareholder - *Balkis Consolidated Co. Ltd.* v. *Fredrick Tomkinson* [1893] AC 396.

3. If the company has been put to loss by reason of the forged transfer, it may recover the loss from the person who procured registration, even though he might have acted in good faith.

A person who presents a transfer of shares for registration by a company thereby represents that the instrument of transfer is genuine, and if it turns out to be a forgery, the company is not estopped from denying his title to the shares, even though he did not know that the transfer was forged when he presented it. Consequently, even if the company issues a share certificate to the person who presents the transfer, and he relies on it, the company may remove his name from the register of members, and he cannot claim damages for wrongful removal - *Sheffield Corpn.* v. *Barclay* [1905] AC 392 at 403; *Johnston* v. *Renton* [1870] LR 9 Eq 181.

9.44 Priority between transferees

When the company accepts the transfer, such transfer relates back to the date of the execution of the instrument of transfer between the transferor and the transferee.[42] Thus, where two or more persons lay their claim to the same shares, the transferee who is earlier in point of time will be preferred.

However, where the transfer is registered, the transferee who first secures registration will get priority over the rest irrespective of the date when his claim arose - *Moore* v. *North Western Bank* [1891] 2 Ch. 599 (Ch.D).

9.45 Transmission of shares and debentures

Transmission of shares takes place (*i*) when the registered shareholder dies; or (*ii*) when he is adjudicated an insolvent; or (*iii*) where the shareholder is a company, it goes into liquidation.

On the death of a shareholder, his shares vest in his legal representative. The legal representative can sell the shares without being registered, if he does not wish to be registered as a member of the company. But, subject to the provisions of the Articles, he is entitled to be put on the Register of members, if he so desires. For this purpose, the company is bound to accept production of 'probate' or 'letter of administration' or 'succession certificate' as sufficient evidence of his title. In case of transmission of shares, a company has no powers to refuse registration of transmission of shares once the legal heir produces a proper legal representation to the estate by way of will/probate/succession certificate, etc., if the same is required in terms of the Articles, unless there is an injunction against acting in terms of the legal representation - *Anil R. Chhabria* v. *Finolex Industries Ltd.* [1999] 22 SCL 437 (CLB - Mum.). In case the legal representative elects to become a member, he

42. Howrah Trading Co. Ltd. v. CIT [1959] 29 Comp. Cas. 283 (SC).

must send a written and signed notice, called "Letter of Request" to the company notifying his decision. If he elects to transfer, he shall notify the election after executing a transfer of the shares. All rules relating to the right of transfer and registration of transfer will apply to such notice and transfer.

Succession certificate is to be insisted upon by public companies for registering transmission of shares - *Ms. Vidya Primlani* v. *ITC Ltd.* [2011] 109 SCL 41/12 taxmann.com 488 (CLB).

Succession certificate covering shares held by a deceased member on the date of his death, would cover subsequent issue of bonus shares and no fresh succession certificate would be required in respect of subsequently issued shares—*Arjun Kumar Israni* v. *Cipla Ltd.* [1999] 35 CLA 339 (CLB - Mum.).

In the aforesaid case, the CLB [Now Tribunal] further observed that the respondent company would not be justified in not acting on the succession certificate issued by the competent court on account of insufficient court fee stamps.

It is for the court to be satisfied about the payment of proper court fees and if court fees paid is insufficient, the recovery of deficit court fees along with penalty is to be decided by the authority of the court or revenue authority and it is not open for the respondent-company to withhold the transmission of shares in the name of the appellant on this ground. Once the succession certificate has been produced from the competent court which has declared the appellant as legal heir for the shares in question and there is no other claimant for the said shares, the company ought to effect the transmission of shares on the basis of succession certificate produced.

Procedure : Section 56(2) provides that the company shall have the power to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

Sub-section (4) further requires that the company shall, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates duly transmitted within a period of one month from the date of receipt by the company of the intimation of transmission.

The transfer of any security or other interest of a deceased person in a company made by his legal representative shall, even if the legal representative is not a holder thereof, be valid as if he had been the holder at the time of the execution of the instrument of transfer [Sub-section (5)]

Case Law: *Namrata Tirumale* v. *Anotech Engineers (P.) Ltd.* [2017] 79 taxmann.com 452 (NCLT-Bang.)

Facts : The entire shareholding was transferred to the mother of the deceased shareholder, mother being the nominee. No shares were transferred to the daughter.

Decision : Held section 10 of Hindu Succession Act, 1956 provides distribution of property amongst heirs of Class-I. Since both daughter and mother are class-I heirs, shares of deceased were to be transmitted equally to his daughter and mother.

Appeal against Refusal and Penalty: Same provisions are contained in section 58 as relate to transfer of shares and discussed above.

Where petitioner filed a petition under section 111 (now section 56) seeking transmission of shares of his deceased mother on basis of succession certificate which had been restrained by issuing competent authority, CLB (now Tribunal) in *Nirav Jhaveri* v. *Mit-N-Mir (P.) Ltd.* [2012] 20 taxmann.com 303, (CLB – Mum.), held that the petition had to be dismissed since the petitioner could not be treated as a legal heir.

In case the legal representative elects to become a member, he must send a written and signed notice, called "Letter of Request" to the company notifying his decision. If he elects to transfer, he shall notify the election after executing a transfer of the shares. All rules relating to the right of transfer and registration of transfer will apply to such notice and transfer.

Succession certificate covering shares held by a deceased member on the date of his death, would cover subsequent issue of bonus shares and no fresh succession certificate would be required in respect of subsequently issued shares - *Arjun Kumar Israni* v. *Cipla Ltd.* [1999] 35 CLA 339 (CLB - Mum.).

In the aforesaid case, the CLB (now Tribunal) further observed that the respondent company would not be justified in not acting on the succession certificate issued by the competent court on account of insufficient court fee stamps.

9.46 Distinction between transfer and transmission

The following points of distinction between transfer and transmission of shares are important and should be kept in mind:

(*i*) Transfer takes place by a voluntary and deliberate act of the transferor, while transmission is the result of operation of law.

(*ii*) In case of transfer, the transferor and the transferee have to execute an instrument of transfer, while the shares are transmitted on the death, insolvency of a member, and instrument of transfer is not required; only a proof of his title to the share is required.

(*iii*) Transfer is the normal method of transferring property in the shares, whereas transmission of shares takes place only on death or insolvency of a shareholder.

9.47 Rectification of register of members [Section 59]

(1) If the name of any person is, without sufficient cause, entered in the register of members of a company, or after having been entered in the register, is, without sufficient cause, omitted therefrom, or if a default is made, or unnecessary delay takes place in entering in the register, the fact of any person having become or ceased to be a member, the person aggrieved, or any member of the company, or the company may appeal in such form as may be prescribed, to the Tribunal for rectification of the register. In respect of foreign members or debenture holders residing outside India, appeal will have to be preferred before a competent court outside India, specified by the Central Government by notification.

Case Law: *MAIF Investments India (P.) Ltd. v. IND-Barath Power Infra Ltd.* [2018] 97 taxmann.com 628 (NCLT - Hyd.)

Facts of the Case:

Respondents were promoters of R2 company. An investment agreement was entered into between petitioner and respondent and in terms of said agreement, petitioner subscribed compulsory convertible debentures (CCDs) of R2 company. Petitioner issued letters to respondent calling upon it to convert CCDs into equity shares. Though later on, petitioner cautioned respondents not to convert CCDs. Board of Directors of R2 held meeting and passed agenda item for proposed conversion of CCDs. Petitioner alleged that said conversion was in derogation of terms of investment agreement and, thus, filed instant petition and sought to declare said conversion as illegal. According to petitioner, without sufficient cause its name had been entered into register of members and equity shares of R2 had been allotted to it.

Decision:

It was noted that investment agreement which was incorporated in Articles of Association, gave a right of election to ask for conversion of CCDs into equity shares. Such election had been made by petitioner. Hence, conversion of CCDs into equity shares was not in derogation of terms of investment agreement and, thus, there was a sufficient cause of mentioning names of petitioners as shareholders of R2 Company on account of conversion. Instant petition was, therefore, dismissed.

In **Relisys Medical Devices Ltd. v. D. Raju Reddy [2018] 95 taxmann.com 252 (NCL-AT),** NCLT, New Delhi held that where appellant company while converting CCDs allotted excess shares to respondent-NRI but opted to unwind excess shares as advised by RBI, appellant's application for rectification under section 59 for wrongful calculation of share capital was to be accepted.

(2) The Tribunal may, after hearing the parties to the appeal under sub-section (1) by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

Thus, where shares of petitioner in a company were transferred to another person and his name was deleted from company's register, since said transfer was made by company knowing fully well that one more duplicate certificate was in existence, NCLT held that since the transfer was made on basis of earlier duplicate share certificate, said transfer was made on forged document and it was *null* and *void* - *S. Ramesh* v. *South Travancore Hindu College Association* [2018] 89 taxmann.com 414 (NCLT- Chennai).

Case Law 1 : *Sangeeta Maheshwari v. Premsagar Agricultural (P.) Ltd.* [2018] 100 taxmann.com 116 (NCL-AT)

Facts of the Case:

Appellant filed petition under section 59 before NCLT alleging that 200 shares held by her in respondent-company were illegally transferred in name of respondent No. 3. NCLT held that petition was not within time and petitioner was not entitled for any relief of rectification of Register of members on grounds of delay and laches.

Decision:

On appeal, the Tribunal held that since appellant gave sufficient ground for delay in filing petition, Tribunal should not have dismissed petition on technical grounds but should have decided petition on merits. It further held that since it was established that shares in name of appellant had been transferred in name of respondent No. 3 without notice, impugned order passed by NCLT was to be set aside and appellant being found to be rightful holder of 200 shares transfer of shares in name of respondent No. 3 was held illegal and appellant was to be restored as holder of those shares.

Case Law 2: *Vestal Educational Services (P.) Ltd. v. Lanka Venkata Naga Muralidhar* [2018] 100 taxmann.com 286 (NCL-AT)

Facts of the Case:

Respondent was one of shareholder of appellant company who previously acted as director also. Respondent alleged that amount lent by him to appellant company towards repayment of loan to lending bank had been converted into equity without his knowledge, intimation or authorization. On the contrary, appellant-company claimed that allotment was done on basis of decision taken in Board meeting where offer was made regarding issue of equity shares at par on right issue basis to existing shareholders and respondent was shown as entitled/offered shares. Appellant-company also claimed that respondent had knowledge about letter of offer. However, company had not produced any evidence with regard to issue of notice offering shares to respondent or any other shareholder and its acceptance by respondent.

Decision:

NCLAT, New Delhi upheld the impugned order passed by the Tribunal declaring said allotment to be null and void as correct.

(3) The provisions of this section shall not restrict the right of a holder of securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

(4) Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being

in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned.

(5) If any default is made in complying with the order of the Tribunal under this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees, or with both.

9.48 Nomination of shares and debentures [Section 72]

In order to allow nomination of shares and debentures in the event of the holder thereof, section 72 provides that every holder of shares in, or holder of debentures of, a company may, at any time, nominate, in the prescribed manner, a person to whom his shares in, or debentures, of the company shall vest in the event of his death [*Sub-section (1)*].

(*2*) Where the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

(3) The nomination will hold good in spite of any will or any other law containing an otherwise provision. Thus, nomination is overriding.

(4) The security holder may change the nomination any time as per the procedure prescribed by the company.

(*5*) Where the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

9.49 Secretarial practice/steps with regard to registration of transfer of shares

The following are the steps involved in the transfer of shares :

1. On receipt of the transfer deed/instrument in the prescribed form along with the share certificate or allotment letter, an acknowledgement for the same should be sent to the person lodging the documents (normally, the transferee). Where the shares are partly paid and the instrument of transfer is received from a person other than the transferee, the company should also send a notice to the transferee in which the fact of shares being partly paid-up should be clearly made out.
2. The instrument of transfer may not be in the prescribed form in the following cases:[43]

43. M.C. Bhandari, Guide to Company Law Procedures, 12th edn., page 453.

(*i*) Shares transferred by a director or nominee on behalf of another body corporate;

(*ii*) Shares transferred by a director or nominee on behalf of a corporation owned or controlled by Central or State Government;

(*iii*) Shares transferred by way of deposit as a security for repayment of any loan or advance, if they are made with any of the following :

(*a*) State Bank of India; or

(*b*) any scheduled bank; or

(*c*) any other banking company; or

(*d*) financial institution; or

(*e*) Central Government; or

(*f*) State Government; or

(*g*) any corporation owned or controlled by the Central or State Government.

(*iv*) Trustees who have filed the declaration.

3. The instrument should be checked thoroughly to find out whether the same is in order, namely the instrument is properly dated, is not stale, is duly stamped and the same have been cancelled, the signature of the transferor tally with the specimen signature available with the company, all columns have been duly filled in, the necessary approvals of the Reserve Bank or the Central Government/Tribunal, wherever necessary, have been obtained and the instrument is properly witnessed.

4. Where the shares are intended to be transferred to a body corporate, it should be ascertained as to whether :

(*a*) the Memorandum and Articles of association empower the transferee company to make the investment;

(*b*) the Board of directors of the transferee body corporate has passed the necessary resolution empowering the person concerned to deal with the matter in this behalf;

(*c*) if the provisions of the FEMA are attracted, whether the necessary formalities have been complied with and the approvals obtained.

5. If the transferor is a body corporate, see that a Board resolution of the transferor company has been passed to this effect and proper authority has been given by the Board of directors to the person signing as the transferor on behalf of the company.

6. Where the transferee is a trust, it should be ensured that the trust is registered under the Societies Registration Act. If it is not so registered, then the trust fails to acquire the status of a body corporate and thus the shares cannot be registered in the name of the trust. In such a case the shares should be registered in the name of one or more trustees authorised by resolution of the Board of trustees in this regard.

7. Where the shares are sought to be transferred in favour of a partnership firm or an association of persons, see that the shares are registered in the individual name(s) of one or more partners or the office bearers of the association. It may be noted that the partnership or an association of persons, being not a body corporate cannot hold shares in its own name. In case of an HUF, however, the shares should be registered in the name of the Karta (Manager).
8. Where the transferee is a minor, see that:
   (*a*) the shares are fully paid-up; and
   (*b*) the articles of association permit transfer in favour of a minor.
9. On being transferred, see that the transfer form and the other relevant details, as noted above, are in order. The officer incharge for scrutiny should put his initials on the form. The Board of directors will consider the application for transfer and will either order for, or refuse registration in exercise of the powers given by the Articles of association.
10. In case of refusal, the company has to notify the transferee and transferor within a period of 30 days from the date on which the valid transfer deed was delivered to the company (section 58). Where the transfer is ordered for registration, the particulars of the transferee will be entered in the share transfer register and also recorded on the back of the share transfer form in the columns provided for the purpose. These entries should be certified by the secretary or an officer authorised by the Board in this behalf.
11. After the aforesaid formalities are gone through the share certificates duly endorsed in favour of the transferee should be returned to the person lodging the same along with a covering letter. Necessary entries should also be made in the register of members with regard to the transferor and the transferee.

9.50 Transfer by legal representative

In the event of death of a member of the company, the legal representative(s) have either of the two options, namely :

(1) To apply for becoming the registered shareholder(s) in place of the deceased; or

(2) To sell the shares by executing the instrument of transfer.

The option at (1) is more appropriately called transmission of shares and has already been dealt with in detail. But if the legal representative is desirous of selling the shares, section 56 permits him to do so. Sub-section (2), in this regard, provides that a company may register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted.

It may, however, be noted that the section does not dispense with the proof of the fact that the person claiming to be the legal representative is in fact the legal representative and for this purpose a probate (confirmation of the will by the court) or the succession certificate or other legal evidence must be produced (in fact, the certified copies should be attached along with the transfer deed).

9.51 Lien on shares

A lien, like a mortgage or pledge, is a form of security. It is an equitable charge on shares to secure any debt which may be due from the member of the company. The Act contains no reference to lien but the Articles of companies normally give the company a lien on the shares of a member for a money owed by him to the company. An article providing that company will have lien on shares of a member for his debts and liabilities to the company is valid - *Canara Bank* v. *Thribhuvandas* [1957] 27 Comp. Cas. 647. Where shares are held in joint names of more than one person, the company will have a lien on such shares in respect of a debt due by any one of the joint holders - *Narandar* v. *The Indian Manufacturing Co. Ltd.* 55 Bom. L.R. 567. This lien extends to the dividends as well. The Articles may provide for a lien even after the death of the shareholder - *Allen* v. *Gold Reefs of West Africa* [1900] 1 Ch. 656.

A lien of a company is transferable. *Thus*, for example, if the company has a lien on X's shares for a debt and X borrows the money from Y to pay the debt, X may request the company to transfer its lien to Y.

Notice that, the company must not enter either on the Register of members or on the share certificate any notice of lien it may have.

Enforcement of lien : A company can enforce its lien on shares by the sale of those shares in case the member defaults in payment of the amount due against him. In the absence of an express power of sale in the Articles, the permission shall have to be sought from the Court.

In case the amount received on sale of such shares is more than the amount due, the excess shall be payable to the former owner. Power to sell should be exercised after a notice has been given to the shareholder requiring him to pay the debt due to the company within a specified time. It should be made clear that the company intends to sell the shares in enforcement of the lien.

But a company cannot enforce the lien by forfeiting the shares. A provision in the Articles to such effect is void as amounting to reduction of capital without an order of the Court.

If a shareholder mortgages his shares and the mortgagee gives notice thereof to the company, the mortgagee has a priority over the company if the shareholder's liability to the company was incurred after the notice of the mortgage has been given to the company - *Bradford Banking Co.* v. *Briggs* [1886] 12 A.C. 29. But the Articles may provide that the company is not bound to recognise such interest of third parties. Even there, the ordinary rules of law and equity will be applicable - *Rainfold* v. *James Keith, etc. Co.* [1905] 2 Ch. 147.

The death of the shareholder does not destroy the lien - *Allen* v. *Gold Reefs of West Africa* [1900] 1 Ch. 656. Company's lien will not be lost by reason of the debt becoming time barred because lien can be enforced without seeking the assistance of the Court - *Unity Company* v. *Diamond Sugar Mills* AIR 1971 Cal. 18.

9.52 Lien and forfeiture compared

(1) Forfeiture involves reduction of capital, in case the forfeited shares are cancelled and not re-issued. Lien never involves a reduction of capital because the shares are necessarily sold if the member defaults in payment.

(2) Lien is a form of security for a debt. Forfeiture is a penal proceeding. Forfeiture can be done for reasons other than non-payment of calls, *e.g.,* in the case of *Naresh Chandra Sanyal* v. *The Calcutta Stock Exchange Association Ltd.* [1971] SC 422, the shares of the stock broker of the Exchange were forfeited for not carrying out his commitment with his client. But lien cannot be exercised for reasons other than the non-payment of a debt.

(3) In case of lien, the former holder is entitled to, on the sale of the share, the amount in excess of the amount due. In case of forfeiture, ordinarily nothing is payable to the former holder. However, subject to articles, recovery in excess of nominal amount on re-issue is payable to original allottee.

9.53 Variation of shareholders' rights

Section 48 of the Companies Act, 2013 provides that where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of special resolution passed at their meeting. However, this variation is possible only if provision for such variation is contained in the Memorandum or Articles of the company, and in the absence of such a provision, if the variation is not prohibited by the terms of issue of the shares of that class.

In case variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained.

Rights of dissentient shareholders

If the holders of 10 per cent of the issued shares of that class who had not assented to the variation apply to the Tribunal within 21 days of the date of the consent or the passing of the special resolution, the Tribunal may, after hearing the interested parties, either confirm or cancel the variation. The company must, within 30 days of the service of the Tribunal's order, forward a copy of the order to the Registrar.

Where any default is made in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

9.53-1 Can equity shares already issued be converted into redeemable preference shares ?

In re, Chowgule & Co. (P.) Ltd. 1972 Tax LR 2163, the Judicial Commissioner of Goa, relying on the judgment in the case of *St. James Court Estates Ltd.* [1944] Ch. 6, held that where the equity shares are sought to be converted into redeemable preference shares, it was necessary to adopt the process of reduction of capital under sections 100-104 [Now section 66] of the Companies Act.

On a proper reading of the *Chowgule's* case judgment, it appears that practically it is not possible to convert equity shares into preference shares of any kind.

9.53-2 Can redeemable preference shares be converted into convertible preference shares?

The proposition relates to variation of rights attached to existing redeemable preference shares. Such shares would continue to be preference shares with further right to be converted into equity shares as may be stipulated in the terms of alteration. Here the case is centering round the company's basic right to issue convertible preference shares. Since the companies generally possess that right (unless prohibited by the Memorandum or the Articles), it seems that the alteration and the consequent creation of Convertible Preference Shares is possible, subject to compliance with the provisions of the Memorandum of Association or the Articles of Association. However, when conversion to equity would take place, the incidence of SEBI's Substantial Acquisition of Shares and Takeover Regulations have to be taken into consideration. If instead of going by the provisions of section 48, the concerned company can successfully get an arrangement approved by the court in term of sections 230-232 of the Act, then the aforesaid compliance requirement with SEBI's Regulations will not arise.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/PE-II/IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. What is the meaning of preference share capital of a company? Explain very briefly the various kinds of preference shares a company is allowed to issue under the provisions of the Companies Act, 2013.
2. Explain the right of pre-emption under the Companies Act when further capital is issued.
3. When can a Public Company offer the new shares (further issue of shares) to persons other than the existing shareholders of the company? Can these shares be offered to the preference shareholders?
4. Explain the circumstances under which a public limited company may refuse to register the transfer of shares.
5. "A company cannot issue shares at a discount". Explain the statement with exceptions, if any.
6. Explain the provisions of the Companies Act, 2013 regarding the issue of shares at a discount. State the liability of the directors in respect of improper issue of shares at a discount.
7. In what way does the Companies Act, 2013 regulate the issue of shares at a Premium? State the purposes for which share premium so charged can be utilised. To what extent it is possible for a company to issue shares at a premium for consideration other than cash?
8. Discuss the procedure for 'reduction of share capital'.
9. A public limited company with a paid-up capital of Rs. 50,00,000 divided into 5,00,000 equity shares of Rs. 10 each wants to reduce its capital to Rs. 10,00,000 by converting the equity shares of Rs. 10 each to Rs. 2 each. Is it possible to do so? If so, explain the provisions of the Companies Act in this regard.
10. The Articles of association of a public limited company empower the Board of directors to refuse registration of transfer of its shares without assigning any reasons.

Is it valid? Explain the provisions of the Companies Act regarding refusal to transfer shares.

11. Can a company purchase its own shares? Explain the provisions of the Companies Act in this regard.

12. Distinguish between the 'reduction of capital' and 'diminution of capital'.

13. Can a company reduce its capital without sanction of the Tribunal?

14. "While the offer for new shares being issued by a public limited company is to be made only to the existing shareholders, yet these shares can also be offered to outsiders". Discuss the statement in the light of the provisions of the Companies Act, 2013.

15. "Sunrise Ltd." is authorised by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'X', a shareholder of the Sunrise Ltd., deposits in advance the remaining amount due on his shares without any calls made by "Sunrise Ltd.". Referring to the provisions of the Companies Act, 2013, decide the rights and liabilities of Mr. X, which will arise on the payment of calls made in advance.

16. State the conditions to be satisfied before a company may forfeit the shares. What is the effect of such a forfeiture?

17. Explain clearly the meaning of 'transfer' and 'transmission' of shares. In what way does the 'transfer of shares' differ from that of 'transmission of shares'?

18. An existing public limited company proposing to issue equity shares and the Partially Convertible Debentures, seeks your advise on the following matters :

(*i*) Preferential allotment of shares to be made in favour of FII's registered with SEBI; and

(*ii*) Buy-back arrangement for Partially Convertible Debentures. Advise the company in the light of guidelines issued by SEBI.

19. Explain the consequences of failure to get the shares listed in stock exchanges named in the prospectus by a public company, under the provisions of the Companies Act, 2013.

20. Explain clearly the meaning of the term 'Share Certificate'. What is the time limit, under the provisions of the Companies Act, 2013 for the issue of such certificates for shares allotted by a company?

21. State as to how and under what circumstances can a company issue duplicate share certificates.

22. When may shares be forfeited ? Explain the procedure and conditions relating to forfeiture of shares.

23. State the law relating to payment of underwriting commission under the Companies Act, 1956.

24. State the conditions under which the rights attached to any class of shares can be varied. Explain the rights of dissentient shareholders in this regard.

25. Pine Company Ltd. is a new company. Its commercial operations started on 1-1-2014 and its audited operative results are not yet available. State the regulation of SEBI which would be applicable to Pine Company Ltd. in respect of its first-issue of shares.

26. Explain the meaning of the term "Sweat Equity". What are the provisions of the Companies Act, 2013 relating to issue of "Sweat Equity"?

27. Examine the provisions of the Companies Act, 2013 regarding 'nomination' in case of transmission of shares.

28. Write a short note on : 'kinds of share capital'.

29. Define and distinguish between equity shares and preference shares.

30. How and subject to what conditions can loan and debentures be converted into shares?

31. What are the provisions of the Companies Act with regard to transfer of shares of a company ?

32. Distinguish between 'surrender of shares' and 'forfeiture of shares'.

33. Explain the difference between a 'share' and a 'debenture'.

34. Write a short note on : Issue of Bonus Shares.

35. Board of Directors of XYZ Ltd. made a final call of Rs. 25 per share on 10000 Equity shares of Rs. 10 each. Some of the shareholders challenged the validity of the act of the Board of Directors on the technical ground that the appointment of one of the Directors who was present in the meeting was invalid because he had failed to acquire the qualification shares within the prescribed time limit. Discuss the validity of the call.

Hints: 'Call' is invalid.

36. Explain the provisions relating to sealing and signing of a share certificate.

37. State the procedure to be followed for redemption of 'preference shares'. Can a company redeem its irredeemable preference shares?

38. Write short notes on : Minimum subscription

39. "Listing of shares is compulsory for every company". Comment.

40. State the provisions of the Companies Act, 2013 regarding payment of commission and brokerage on public issue of shares.

41. Write short notes on : Return of allotment

42. Answer the following :

Do Well Company limited issued 10,000 shares of Rs. 10 each. The entire issue was underwritten by ICICI; but before the prospectus was issued the entire capital was subscribed by the friends of directors of the company. Would ICICI be entitled to receive any underwriting commission?

43. (*i*) What is 'transfer of shares'?

(*ii*) What does a company do in case of an incomplete transfer deed?

(*iii*) How is transfer of shares effected in the dematerialized form?

44. Write short note on : 'Blank transfer'.

45. "The Directors have uncontrolled and unfettered powers to refuse registration of transfer of shares". Comment.

46. Write short notes on the following : Rights of transferees pending registration of shares

47. How is transfer of shares effected? When may the Board of directors refuse to register the transfer? What are the remedies available to an aggrieved person against such refusal?

48. An agreement for transfer of certain shares was entered into and the transferee was registered as a member without transfer deed being executed. Is the registration of this transfer valid?

49. A letter is received from a nominee of a sole shareholder for registering his name in the register of members. Explain the provisions of the Companies Act, 2013 in regard to the following:

(*i*) The rights of the nominee and that of the company.

(*ii*) The steps to be taken by the nominee for getting himself registered as a shareholder.

50. Write a short note on : 'Company's lien on shares'.

51. State the procedure for forfeiture of shares and re-issue thereof.

52. Write a short note on : 'Calls on shares'.

53. What are 'sweat equity shares'? Explain the provisions relating to issue of sweat equity shares.

54. What do you understand by the expression 'share capital with differential voting rights'? Can a company convert its existing equity shares as shares with differential voting rights?.

55. Bonus issue may be viewed as a 'rights issue' except that money is paid by the company on behalf of the investing shareholders from its reserves. Comment.

56. "Bonus Shares cannot be issued out of revaluation reserve". Comment.

PRACTICAL PROBLEMS

1. The capital of 'X' Ltd. is Rs. 50 lakhs, consisting of Equity Share Capital of Rs. 40 lakhs and Redeemable Preference Share Capital of Rs. 10 lakhs. The preference share capital is to be redeemed before 31st July, 2014. The company is running in losses and its accumulated losses aggregated to Rs. 15 lakhs. The company wants to borrow Rs. 20 lakhs from financial institutions to improve its working and also to redeem the preference share capital. Advise.

Hints : According to section 55, redemption of preference share capital is permitted only out of (*i*) profits of company, or (*ii*) out of a fresh issue of shares made for the purposes of redemption. Thus, borrowing from financial institutions for redemption of preference shares shall not be permissible. The amount may, however, be raised for improving its working. The limits to deposits do not apply to borrowing from financial institutions since the same is excluded from the expression 'deposit' as per the Companies (Acceptance of Deposits) Rules, 2014.

2. DJA Company Ltd. wants to provide financial assistance to its employees, to enable them to subscribe for certain number of fully paid shares. Considering the provisions of the Companies Act, what advice you would give to the company in this regard.

Hints : Section 67 of the Companies Act allows making of loan by a company to its *bona fide* employees for purchasing or subscribing to the fully paid shares of the company. However, sub-section (3) provides that such financial assistance should not exceed six months wages or salary of the employee.

3. A, the secretary of a company issues a certificate in favour of B by forging the signatures of two directors. He also affixes the seal of the company on the certificate without authority. Can B hold the company liable for the shares covered by the share certificate ? Give reasons

Hints : *No* - see *Rubben* v. *Great Fingall Consolidated Co.* [1906] A.C. 439

4. At a meeting of the two directors of a private company, one director refuses, but the other agrees, to approve a duly completed form of transfer of shares in the company from an existing shareholder to a third person. Explain the legal position of the proposed transferee of the shares.

[Hints: The transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, as the case may be, was delivered to the company.]

5. Ram Lal is a shareholder of a company holding 100 shares. Ram Lal dies leaving Mohan as his legal representative. Mohan is not a member of the company. Mohan transfers all 100 shares of the deceased member to Anil. Is the transfer valid? State reasons for your answer.

   [Hints : No, transfer is not valid. Mohan can effect a valid transfer only after the succession in his favour is duly registered with the company. Till then, the shares do not vest in him and, therefore, he has no right to transfer the same].

6. Wasim and Hamid, each held half the issued share capital of a company, whose articles of association provide thus : "The Board of directors may, at any time, in their absolute and uncontrolled discretion, refuse to register any transfer of shares." Wasim died and his executor applied to have Wasim's shares registered in his name. The Board of directors refused to register the transfer of shares under the abovementioned provision of the articles of association. State with reasons whether the court can come to the rescue of Wasim's executor.

   [Hints : The impugned clause is invalid. Section 58 disallows a company to reject registration of transfer of shares without assigning any reason. A company, therefore, cannot empower itself with a blanket power of refusal. Refusal is permitted, *only on specific grounds* as stated in Articles.

7. "Moonstar Ltd." is authorized by its articles to accept the whole or any part of the amount of remaining unpaid calls from any member although no part of that amount has been called up. 'A', a shareholder of the Moonstar Ltd. deposits in advance the remaining amount due on his shares without any calls made by "Moonstar Ltd." Referring to the provisions of the Companies Act, 2013, state the rights and liabilities of Mr. A, which will arise on the payment of calls made in advance.

   [Hints: 1. According to Section 50 a company may, if so authorised by its articles, accept from any member, the whole or a part of the amount remaining unpaid on any shares held by him, even if no part of that amount has been called up.

   He shall not be entitled to any voting rights in respect of the amount so paid by him until that amount has been called up.

   A company may, if so authorised by its articles, pay dividends in proportion to the amount paid-up on each share (Section 51)].

8. A private limited company issued certain number of shares as fully paid up to a subscriber to the memorandum on the basis of promissory note executed by him as consideration towards the shares. Since no money was paid towards the allotment, the company after five years from the date of allotment wants to forfeit those shares. Can the company do so?

   [Hints: Normally in the case of allotment of shares, a company may call for the entire face value of the shares on allotment or it may call for a portion of the face value. In case where a company has allotted shares for part of the face value, it issues call notice for the balance money in one or more instalments.

   Therefore, in the normal course, no share is allotted unless otherwise allotment money is received and the question of forfeiture would arise only when on the basis of call made for the balance amount, the same is not paid by the shareholder. In the instant unique case, the consideration for the shares has been received by the company in a form other than cash (i.e., Promissory Note).

   If the concerned shareholder has not paid any money as per the promissory note, the course of action for the company would be to initiate legal proceedings for realising the money. It cannot forfeit those shares after 5 years from the date of allotment. *K. Md. Farooq Ahmed* v. *F.C. Electronics (P.) Ltd. & Others* (1997)]

9. The directors of Vijay Electronics Ltd. allotted to themselves certain rights shares for which no application was made by certain shareholders as required by Section 62 of the Companies Act. Discuss the validity of their action especially in view of the fact that market price of shares of the company is 50 per cent above par.

[Hints: If no application is made by the shareholders to whom the offer is made under Section 62 of the Companies Act, 2013, the Board of directors may dispose of the shares in such a manner as they think most beneficial to the company. Therefore, unless shares were allotted to directors on terms unfavourable to the company, the allotment would be valid.]

10. Mars India Ltd. owed to Sunil Rs.1,000. On becoming this debt payable, the company offered Sunil 10 shares of Rs.100 each in full settlement of the debt. The said shares were fully paid and were allotted to Sunil. Examine the validity of this allotment in the light of the provisions of the Companies Act.

[Hints: When shares are allotted to a person by a company, payment may be made – (i) in cash, or (ii) in kind (with the consent of the company).

'Cash' here does not necessarily mean the currency of the country. It means "such transaction as would in an action at law for calls, support a plea of payment."

On the basis of the above provision and Rule 12 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 as well as the decision of the related case Coregam Gold Mining Co. of India vs. Roper, (1892), the allotment of fully paid up shares in full satisfaction of Sunil's debt is valid].

11. ABC Company Limited, at a general meeting of members of the company, passes an ordinary resolution to buy-back 30% of its Equity Share Capital. The Articles of the Company empower the company for buy-back of shares. The company further decides that the payment for buy-back be made out of the proceeds of the company's earlier issue of equity shares. Explaining the provisions of the Companies Act 2013, and stating the sources through which the buy-back of the company own shares can be executed, Examine :

(*i*) Whether company's proposal is in order?

(*ii*) Would your answer be still the same in case the company instead of 30% decides to buy-back only 20% of its Equity Share Capital?

[Hints: The Companies Act, 2013 has permitted companies to buy-back their own shares but subject to certain limitations and compliances. Section 68 contains the necessary provisions in this regard. Besides other requirements, in case of buy-back of equity shares, buy-back beyond 25% of the paid-up equity capital in a financial year is not allowed. Again, buy-back cannot be affected out of the proceeds of an earlier issue of the same kind of shares/security. Moreover, special resolution of shareholders is required to be passed. Thus, the buy-back effected by the company is not valid on the following counts:

(i) Instead of special resolution, ordinary resolution has been passed.

(ii) Buy-back of 30% of equity share capital exceeds the maximum permissible buy-back, viz. 25%.

(iii) Buy-back could not have been affected from the proceeds of an earlier issue of equity shares.]

12. After receiving 80% of the minimum subscription as stated in the prospectus, a company allotted 100 equity shares to 'X', the company deposited the said amount in the bank but withdrew 50% of the amount, before finalization of all the allotment, for the purpose of certain assets. 'X' refuses to accept the allotment of shares on the ground that the allotment is violative of the provisions of the Companies Act. Comment.

[Hints: Minimum subscription having not been received: (i) allotment is void (Section 39); (ii) application money must be refunded back (Section 39). Company is further guilty of withdrawing 50% of the amount].

13. The Board of directors of a company decide to pay 5% of issue price of shares as underwriting commission to the underwriters. On the other hand, the Articles of Association of the company permit only 3% commission. The Board of directors further decides to pay the commission out of the proceeds of the share capital. Are the decisions taken by the Board of directors valid under the Companies Act?

[Hints: As per Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014, a company may pay up to 5% of the issue price as underwriting commission but subject to the maximum prescribed under the company's articles of association. The commission may, however, be paid out of proceeds of the issue or the profit of the company or both.

Thus, the company cannot pay more than 3% but can well pay out of the proceeds of the share capital.]

14. Unique Builders Limited, decides to pay 2.5 per cent of the value of debentures as underwriting commission to the underwriters but the Articles of the company authorize only 2.0 percent underwriting commission on debentures. The company further decides to pay the underwriting commission in the form of flats. Examine the validity of the above arrangements under the provisions of the Companies Act **[Hints: As per Rule 13 of the Companies (Prospectus and Allotment of Securities) Rules, 2014, a company may pay up to 2½ per cent of the issue price of debentures as underwriting commission but subject to the maximum prescribed under the company's articles of association.**

(i) Hence the decision of Unique Builders Limited, to pay underwriting commission exceeding the percentage prescribed under Articles is not valid.

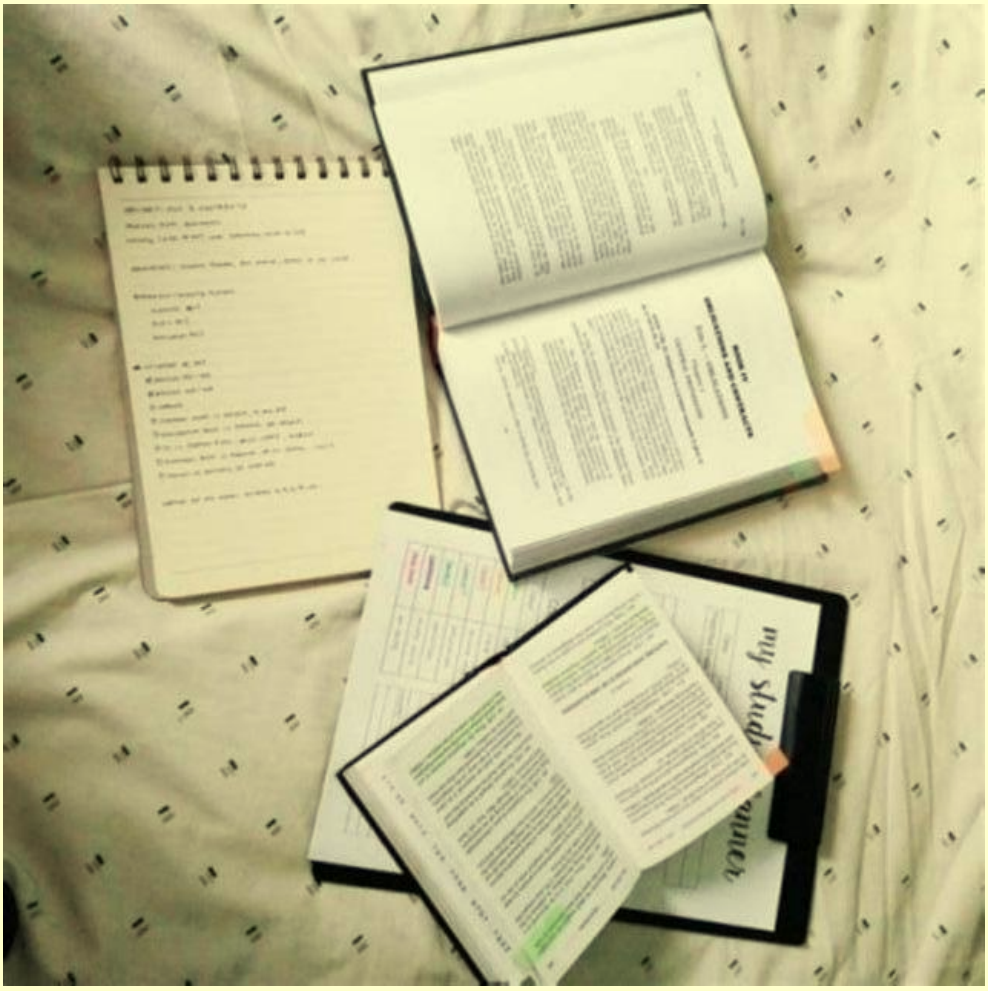
(ii) The company may pay the underwriting commission in the form of flats as decided in the Booth vs. New Afrikander Gold Mining Co. (1903) case. Underwriting commission may be paid in cash or kind or as lump sum or by way of percentage but in no case can it go beyond the statutory limits of 2 ½ %.]

15. The Board of Directors of XYZ Private Limited, a subsidiary of SRN Limited, decides to grant a loan of Rs. 2.00 lac to P, the Finance Manager of the company getting salary of Rs. 30,000 per month, to buy 400 partly paid-up equity share of Rs.1,000 each of XYZ Limited. Examine the validity of Board's decision with reference to the provisions of the Companies Act.

[**Hints: According to Section 67 of the Companies Act, 2013 No Public Company shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of, or in connection with, a purchase or subscription made or to be made, by any person of or for any shares in the company or in its holding company.**

However, a company may advance a loan to a person in its employment (other than directors, or key managerial personnel) , an amount not exceeding their salary or wages for a period of six months with a view to enabling them to purchase or subscribe for fully paid-up shares in the company or its holding company to be held by them by way of beneficial ownership.

On the basis of above provisions, the proposals of the Board of Directors of XYZ Limited are not valid because (i) P wants to purchase partly paid up shares of the company; and (ii) the amount of loan is also higher than the six months salary of P.]



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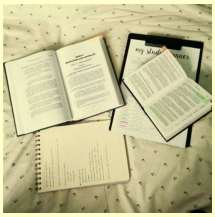

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10 Membership

10.1 Definition of a member

Section 2(*55*) of the Companies Act, 2013 defines a member in the following words:

1. The subscribers to the Memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.
2. Every other person who agrees *in writing* to become a member of a company and whose name is entered in its register of members, shall be a member of the company.

   In *Herdilia Unimers Ltd.* v. *Renu Jain* [1995] 4 Comp. LJ. 45 (Raj.), it was held that the moment the shares were allotted and share certificate signed and the name entered in the Register of members, the allottee became the share-holder, irrespective of the allottee receiving the shares or not.

   A person whose name is not entered into register of members of company cannot be treated as member or deemed member - *Sant Chemicals (P.) Ltd.* v. *Aviat Chemicals (P.) Ltd.* [2000] 25 SCL 473 (Bom.).
3. Every person holding shares of the company and whose name is entered as beneficial owner in the records of a depository.

On this basis, apart from signing of the memorandum two pre-requisites for a person to become a member of a company are :

(*i*) the agreement in writing to take shares of the company; and

(*ii*) the registration of his name in its register of members.

Besides, a person may also become a member of a company through the depository system.

Thus, a person can agree to take shares of a company either as the subscriber to the memorandum at the initial stage of its formation or in any of the following manner :

(*a*) by subscribing to its further or new shares;

(*b*) on transfer of its shares from an existing member;

(*c*) on acquisition or purchase of its shares (*for example*, take-over bid, renunciation of rights shares by an existing member);

(*d*) on acquisition of its shares by devolution (for example, transmission of shares to legal heirs of a deceased member, on insolvency, upon merger/amalgamation through Tribunal's order); and

(*e*) on conversion of convertible debentures or loans pursuant to the terms of issue of such debenture or loan agreement respectively.

The fundamental difference between the subscribers who agree to take shares at the time of formation of the company and persons who agree to take shares later is that the former become members immediately on incorporation of the company, that is, they automatically become members. The latter, though having agreed to take shares, become members only after their names are entered in the register of members of the company.

10.1-1 Can purported promise to convert loan into shares be a ground for rectification of Register of members?

In *Kumaran Potty* v. *Venod Pharmaceuticals & Chemicals Ltd.* [1996] 2 Comp. LJ. 288 (Ker.), the vice-chairman of the company collected huge sums of money from employees as if they were loans. After repayment of the substantial part of the loans, the Managing Director reportedly agreed to convert the remaining amounts into shares. However, the same was not done and it was prayed that the Register of members be rectified to make the petitioner employee a shareholder for the unpaid amount.

It was held that the amount was nothing but a loan and it always remained a loan. To become a shareholder there must be an agreement in writing under section 41(2) [Now section 2(55)] of the Companies Act between the petitioner and the company.

10.2 Member *v.* Shareholder

In the case of a company limited by shares, the persons whose names are put on the Register of members are the members of the company. They may also be called shareholders of the company as they have been allotted shares and are holding them in their own right. In such a situation, the terms 'member' and 'shareholder' are interchangeably used to mean the same person. But in the case of an unlimited company or a company limited by guarantee, a member may not be a shareholder, for such a company may not have a share capital. However, sometimes a distinction is maintained between a member and a shareholder in the case of a company having a share capital. *In other words*, as regards the same set of shares one person is a member and another is the shareholder of the company. This distinction arises in the following situations:

(1) 'X' is a member of a company limited by shares. His name is placed on the Register of members and he is holding shares in his own right and, therefore, whether we call him a member or a shareholder, it is immaterial. In such a situation, the terms 'member' and 'shareholder' may be used interchangeably. Now, in the following three situations he will cease to be a shareholder, though he continues to be the member of the company :

(*a*) *On sale* - X sells the shares to Y. He fills in a share transfer form and hands it over to Y. He also gives the share certificate representing the shares to Y. In return for sale of shares, he receives consideration from Y. X is no longer a shareholder as he has sold the shares and property in the shares has passed to Y. But the name of X continues to be on the Register of members till the transfer of shares is registered by the company in favour of Y.

(*b*) *On death* - X dies and his property, including shares, is inherited by Y, his legal representative. X is no longer the shareholder. He is not in existence to hold the shares. Y is holding the shares in his own right and, therefore, can rightly be called the shareholder. But X continues to be the member as his name still appears on the Register of members. However, as soon as Y gets his own name registered in the Register of members, then X will cease to be a member.

(*c*) *On becoming insolvent* - X becomes insolvent and his property, including shares, vests in the Official Receiver or Official Assignee. The Official Receiver or Assignee is holding the shares in his own right. Therefore, X is no longer the shareholder, though he continues to be the member of the company.

(2) A person who subscribes to the memorandum of association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not the shareholder of the company.

(3) In the case of a company limited by guarantee having no share capital or an unlimited company having no share capital, there will be only 'members' but no 'shareholders'.

10.3 Modes of acquiring membership

A person may become a member or a shareholder of a company in any of the following ways :

10.3-1 By subscribing to the memorandum of association

The subscribers of the memorandum of a company are deemed to have agreed to become members of the company only by reason of their having signed the memorandum - *U.P. Oil Mills* v. *Jamna Pd.* [1933] 3 Comp. Cas. 256 (All.). Subscribers to the memorandum become members, the moment the company is registered, and it is not necessary that their names must have been entered in the Register of members.

Further, by subscribing the memorandum every one of the subscribers is deemed to have contracted to become a shareholder in respect of the shares, he subscribed for.

10.3-2 By agreement and registration

Section 2(55) of the Companies Act, 2013 provides that apart from the subscribers of the memorandum, 'every other person who agrees in writing to become a

member and whose name is entered in the Register of members shall be a member of the company'.

It follows that except in the case of the subscribers to the Memorandum, to be a member of the company, two conditions must be satisfied, namely, (*i*) that there is an agreement in writing to become a member; and (*ii*) his name is entered in the Register of members of the company.

The Supreme Court in *Balkrishan Gupta* v. *Swadeshi Polytex Ltd.* [1985] 58 Comp. Cas. 563 held that the two conditions of section 41(2) [Now Section 2(55)] are cumulative. Both the conditions have to be satisfied to enable him to exercise the rights of a member. Similar view was expressed by the Kerala High Court in the case of *Lalithamba Bai* v. *Harrisons Malayalam Ltd.* [1988] 63 Comp. Cas. 662.

However, for purposes of relief under section 397 or 398 [Now section 241], in *Shri Balaji Textiles Mills (P.) Ltd.* v. *Ashok Kamble* [1989] Comp. L.J. 322 (Kar.), it was held that the requirement of application in writing was not an essential condition for a member to file a petition for relief against alleged oppression and mismanagement, since other evidence was available to show that petitioner was member of the company.

Registration of the name of a person as a member of a company may arise :

(*a*) upon *application and allotment.*

(*b*) *by transfer* - the member may acquire shares from an existing member by sale, gift or some other transaction.

(*c*) *by transmission* - here a person becomes a shareholder by transmission of shares through death, lunacy or insolvency.

(*d*) *by estoppel/holding out* - This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding-up, he will be liable, like other genuine members as a contributory (*Hans Raj* v. *Asthana*). However, he may escape liability by applying to Tribunal for rectification of register of members under section 59 for removal of his name from the Register.

10.3-3 By agreeing to purchase qualification shares

Some authors believe that a person who signs and delivers to the Registrar a written undertaking to take from the company and pay for qualification shares is in the same position as if he had subscribed to the memorandum for a similar number. As such, he is also deemed to have become a member automatically on incorporation of the company.

The opinion, however, is not free from controversy since it is doubtful that the name of such a director could be included in the list of contributories in the event of company going into liquidation before the said shares are allotted to him.

10.3-4 Can legal heirs of a deceased shareholder be regarded as members for the purpose of filing a petition for prevention of oppression and mismanagement under sections 397-398 [Now section 241]?

The Court answered the question in the affirmative— *Mrs. Margaret T. Desor* v.

World Wide Agencies (P.) Ltd. [1989] 3 Comp. L.J 11 (Delhi). Even if the name of the legal heir has not been placed on the Register of members, he can maintain a petition under sections 397-398 [Now section 241].

10.4 Who may become a member

Subject to the provisions of law, the Memorandum and the Articles, any person *sui juris* can become a member of a company. The position of certain persons in this regard is as follows :

10.4-1 Minor

The position of a minor as a member of a company may be noted as under :

(*i*) As a minor is wholly incompetent to enter into a contract - *Mohri Bibi* v. *Dharmadas Ghose* [1903] 30 ILR Cal. 539 (PC), an agreement by a minor in India to take shares is void and hence, he cannot be a member of a company.

(*ii*) If shares are allotted to a minor in response to his application, and his name entered on the Register of members, in ignorance of the fact of minority, the company can repudiate the allotment and remove his name from the Register on coming to know of the minority of the member. The company must repay all moneys received from him in respect of the allotted shares.

(*iii*) The minor also can repudiate the allotment during his minority and he shall be returned the amount he paid towards the allotment of shares.

(*iv*) If the name of the minor continues on the Register of members and neither party repudiates the allotment, the minor does not incur any liability on the shares during minority - *Fazulbhoy Jaffar* v. *The Credit Bank of India* AIR 1914 Bom. 128.

(*v*) If an application for shares is made by a father as guardian of his minor child and the company registers the shares in the name of the child describing him as a minor, neither the minor nor the guardian can be placed on the list of contributories at the time of winding-up - *Palaniappa* v. *Official Liquidator, Pasupati Bank Ltd.* AIR 1942 Mad. 470.

(*vi*) If somehow the name of a minor appears on the Register of members and in the meantime he attains majority, and if he does not want to continue to be a member, then he must repudiate his liability on the shares on the ground of minority. The company cannot take defence on the principle of estoppel that the minor had fraudulently mis-represented his age or had received dividends and other privileges as a member. However, if he had received dividends and exercised his rights as a member of the company after attaining majority, then he cannot repudiate his liability on shares—*Fazulbhoy Zafar* v. *Credit Bank of India Ltd.* (*supra*).

(*vii*) In case of transfer of partly-paid shares to a minor, the company may refuse to register him as a member. In case the company, in ignorance of the minority, has permitted the transfer, then the company may remove the name of the minor and replace it by that of transferor, even though the latter may have been ignorant of the minority.

(*viii*) In case of fully paid shares, minor's name may be entered in the Register of members, if he happens to acquire the same by way of transfer or transmission. In *Devan Singh* v. *Minerva Films Ltd.* AIR 1956 Punj. 106, the Punjab High Court held that there is no legal bar to a minor becoming a member of a company by acquiring shares (by way of transfer) provided the shares are fully paid-up and no further obligation or liability is attached to them. Similarly, in *S.L. Bagree* v. *Britannia Industries Ltd.* [1980], Company Law Board (now Tribunal) upheld transfer in favour of a minor.

The position with respect to a minor becoming a member of a company may be summarised in terms of the following two circulars issued by the Department of Company Affairs (now Ministry of Corporate Affairs) in this regard:

1. In a reference from the Federation of Indian Chambers of Commerce and Industry, New Delhi, the question relating to the holding of shares in a company by a minor was examined in the Department and it has been decided that due to the provisions of section 10 of the Indian Contract Act, for the purchase of shares, there is no bar to a minor purchasing fully paid up shares, provided the name of the guardian and not that of the minor is entered in the Register of members—*Circular No. 8/18/(41)/63-PR, dated 2-11-1963*: Government of India Publication, *Clarifications and Circulars on Company Law*, 1977 Edition, page 23.
2. Registrars should not raise any objection to the registration of transfer/transmission of shares to a minor and the entry of the name of the minor in the Register of members or in the return of allotment or in any other return—*Letter No. 8/18(41)/63-PR, dated 31-3-1964*: Government of India Publication, *Clarifications and Circulars on Company Law*, 1977 Edition, page 23.

We may thus conclude that there is no objection to a minor being admitted as a member in respect of fully paid shares provided he happens to acquire the same by way of transfer or transmission.

10.4-2 Company

A company, being a juristic person and a separate legal entity may become a member of another company, if it is so authorised by its memorandum to purchase or invest in shares. This is, however, subject to the provisions of section 19 and section 186. Under section 19, a subsidiary company cannot be a member of its holding company, and any allotment or transfer of shares in a holding company to its subsidiary, or even to a nominee for such subsidiary, is void, except that a subsidiary company may :

(*i*) hold shares in the holding company in the capacity of a personal representative of a deceased shareholder; or

(*ii*) hold such shares as a trustee; or

(*iii*) where the subsidiary company is a shareholder even before it became a subsidiary of the holding company.

10.4-3 A partnership firm

A partnership firm being an unincorporated association and, therefore, not having a separate legal entity from the partners, cannot be registered as a member in the

register of members of a company. However, partners either individually or in their joint names (as joint members) may hold shares in a company as a part of the partnership property. But a partnership firm may become a member of a company registered under section 8 of the Companies Act, 2013 (*i.e.*, associations not for profit).

10.4-4 A foreigner

As per Law of Contract, a foreigner can enter into contracts and, therefore, can purchase shares in a company but this is subject to the provisions of Foreign Exchange Management Act, 1999.

When the country, of which the foreigner is resident, is at war with India, the foreigner becomes an alien enemy and, therefore, his power of voting and his right to receive notices are suspended during the war period.

10.4-5 Receiver/Official Liquidator

Receiver, official liquidator or administrator normally cannot be members because the shares do not vest in them. In *Balkrishan Gupta* v. *Swadeshi Polytex Ltd.* [1985] 58 Comp. Cas. 563, the Supreme Court observed that a perusal of the provisions of section 182A of the Land Revenue Act shows that there is no provision in it, which states that on the appointment of a person as a receiver, the property in respect of which he is so appointed vested in him, similar to the provisions of section 17 and section 28(2) of the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 respectively. It was further observed that the privilege of a member can be exercised by only that person whose name is entered in the Register of members. Mere appointment of a receiver in respect of certain shares of a company, without more, cannot, deprive the holder of the shares whose name is entered in the Register of members of the company of the right to vote at the meetings of the company.

10.4-6 Can a public office be registered as a member

There is no provision in the Companies Act, 2013 that the shares in a company may be held in the name of a public office. Section 2(55) provides how a 'person' (other than a subscriber of the Memorandum) becomes a member. The term 'person' has been held to include, among others, a corporation sole. Thus, a public office cannot be a member of a company unless it is a corporation sole such as Administrator-General constituted as a corporation sole by the Administrators' General Act, 1963. But the Collector of a District is not a corporation sole and, therefore, shares cannot be registered in the name of a Collector of a District. However, a public trustee is a corporation sole and is capable of holding shares in its name.

In the words of Palmer, illustrations of corporation sole in existence in the modern law are the sovereign, an archbishop, a minister or officer of the Crown, who is given the status usually by statutes.

As to whether President of India or Governor of a State is a corporation sole for the purposes of shares to be held in the name of these public offices, the Department of Company Affairs has opined as follows:

> "The President or the Governor of a State under the Constitution is not a corporate sole, just as the Administrator-General constituted under the Administrators' General Act,

> 1963 is. As provided by Articles 77(1) and 166(1) of the Constitution, an executive action of the Government of India or the Government of a State shall be expressed to be taken in the name of the President or the Governor, as the case may be. Executive action or executive power has been broadly stated to be 'the residue of governmental function that remains after legislative and judicial functions are taken away'. Further, it appears that the said Articles are confined to cases where the executive action is required to be expressed in the shape of a formal order or notification or any other instrument. When an executive decision affects an outsider or is required to be officially notified or communicated, it should be normally expressed in the form mentioned in these Articles, that is, in the name of the President or the Governor, as the case may be."

The acquisition or holding of shares in a company by the Government of India or a State Government is an "executive action" as contemplated by Articles 77(1) and 166(1) of the Constitution and can, therefore, be made in the name of the President of India or the Governor of the State, as the case may be.

In view of the above, shares in a Government company can be held in the name of the President of India or the Governor of the State—*Department of Company Affairs Circular No. 15/32/65-IGC, dated 30 September, 1966.*

10.4-7 Societies registered under the Societies Registration Act, 1860

A society is treated as a 'person' having separate legal entity apart from members constituting it and thereby is capable of becoming a member of a company under section 2(55) of the Companies Act—*Circular letter dated 24-11-1962 issued by the Department of Company Affairs.*

10.4-8 Can shares be held in the name of a trade union ?

In *All India Bank Officers' Confederation* v. *The Dhanlakshmi Bank Ltd.* (decided on 3-4-1997), the CLB [Now Tribunal] held that a registered trade union is a body corporate and, thus, can sue and be sued and enter into contracts in its own name.

CLB [Now Tribunal] further observed that section 14 of the Trade Unions Act which prohibits trade unions from spending money for objects other than what were stated in the section had no relevance in this case because investment in shares would not be an expenditure but was only an investment. Section 14 dealt only with expenditure of a revenue nature and not investments or expenditure of a capital nature. Under section 13, a trade union had power to acquire and hold both movable and immovable properties.

10.4-9 Joint membership

It is possible for two or more than two persons to hold shares jointly in a company. In that case all of them are not the individual members of the company. Instead, they are said to hold the shares jointly. There is no direct provision for joint membership, but there are a few indirect references.

Therefore, Articles of Association of a company provide for joint membership and sometimes the maximum number of persons who can be joint-holders of shares is given in the Articles as not more than three (Since Standard Listing Agreement provides for maximum three joint-holders).

Some provisions relating to joint membership, worth noting are:

Only one share certificate is issued to them :

(*i*) All the joint members are jointly and severally liable to make payment of calls (Reg. 15, Table F and section 43 of the Indian Contract Act).

(*ii*) In the case of joint-holders, the vote of the senior who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of the other joint holders. (Reg. 52, Table F).

(*iii*) The names of the joint-holders may be entered in the Register of members in the order in which they appear in the application form or in the share transfer form.

(*iv*) For purposes of ensuring that the number of members of a private company does not exceed 200 as required by section 2(*68*), joint-holders of shares are counted as one member.

(*v*) Transfer of shares held by joint-holders shall be effective only if it is made by all the joint-holders.

10.4-9a JOINT SHAREHOLDERS - CHANGE OF ORDER OF NAMES - In case of joint shareholdings one or more of them may require the company to alter or rearrange the serial order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. Since no transfer of any interest in the shares takes place on such transposition, the question of insisting on filing transfer deed with the company, may not arise.

A request signed by all the holders (in the existing order and also proposed order) is sufficient which the Board of directors can consider and effect transposition of names.

10.4-10 Hindu undivided family

Hindu undivided family can be a shareholder of a company through the name of the Karta.

10.5 Termination of membership

A person may cease to be a member of a company when—

(*i*) he transfers his shares to another person and the shares are registered in the name of the transferee;

(*ii*) his shares are forfeited by the company for non-payment of calls or on any other ground provided in the Articles, say, for carrying a competing business;

(*iii*) he surrenders his shares to the company and the latter accepts the surrender;

(*iv*) his shares are sold by the company to enforce its lien, and the buyer of these shares is registered as a member;

(*v*) he dies and his legal representative gets his own name registered in the Register of members or sells shares to a third party who gets his name registered with the company ;

(*vi*) he is adjudged insolvent and the Official Receiver/Official Assignee either transfers the shares to a third party who gets registered as a member or disclaims shares;

(*vii*) he was holder of redeemable preference shares which have now been redeemed by the company;

(*viii*) he rescinds the contract of membership on the ground of fraud or misrepresentation;

(*ix*) his shares are purchased either by another member of the company or by the company itself under a buy-back scheme or an order of the Tribunal under section 242; and

(*x*) on the commencement of winding-up (but he will be liable as a contributory and is also entitled to a share in the surplus assets, if any).

As mentioned earlier, a company may be a member of another company. In such a situation if the shareholding company is being wound up then the membership will come to an end if the liquidator disclaims the shares.

10.6 Impersonation as a shareholder

If any person deceitfully personates an owner of any share or interest in a company or any share warrant* or coupon issued in pursuance of the provisions of the Companies Act, and thereby obtains or attempts to obtain any such share or interest or any such share warrant or coupon or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees (Section 57).

10.7 Rights of a member/shareholder

A shareholder of a company has two kinds of rights, namely, (*i*) individual rights and (*ii*) corporate rights. Every shareholder can enforce his individual rights singly but corporate rights have to be enforced by the majority— *Suresh Chandra Marwaha* v. *Lauls (P.) Ltd.* [1978] 48 Comp. Cas. 110 (Punj. & Har.).

However, individual and corporate membership rights may not be mutually exclusive. Where the same transaction infringes both individual and corporate membership rights, one composite action can be brought.

The dividing line between personal and corporate right is very thin and the court will probably be inclined to treat a right as a 'personal right' only if he has a 'special interest' distinct from the general interest which other members have in the company complying with the terms and conditions of the Act, the Memorandum and the Articles of association.

In case of infringement of a personal right, a member may sue a wrongdoer and the company in his own name. But for infringement of his corporate right, the action should be brought in the name of the company. The company should be the plaintiff and the wrongdoers should be made the defendants.

The various rights of a member could be grouped under the following two categories:

*Whereas, the Companies Act, 2013 has omitted provisions relating to share warrants, Section 57, it seems, inadvertently makes reference to the same.

(*a*) Contractual or otherwise; and

(*b*) Statutory.

10.7-1 Contractual and other Rights

A member by virtue of the contract with the company and any other members *via* the Memorandum and Articles is entitled to have his name on the Register of members, to vote at the meeting of members, to receive dividends when declared, to exercise the right of pre-emption, return of capital on winding-up or on reduction of share capital of the company.

As a member he also has certain other rights which may or may not arise out of contract. In exercise of such rights he is entitled to bring action to restrain the company from doing an *ultra vires* act, to attend and take part in the proceedings of meetings of the company and to move amendments.

10.7-2 Statutory Rights

A person who is a shareholder of a company has many rights under the Act[1]. Some of them are :

(*i*) The right to vote at all meetings [Sec. 47];

(*ii*) The right to requisition an extraordinary general meeting of the company [Sec. 100];

(*iii*) The right to receive notice of a general meeting [Sec. 101];

(*iv*) The right to appoint proxy and inspect proxy register [Sec. 105];

(*v*) In the case of a body corporate which is a member, the right to appoint a representative to attend a general meeting on its behalf [Sec. 113]; and

(*vi*) The right to require the company to circulate resolution [Sec. 111].

(*vii*) To have the certificate of shares held ready for delivery to him within two months from the date of allotment [Sec. 56].

(*viii*) To transfer shares subject to the provisions of the Act and the Articles of Association [Sec. 44].

(*ix*) To inspect the Register of members and Register of debenture-holders and get extracts therefrom [Sec. 94].

(*x*) To obtain, on request, minutes of proceedings at general meetings as also to inspect the minutes [Sec. 119].

(*xi*) To apply to the Tribunal to have any variation of shareholders' rights set aside [Sec. 48].

(*xii*) To participate in the removal of directors by passing an ordinary resolution [Sec. 169].

10.7-3 Other Rights

Certain other rights of a member spelt out by the Supreme Court in *Life Insurance Corporation of India* v. *Escorts Ltd.* [1986] are:

1. *Balkrishan Gupta* v. *Swadeshi Polytex Ltd.* [1985] 58 Comp. Cas. 563 (SC).

(*i*) To elect directors and thus to participate in the management through them;

(*ii*) To enjoy the profits of the company in the shape of dividends;

(*iii*) To apply to the court (now Tribunal) for relief in case of oppression;

(*iv*) To apply to the court (now Tribunal) for relief in case of mismanagement;

(*v*) To apply to the court (now Tribunal) for winding-up of the company; and

(*vi*) To share in the surplus on winding-up.

The aforesaid rights are in no way exhaustive but are only illustrative.

Again, SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 have enumerated rights of shareholders of listed companies. These Regulations provide that:

The listed entity shall seek to protect and facilitate the exercise of the following rights of shareholders:

(*i*) Right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes.

(*ii*) Opportunity to participate effectively and vote in general shareholder meetings.

(*iii*) Being informed of the rules, including voting procedures that govern general shareholder meetings.

(*iv*) Opportunity to ask questions to the board of directors, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

(*v*) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors.

(*vi*) Exercise of ownership rights by all shareholders, including institutional investors.

(*vii*) Adequate mechanism to address the grievances of the shareholders.

(*viii*) Protection of minority shareholders from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and effective means of redress.

Further, these Regulations require that the listed entity shall provide adequate and timely information to shareholders, including but not limited to the following:

(*i*) Sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be discussed at the meeting.

(*ii*) Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership.

(*iii*) Rights attached to all series and classes of shares, which shall be disclosed to investors before they acquire shares.

Besides, the listed entity shall ensure equitable treatment of all shareholders, including minority and foreign shareholders, in the following manner:

(*i*) All shareholders of the same series of a class shall be treated equally.

(*ii*) Effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of board of directors, shall be facilitated.

(*iii*) Exercise of voting rights by foreign shareholders shall be facilitated.

(*iv*) The listed entity shall devise a framework to avoid insider trading and abusive self-dealing.

(*v*) Processes and procedures for general shareholder meetings shall allow for equitable treatment of all shareholders.

(*vi*) Procedures of listed entity shall not make it unduly difficult or expensive to cast votes.

10.8 Duties and Liability of members

A member is subject to certain liabilities and obligations either under the Act or by the Articles of Association. Some of the important ones are stated hereunder:

1. If shares are not allotted for consideration other than cash, then a member must pay the whole nominal value of his shares in cash.
2. If a member is holding partly paid-up shares and the company goes into liquidation, then he becomes liable as contributory to pay, if called upon to do so, towards the assets of the company [Sec. 2(*26*)]. A contributory is generally a person who can be called upon to contribute money unpaid on the shares of the company in the event of liquidation of the company. However, in the list of contributories, names of persons who hold fully paid-up shares are also included though they are not liable to contribute but shall have rights of a contributory.
3. A person may be included in the 'B' list of contributories, as a past member, and required to pay to the extent of the amount remaining unpaid on the shares which he held within one year prior to the commencement of winding-up, if :
   (*i*) on the commencement of winding-up, debts exist which were incurred while he was a member, and
   (*ii*) the contributories of the 'A' list (*i.e.,* present members) are not able to satisfy the contribution required from them in respect of their shares.
4. A member is bound to the company by all the covenants of the Articles of association, *e.g.,* a company may have a paramount lien on a member's shares for any amount due from him to the company.
5. In the case of a company limited by guarantee, which each member may be called upon to contribute—
   - to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
   - to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves [Section 4(1)(*d*)(*ii*)].

10.9 Member v. Contributory

In the event of winding up of a company, members may be called upon to contribute towards the assets of the company. Accordingly, they are called 'contributories'. However, the expression 'contributory', as per section 2(26), includes the holder of fully paid up shares. The question, therefore, may arise as to whether a member ceases to be a member on the commencement of winding-up of a company. The question has been examined by various courts resulting in conflicting judgments. In *Raja Surrindar Singh* v. *P.B. & A Products Company Ltd.* [1956] 26 Comp. Cas. 41, it was observed that the series of sections which are headed "Winding-up by Court", "Official Liquidator" and "Ordinary powers of Court", leave no doubt that the word 'contributory' is really used synonymously with the word "member". But in *National Steel and General Mills* v. *Official Liquidator* [1989] 2 Comp. L.J. 207; [1990] 69 Comp. Cas. 416, Delhi High Court held that a member does not cease to be a member merely because winding-up of the company has commenced. He continues to be a member of the company so long as the requirements of section 41 [Now section 2(55) read with section 150] [Now section 88] are complied with. In other words, it can be interpreted to mean that till a person's name continues to remain on the Register of members, he shall be a member of the company entitled to the rights of a member and subject to the obligations of a member.

Again, in *Rajdhani Grains & Jaggery Exchange Limited, In re* [1983] 54 Comp. Cas. 166 (Delhi), it was observed that the terms 'contributory' and 'member' are not interchangeable, since under section 428 [Now section 2(26)] while every member would become a contributory, the converse would not be true, unless the name of the contributory is entered in the Register of members.

10.10 Expulsion of a member

It cannot be denied that there are some members who, by creating various kinds of troubles for the management, try to wrest undue advantage for themselves. Can such members be expelled? The Department of Company Affairs following the judgment in the case of *Bajaj Auto Ltd.* v. *N.K. Firodia* [1971] 41 Comp. Cas. 338 has expressed the view that the company cannot by amending the Articles of association give itself a power to expel a member. Such an amendment of Articles of association is opposed to the fundamental principles of the Companies' jurisprudence and is *ultra vires* the company. Such a provision is repugnant to the various provisions in the Act pertaining to the rights of a member in a public limited company and cuts across the scheme of the Act as it has the effect of rendering nugatory the very powers of the Central Government (now Tribunal) under section 111 [Now section 58] of the Act and the powers of the courts (Now Tribunal) under section 107 [Now section 48] and section 395 [Now section 235] of the Act and is, therefore, void by the operation of the provisions of section 9 [Now section 6] of the Act.

However, many authors are in disagreement with the views expressed by the Department of Company Affairs on the subject. Datta and Kamal Gupta, for example, feel that the Department's view does not give due weight to the contractual aspect of the Articles of association. If the right of expulsion of a member has been obtained in accordance with the procedure laid down by law of agreement,

They feel, it can only be set aside by the court (now Tribunal) on proof of *mala fide* exercise of power by the majority shareholders or the Board of directors. They are of the view that if Articles authorise the directors to expel a member under certain circumstances such power may be exercised *bona fide* and in the general interest of the company. So far as the 'property right' is concerned, the company should arrange that the expelled member gets appropriate price for his shares. Thus, they believe the correct analogy should be drawn from the Supreme Court's decision in the *Bajaj Auto Ltd.'s* case *(supra).*

Similarly, Ramaiya has observed that on a careful consideration of the subject in all its aspects, it would appear that there is nothing illegal or *ultra vires* in the exercise of a power of expulsion of the shareholder, if it is exercised *bona fide* to protect the interest of the company where the shareholder's act or conduct is considered to be detrimental or injurious to the interest of the company. An article giving such power is not necessarily invalid or *ultra vires.*

However, it seems permissible for a company limited by guarantee or a company governed by section 8 of the Act to include a provision for expulsion of a member from the company, if his conduct or action is considered detrimental to the interest of the company.

Suspension of a member - A Section 25 [Now section 8] company has been further held to be empowered to suspend a member temporarily provided the power is contained in its articles and the same is exercised *bona fide* by its managing committee - [*K. Leela Kumar* v. *Govt. of India* [1997] 27 CLA 145 (Mad.)].

Expulsion of a member on the ground of his making complaints before various authorities - The petitioner had been complaining to various authorities regarding the functioning/management of the company. Considering these complaints as prejudicial to its interest, the company amended its articles by which if 90 per cent of the shareholders in number and share capital decided that a member shall cease to be a member by a special resolution then his membership shall stand cancelled immediately and such shareholder shall then transfer his shares to another existing member on consideration to be determined in terms of the articles. Accordingly, an EOGM called for the purpose resolved to cancel the petitioner's membership and get her shares transferred to a member. When the petitioner declined to sell her shares, the company determined the fair price of the shares and sent her a demand draft towards consideration of the shares, besides transferring her shares to another shareholder.

Held, the aforesaid transfer of shares was in contravention of the mandatory provisions of section 108 [Now section 56] and consequent omission of petitioner's name was without sufficient cause. The company was, therefore, directed to restore her name on the Register of Members in respect of her shares and rectify register accordingly - *Smt. Mallina Rao* v. *Gowthami Solvent Oils Ltd.* [2001] 31 SCL 60 (CLB-Chennai).

In appeal before the High Court of Andhra Pradesh[2] against the decision of the Company Law Board (now Tribunal), as aforesaid, the learned judge upheld the decision of the Company Law Board (now Tribunal) and held the cancellation of the membership of the respondent as illegal.

2. *Gowthami Solvent Oils Ltd.* v. *Mallina Bharati Rao* [2001] 31 SCL 178 (AP)

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Distinguish between a 'shareholder' and 'member' of a company.
2. Explain the different ways through which a person may become member of a company.
3. In what ways may a person become member of a company? When may such a person cease to be member of a company?
4. To what extent is it possible for a minor to become a member of a company under the provisions of the Companies Act, 2013. Explain.
5. (*a*) What are the various modes of becoming a member of a company?

   (*b*) Can the following become a member of a company ?

   (*i*) a partnership firm; and

   (*ii*) a private limited company.

   (*c*) Can a subsidiary company hold shares in its holding company? S Ltd. held shares of H Ltd. before becoming its subsidiary. Will it be necessary for S Ltd. to surrender those shares on its becoming a subsidiary of H Ltd.?
6. Write short notes on: Membership by holding out
7. State with reasons whether following can become members of a company:

   (*i*) A minor

   (*ii*) A foreigner

   (*iii*) A partnership firm

   (*iv*) A Company

   (*v*) HUF
8. Write a short note on 'Joint Member'.
9. Shyam's name appears in the register of members of a company. He contends that he is not a member. The company maintains that Shyam had orally agreed to become the member. Is the contention of Shyam maintainable ?
10. Whether a member of a company can be expelled? Discuss with reference to a case law.
11. "Stock exchanges registered under the Companies Act can carry a provision in their articles empowering directors to expel any member of the company under any of the given conditions". Discuss.

    Hints :

    A stock exchange is an 'association not for profit'. Such a company is governed by section 8 of the Act and may include a provision for expulsion of a member from the company, if his conduct or action is considered detrimental to the interest of the company.

PRACTICAL PROBLEM

P. 1 A, B and C hold jointly 100 shares in a company. They want the order of names changed in the share certificate as B, A and C and make an application for change and lodge the original share certificate. The company directed them to execute a proper instrument of transfer to effect the change. Is the company justified?

Hints : *See under Para 10.4-9.*

11 Registers and Returns

11.1 Introduction

The Companies Act, 2013 requires a company to keep at its registered office certain books known as statutory books and also to keep copies of certain documents and deeds. Similarly, the Act places an obligation on each company to file certain returns and documents with the Registrar of Companies. Default in keeping any of the statutory books and returns or to file any of the returns or documents with the Registrar of Companies renders the company and their officers in default liable to penalties provided under the respective provisions of the Act.

11.2 Statutory books to be kept by a company

The various statutory books to be maintained by a company, *inter alia*, include:

1. Register of Charges (Section 85).
2. Register and Index of Members and Debentureholders (Section 88).
3. Register of Investments not held in company's name (Section 187).
4. Register of Fixed Deposits (Section 73)
5. Books of Account (Section 128).
6. Register of Contracts or Arrangements in which Directors are interested (Section 189).
7. Register of Directors and Key Managerial Personnel and their Shareholding (Section 170).
8. Register of Loans and Investments by Company (Section 186).

11.3 Optional books

Besides the statutory books, companies usually maintain certain other books. These books are maintained for effective and efficient working of the company. These books are maintained with a view to having a detailed information regarding

holding and transfer of shares and debentures, calls made on shareholders and debentureholders, interest paid to debentureholders, share warrant issued and surrendered and such other matters not covered by the statutory books. The optional books normally maintained by a company are :

1. Share Application and Allotment Book.
2. Share Calls Book
3. Debenture Application and Allotment Book
4. Debenture Calls Book
5. Register of Share Transfers
6. Shareholders' Dividend Book
7. Debenture Interest Book
8. Debenture Transfer Register
9. Register of Share Certificates
10. Register of Probates
11. Register of Dividend Mandates
12. Agenda Book
13. Register of Sealed Documents
14. Register of Proxies
15. Register of Powers of Attorney
16. Register of Lost Share Certificates.

Let us now note a brief description of some of the important books kept by companies.

11.4 Register of Charges (Section 85)

1. Every company shall keep at its registered office a register of charges in such form and in such manner as may be prescribed, which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case such particulars as may be prescribed.

Rule 10 of Companies (Registration of Charges) Rules, 2014 provides as follows:

(*i*) Every company shall keep at its registered office a register of charges in Form No. CHG.7 and enter therein particulars of all the charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.

(*ii*) The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.

(*iii*) Entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.

(*iv*) The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of eight years from the date of satisfaction of charge by the company.

2. A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

3. The register of charges and instrument of charges shall be open for inspection during business hours—

(*a*) by any member or creditor without any payment of fee; or

(*b*) by any other person on payment of such fees as may be prescribed,

subject to such reasonable restrictions as the company may, by its articles, impose.

11.5 Register of members/debentureholders

11.5-1 Register of Members/Debenture-holders and Index of Members/ Debenture-holders, etc. [Sec. 88]

Section 88 requires every company to maintain in the prescribed form and manner the following registers, namely:—

(*a*) register of members indicating separately for each class of equity and preference shares held by each member residing in or outside India;

(*b*) register of debenture-holders; and

(*c*) register of any other security holders.

Every register, as aforesaid, shall include an index of the names included therein.

In case of shares held in depository mode, the register and index of beneficial owners maintained by a depository shall be deemed to be the corresponding register and index for the purposes of this Act.

Companies (Management and Administration) Rules, 2014, in this regard, *inter alia*, provide as follows:

1. **Entries in the Register:** The entries in the registers maintained under section 88 shall be made **within seven days** after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

2. **Place of Keeping:** The registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorising the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one-tenth of the total members entered in the register of members reside.

3. **Changes in the Entries:** Changes on account of forfeiture, buy-back, reduction, issue of sweat equity shares, transmission of shares, shares issued under employees stock option scheme, etc. shall be recorded **within seven days** after approval by the Board or committee.

The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in the Register of members.

4. **Particulars of Pledge, etc.:** In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register **within fifteen days** from such an event.

11.5-2 Foreign Register

Sub-section (*4*) of Section 88 provides that a company may, if so authorised by its articles, keep in any country outside India, in prescribed manner, a part of the register, as aforesaid, called "foreign register" containing the names and particulars of the members, debenture-holders, other security holders or beneficial owners residing outside India.

As per the Companies (Management and Administration) Rules, 2014, the foreign register shall be maintained in the same format as the principal register.

11.5-3 Penalty

If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of Act, the company and every officer of the company who is in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues [Section 88(5)].

11.5-4 Shares held in Trust

In case of shares held by a trustee, a declaration specifying the name and other particulars of the person who holds the beneficial interest in such shares must be filed with the company. As per Rule 9 of the Companies (Management and Administration) Rules, 2014, the said declaration shall be filed within a period of thirty days from the date on which his name is entered in the register of members of such company.

Again, any change in the beneficial interest shall be filed within a period of thirty days from the date of such change.

11.5-5 Inspection of Register of Members, etc. (Section 94)

1. The registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees. Any other person may inspect on payment of the prescribed fees.

2. Any such member, debenture-holder, other security holder or beneficial owner or any other person may—

(*a*) take extracts from any register, or index or return without payment of any fee; or

(*b*) require a copy of any such register or entries therein or return on payment of prescribed fees.

However, such particulars of the register or index or return as may be prescribed shall not be available for inspection under sub-section (2) or for taking extracts or copies under this sub-section[1].

3. If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues.

4. The Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it.

11.6 Register of Investments not held in company's name (Section 187)

Where any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as may be prescribed and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose [Sub-section (3)].

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both [Sub-section (4)].

11.7 Register of fixed deposits [Sec. 73]

Every company accepting deposits from public shall maintain at its registered office one or more separate registers for deposits accepted or renewed, in which there shall be entered separately in the case of each depositor the prescribed particulars.

11.8 Books of account

Section 128 of the Act requires every company to prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year which give a true and fair view of the state of the affairs of the company, including that of its branch office or offices, if any.

11.8-1 Place of maintenance of books of account

Books of account shall be maintained at the company's registered office unless the Board of directors decides to keep them at another place in India [Proviso to section 128(1)]. It will be the duty of the company to inform the Registrar of Companies within 7 days of the decision in case the Board decides to maintain books at a place other than the registered office.

1. Proviso inserted by the Companies (Amendment) Act, 2017.

The company may keep such books of account or other relevant papers in electronic mode in such manner as may be prescribed [Second proviso to section 128(1)].

Where a company has a branch office whether in or outside India, it may maintain books of account with respect to the transactions effected at such branch, at that branch itself. However, in such a case, proper summarised returns periodically should be sent to the registered office or to the other place where the Board has decided to keep the books of account.

11.8-2 Inspection of books of account, etc. of companies

Sub-section (3) of section 128 provides that the books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours. In the case of financial information, if any, maintained outside the country, copies of such financial information shall be maintained and produced for inspection by any director subject to such conditions as may be prescribed.

However, the inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors.

Where an inspection is made under sub-section (3), the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

11.8-3 Period for which books of account to be preserved

Sub-section (5) of section 128 requires the books of account together with vouchers supporting the entries therein relating to a period of at least eight years immediately preceding a financial year to be preserved by every company.

However, where an investigation has been ordered in respect of the company under Chapter XIV, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

11.9 Register of contracts or arrangements in which directors are interested [Sec. 189]

Section 189 read along with the Companies (Meetings of Board and its Powers) Rules, 2014 require that every company shall keep one or more registers in Form MBP 4 and shall enter therein the particulars of—

1. (*a*) company or companies or bodies corporate, firms or other association of individuals, in which any director has any concern or interest, as mentioned under sub-section (1) of section 184.

However, the particulars of the company or companies or bodies corporate in which a director himself together with any other director holds two per cent or less of the paid-up share capital would not be required to be entered in the register;

(*b*) contracts or arrangements with a body corporate or firm or other entity as mentioned under sub-section (2) of section 184, in which any director is, directly or indirectly, concerned or interested; and

(*c*) contracts or arrangements with a related party with respect to transactions to which section 188 applies.

11.9-1 Entries in the register

The entries in the register shall be made at once, whenever there is a cause to make entry. The entries shall be made in chronological order and shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

11.9-2 Place of keeping and inspection of the register

The register shall be kept at the registered office of the company and it shall be open for inspection at such office during business hours and extracts may be taken therefrom, and copies thereof as may be required by any member of the company shall be furnished by the company to such extent, in such manner, and on payment of such fees as may be prescribed.

11.9-3 Period for which register to be preserved

The register shall be preserved **permanently** and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

11.9-4 Filing of particulars

Sub-section (2) of section 189 provides that every director or key managerial personnel shall, within a period of thirty days of his appointment, or relinquishment of his office, as the case may be, disclose to the company the particulars specified in sub-section (1) of section 184 relating to his concern or interest in the other associations.

11.9-5 To be produced at general meeting

The register shall also be produced at the commencement of every annual general meeting of the company and shall remain open and accessible during the continuance of the meeting to any person having the right to attend the meeting.

11.9-6 Exemptions

The following contracts or arrangements have been exempted from the aforesaid requirements—

(*a*) sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the cost of such services does not exceed five lakh rupees in the aggregate in any year; or

(*b*) collection of bills by a banking company in the ordinary course of its business.

11.9-7 Penalty

Every director who fails to comply with the provisions of this section and the rules made thereunder shall be liable to a penalty of twenty-five thousand rupees.

11.10 Register of Directors and Key Managerial Personnel and their shareholding [Sec. 170]*

Every company shall keep at its registered office a register containing such particulars of its directors and key managerial personnel as may be prescribed, which shall include the details of securities held by each of them in the company or its holding, subsidiary, subsidiary of company's holding company or associate companies.

As per Rule 17 of Companies (Appointment and Qualification of Directors) Rules, 2014, the Register must contain the following particulars, namely:—

(*a*) Director Identification Number (optional for key-managerial personnel);

(*b*) present name and surname in full;

(*c*) any former name or surname in full;

(*d*) father's name, mother's name and spouse's name (if married) and surnames in full;

(*e*) date of birth

(*f*) residential address (present as well as permanent);

(*g*) nationality (including the nationality of origin, if different);

(*h*) occupation;

(*i*) date of the board resolution in which the appointment was made;

(*j*) date of appointment and reappointment in the company;

(*k*) date of cessation of office and reasons therefor;

(*l*) office of director or key managerial personnel held or relinquished in any other body corporate;

(*m*) membership number of the Institute of Company Secretaries of India in case of Company Secretary, if applicable; and

(*n*) Permanent Account Number (mandatory for key-managerial personnel if not having DIN).

Rule 17(2) further requires that in addition to the details of the directors or key managerial personnel, the company shall also include in the aforesaid Register the details of securities held by them in the company, its holding company, subsidiaries, subsidiaries of the company's holding company and associate companies relating to—

(*a*) the number, description and nominal value of securities;

(*b*) the date of acquisition and the price or other consideration paid;

(*c*) date of disposal and price and other consideration received;

(*d*) cumulative balance and number of securities held after each transaction;

(*e*) mode of acquisition of securities;

(*f*) mode of holding - physical or in dematerialized form; and

(*g*) whether securities have been pledged or any encumbrance has been created on the securities :

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*Not applicable to a Government Company in which entire paid up share capital is held by the Central Govt. and/or State Govt.(s).

11.10-1 Filing of Return with the Registrar

A return containing such particulars and documents as may be prescribed, of the directors and the key-managerial personnel shall be filed with the Registrar within thirty days from the appointment of every director and key managerial personnel, as the case may be, and within thirty days of any change taking place [Section 170(2)].

Every listed company shall file with the Registrar, a return in Form No. MGT.10, with respect to changes in the shareholding position of promoters and top ten shareholders of the company, in each case, representing increase or decrease by two per cent or more of the paid-up share capital of the company, within fifteen days of such change - *The Companies (Management and Administration) Amendment Rules, 2016.*

11.10-2 Can the register be kept in loose-leaf form ?

The Department of Company Affairs [Now Ministry of Corporate Affairs], in this regard, has opined that no objection need be raised if a company finds it more convenient or necessary to maintain the register in the loose-leaf form provided the company takes all possible safeguards against manipulation, tampering with or interpolation of the registers and arranges for the binding up of the loose-leaf books at reasonable intervals, as in the case of minute books maintained by large companies under section 193 (now Section 118) - *Taxmann's Circulars and Clarifications,* 1992 Edition, page 328.

11.11 Register of Loans and Investments by company (Section 186)

Every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed [Section 186(9)].

Rule 12 of the Companies (Meetings of Board of and its Powers) Rules, 2014 provide as follows:

(1) Every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in Form MBP 2 and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid.

(2) The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition.

(3) The register shall be kept at the registered office of the company and the register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

(4) The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

(5) For the purpose of sub-rule (4), the register can be maintained either manually or in electronic mode.

The register, as aforesaid, —

(*a*) shall be open to inspection at such office; and

(*b*) extracts may be taken therefrom by any member, and copies thereof may be furnished to any member of the company on payment of the prescribed fee [Section 186(10)].

11.12 Minutes book

(1) Section 118(1)* of the Companies Act, 2013 requires every company to cause minutes of the :

(*i*) proceedings of every general meeting of any class of shareholders or creditors;

(*ii*) every resolution passed by postal ballot; and

(*iii*) every meeting of its Board of Directors or of every committee of the Board,

to be prepared and signed[2] in such manner as may be prescribed. Rule 25 of the Companies (Management and Administration) Rules, 2014 provides that each page

*Provisions of section 118 shall not apply to section 8 company except that minutes may be recorded within 30 days of the conclusion of every meeting in case of companies where the AOA provide for confirmation of minutes— *Vide MCA Notification dated 5-6-2015.*

2. Rule 25 of the Companies (Management and Administration) Rules, 2014, as amended by the Amendment Rules, 2016 w.e.f. 23-9-2016 provides as follows:

(1)(*a*) A distinct minute book shall be maintained for each type of meeting namely:- (*i*) general meetings of the members; (*ii*) meetings of the creditors; (*iii*) meetings of the Board; and (*iv*) meetings of each of the committees of the Board.

Explanation.—For the proposes of this sub-rule, resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting.

(*b*) (*i*) The minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.

(*ii*) In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

(*c*) Each page of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed –

(*i*) in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;

(*ii*) in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose;

(*iii*) in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

(Contd. on p. 372)

of every such book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed—

(*i*) in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;

(*ii*) in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose.

The Minutes shall be kept within thirty days of the conclusion of every such meeting concerned, or passing of resolution by postal ballot in books kept for that purpose. The pages of the Minute Book shall be consecutively numbered.

(2) The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat.

(3) All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.

(*4*) In the case of a meeting of the Board of Directors or of a committee of the Board, the minutes shall also contain—

(*a*) the names of the directors present at the meeting; and

(*b*) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.

(*5*) There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting,—

(*a*) is or could reasonably be regarded as defamatory of any person; or

(*b*) is irrelevant or immaterial to the proceedings; or

(*c*) is detrimental to the interests of the company.

(*6*) The Chairman shall exercise absolute discretion in regard to the inclusion or non- inclusion of any matter in the minutes on the grounds specified in sub-section (5).

(*7*) The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.

(*8*) Where the minutes have been kept in accordance with sub-section (1) then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and the resolutions passed by postal ballot to have been duly passed and in particular, all appointments

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(Contd. from p. 371)

(*d*) The minute books of general meetings, shall be kept at the registered office of the company and shall be preserved permanently and kept in the custody of the company secretary or any director duly authorised by the board.

(*e*) The minutes books of the Board and committee meetings shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose and shall be kept in the registered office or such place as Board may decide.

of directors, key managerial personnel, auditors or company secretary in practice, shall be deemed to be valid.

(*9*) No document purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters required by this section to be contained in the minutes of the proceedings of such meeting.

(*10*) Every company shall observe secretarial standards with respect to general and Board meetings specified by the Institute of Company Secretaries of India and approved as such by the Central Government.

(*11*) If any default is made in complying with any of the aforesaid provisions in respect of any meeting, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

(*12*) If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

11.12-1 Inspection of minute-books of general meeting (Section 119)

(*1*) The books containing the minutes of the proceedings of any general meeting of a company or of a resolution passed by postal ballot, shall—

(*a*) be kept at the registered office of the company; and

(*b*) be open, during business hours, to the inspection by any member without charge, subject to such reasonable restrictions as the company may, by its articles or in general meeting, impose, so, however, that not less than two hours in each business day are allowed for inspection.

(*2*) Any member shall be entitled to be furnished, within seven working days after he has made a request in that behalf to the company, and on payment of the prescribed fees, with a copy of any minutes, as aforesaid.

(*3*) If any inspection is refused, or if any copy required is not furnished within the time specified, as above, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees for each such refusal or default, as the case may be.

Besides, the Tribunal may, by order, direct an immediate inspection of the minute-books or direct that the copy required shall forthwith be sent to the person requiring it.

Likewise, Section 120 allows keeping and inspection, etc. of the minutes in electronic form in the prescribed manner.

Rule 29 of the Companies (Management and Administration) Rules, 2014 provides that where a company maintains its records in electronic form, copies of those records containing a clear reproduction of the whole or part thereof, as the case may be, shall be provided on payment of not exceeding ten rupees per page.

11.12-2 Signing of minutes of board meetings

Rule 25 of the Companies (Management and Administration) Rules, 2014 requires that each page of every minute book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report shall be dated and signed—

(*i*) in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;

(*ii*) in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose;

(*iii*) in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

11.12-3 Minutes kept in a loose-leaf form

As noted in the preceding paragraphs, minutes book must be a bound book and cannot be a loose-leaf binder. In *Gluco Series (P.) Ltd.*, In re [1987] 61 Comp. Cas. 227 (Cal.), the Calcutta High Court held that minutes of a meeting which were found pasted in the minutes book could not be regarded as evidence. *The Department of Company Affairs [Now Ministry of Corporate Affairs]* has, however, permitted minute's book to be kept in loose-leaf form subject to certain safeguards in this regard. The opinion of the *Department* is being given hereunder:

> ". . . that on a strict interpretation of the Companies Act, the minutes of proceedings of the meetings shall not be attached to the Minutes book by pasting or otherwise. However, without prejudice to the strict legal position, the Department of Company Affairs are agreeable to permit the loose-leaf minutes book, provided the company takes appropriate safeguards against interpolation of the leaves in the books such as serial numbering of pages, authentication of each page of the book, safe custody of the key, if any, to the loose-leaf register. The company should also arrange for the loose-leaf minutes to be bound into books at regular intervals of, say, six months." [*Letter No. 16047/TA/VII dated 16-12-1972*].

11.13 Annual return (Section 92)

Every company shall prepare a return (hereinafter referred to as the annual return) in the prescribed form, namely, Form No. MGT.7, containing the particulars as they stood on the close of the financial year regarding—

(*a*) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;

(*b*) its shares, debentures and other securities and shareholding pattern;

(*c*) its members and debenture-holders along with changes therein since the close of the previous financial year;

(*d*) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;

(*e*) meetings of members or a class thereof, Board and its various committees along with attendance details;

(*f*) remuneration of directors and key managerial personnel;

(*g*) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;

(*h*) matters relating to certification of compliances, disclosures as may be prescribed;

(*i*) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors; and

(*j*) such other matters as may be prescribed.

11.13-1 Signing and Filing of the Annual Return

The Annual Return shall be signed by a director and the company secretary, or where there is no company secretary, by a company secretary in practice. However, in relation to One Person Company and small company, the annual return shall be signed by the company secretary, or where there is no company secretary, by the director of the company.

Again, the Central Government may prescribe abridged form of annual return for "One Person Company, small company and such other class or classes of companies as may be prescribed.

Every company shall place a copy of the annual return on the website of the company, if any, and the web-link of such annual return shall be disclosed in the Board's report - sub-section (3) of the Companies Act, 2013 as amended by the Amendment Act, 2017.

Rules 11 and 12 of the Companies (Management and Administration) Rules, 2014 read alongwith the provisions of section 92, as amended by the Amendment Act, 2017 provide:

(1) Every company shall prepare its annual return in Form No. MGT.7.

(2) The annual return, filed by a listed company or a company having paid-up share capital of ten crore rupees or more or turnover of fifty crore rupees or more, shall be certified by a Company Secretary in practice.

(3) A copy of the annual return shall be filed with the Registrar with such fee as may be specified for the purpose.

(4) Every company shall file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed.

(5) If any company fails to file its annual return under sub-section (4), before the expiry of the period specified therein, such company and its every officer who is in default shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of five lakh rupees [*Sub-section (5), as amended by the Companies (Amendment) Act, 2019*].

In *Carpet Export Promotion Council, In re* [2017] 77 taxmann.com 46 (NCLT - Allahabad), the National Company Law Tribunal, Allahabad held that delay in filing annual return could be compounded if recommended by ROC.

11.13-2 Place of keeping

Copies of the annual return filed under section 92 shall be kept at the registered office of the company. However, copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members resides, if approved by a special resolution passed at a general meeting of the company and the Registrar (Section 94).

11.14 Return of allotment (Section 39)

As per section 39(4) of the Companies Act, 2013, whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment in such manner as may be prescribed. The Companies (Prospectus and Allotment of Securities) Rules, 2014, in this regard, have prescribed the following in Rule 12:

(1) Whenever a company having a share capital makes any allotment of its securities, the company shall, within thirty days thereafter, file with the Registrar a return of allotment in Form PAS-3, along with the prescribed fee.

(2) There shall be attached to the Form PAS-3:

(i) a list of allottees stating their names, address, occupation, if any, and

(ii) number of securities allotted to each of the allottees.

The aforesaid list shall be certified by the signatory of the Form PAS-3 as being complete and correct as per the records of the company.

(3) In the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, there shall be attached a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration.

(4) Where a contract referred to in (3) above is not reduced to writing, the company shall furnish complete particulars of the contract duly stamped.

(5) A report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract.

(6) In the case of issue of bonus shares, a copy of the resolution passed in the general meeting authorizing the issue of such shares shall also be attached.

11.14A Return of Changes in Shareholding position of Promoters and Top Ten Shareholders

Rule 13 of the Companies (Management and Administration) Rules, 2014, as amended w.e.f. 23.9.2016 require every listed company to file with the Registrar, a return in Form No. MGT 10, with respect to the shareholding position of promoters and top ten shareholders of the company, in each case, representing increase or decrease by two per cent or more of the paid- up share capital of the company within 15 days of such change.

11.15 Place of keeping and inspection of registers, returns, etc. (Section 94)

The registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company. However, such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company.

Petitioner made an application for inspection of register of members and annual return of respondent company for years 2009 to 2012. When company failed to provide copies of aforementioned documents, petitioner filed petition for supply of documents. Since petitioner was neither a shareholder, nor debenture holder nor holding commercial interest in respondent-company, NCLT, Mumbai held that he was not entitled for supply of copies of documents for inspection – *Anil Kumar Poddar* v. *Nessville Trading (P.) Ltd.* [2016] 76 taxmann.com 247 (NCLT - Mum.)

Again, in similar circumstances, the petitioner was held not qualified under section 94 (163 of 1956 Act) to seek inspection of statutory documents and copies thereof – *Anil Kumar Poddar* v. *Darshan Securities (P.) Ltd.* [2016] 76 taxmann.com 194 (NCLT - Mum.)[3]

11.15-1 Period for which the registers, returns and records are required to be kept:

The period for which the registers, returns and records are required to be kept shall be such as may be prescribed (Section 94).

Rule 15 of the Companies (Management and Administration) Rules, 2014 has prescribed the following periods:

(1) The **register of members along with the index** shall be preserved **permanently** and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose; and

(2) The **register of debenture holders or any other security holders along with the index** shall be preserved for a period of **eight years** from the date of redemption of debentures or securities, as the case may be, and shall be kept

3. Also see, *Anil Kumar Poddar* v. *Futura Commercials (P.) Ltd.* [2017] 77 taxmann.com 111 (NCLT – Mum.).

in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.

(3) Copies of all **annual returns** prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of **eight years** from the date of filing with the Registrar.

(4) The **foreign register of members** shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any other security holders shall be preserved for a period of **eight years** from the date of redemption of such debentures or securities.

(5) The foreign register shall be kept in the custody of the company secretary or person authorised by the Board.

11.15-2 Inspection of registers and returns (Section 94)

The registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be prescribed.

Any such member, debenture-holder, other security holder or beneficial owner or any other person may—

(*a*) take extracts from any register, or index or return without payment of any fee; or

(*b*) require a copy of any such register or entries therein or return on payment of such fees as may be prescribed [Sub-section (3)].

11.15-3 Penalty

If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues [Sub-section (4)].

11.15-4 Power of the Central Government to order inspection

The Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it [Sub-section (5)].

11.15-5 Registers, etc., to be evidence

The registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be *prima facie* evidence of any matter directed or authorised to be inserted therein by or under this Act (Section 95).

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Who is entitled to inspect or to have a copy of the following :
   (*a*) Register of members
   (*b*) Register of Contracts and arrangements
   (*c*) Register of charges
   (*d*) Minutes of Board meetings.
2. Write short notes on: 'Register of members' and 'Annual Return'.
3. Write short notes on register of contracts and arrangements in which directors or key managerial personnel are interested.
4. What are the details which have to be included in the Register of directors' shareholdings? Who can inspect the register and require a copy thereof, and when?
5. State the law relating to inspection of any four of the following :
   (*a*) Books of account
   (*b*) Minutes book of the Board meetings
   (*c*) Register of directors' shareholding
   (*d*) Register of charges
6. Explain the provisions of the Companies Act, 1956 relating to Annual Return.
7. Who may inspect the books of account and other books and papers of a company? What is the position of a member of a company in this regard?
8. What are the legal requirements to be complied with regard to recording of minutes and maintenance of minute books ?
9. (*i*) A non-member from whom the company has accepted deposits asks for a copy of the latest Balance Sheet of the Company.
   (*ii*) A member wants to inspect the register of Directors' shareholdings on a day other than the date on which the Annual General Meeting of the Company is held.
   As a Secretary of a Public Company how will you deal with the above situations?

PRACTICAL PROBLEMS

P. 1 M/s. Greenfields Industries Ltd. has completed its public issue in the year 2013. One Shri Pratap Singh who is not a shareholder and who is no way connected with the business of the company demanded the production of the register of members for getting some information for his use. The company's officials have refused the request/demand of Shri Pratap Singh. The company has since received a legal notice from Shri Pratap Singh. Advise the company.

Hints : Company's Officials were not right in refusing the request/demand. *See para 11.15-2.*

P. 2 The board of directors of M/s. All India Film Producers and Exhibitors Association Ltd. have passed a resolution to the effect that no member who is indulging in activities detrimental to the interests of the company be permitted to examine the records or obtain certified copies thereof. A member of the company who is also a member of the Rival Association demands inspection of the register of members and minutes of general meetings and certified true copies thereof. The company refuses the inspection, etc., on the strength of the resolution referred to above. Examine the correctness of refusal by the company in the light of the provisions of the Companies Act and the remedial action, if any, that can be taken by the aggrieved member in this case.

Hints : According to the provisions contained in section 94 of the Companies Act, 2013, every member of the Company is entitled to inspect the register of members without payment of any fee. Even a non-member of the company can inspect the register of members on payment of prescribed fee. They can also ask for copies of extracts from the register of members on payment of the prescribed fee as copying charges. Similarly, as per section 119, the minutes books of the general meetings are also to be made available for inspection of the members of the Company without any charge. Thus, All India Film Producers and Exhibitors Association Ltd. have no right to refuse the inspection of the register of members and minutes books of general meetings. The resolution passed by the said Association is not valid as it cannot go beyond the provisions of the Act. The aggrieved member has every right to approach the Central Government under sections 94(5) and 119(4) of the Companies Act.

P. 3 Immediately upon conducting the last general meeting held in July, the Chairman went overseas for medical treatment. Accordingly, the minutes of the said meeting could not be signed by him. To meet the requirements of the law, he sent a letter of authority to the Secretary authorising the latter to sign the minutes on the former's behalf. Can the Secretary act on the letter of authority? If not, what procedure should be followed?

Hints : According to section 118(1) of the Companies Act, 2013 read along with Rule 25 of the Companies (Management and Administration) Rules, 2014 provides that the minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting. Further, each page of the minute book shall be initialled or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed. In the case of minutes of proceedings of a general meeting, it shall be initialled/signed by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that Chairman within that period, by a director duly authorised by the Board for the purpose. Thus, a Director can be authorised by the Board to sign and date the same. The Company Secretary cannot carry out the said function, although he had been authorised by the Chairman and a letter of authority was issued to him by the Chairman for the said purpose.

It is, therefore, necessary for the Secretary to get a Board resolution authorising a director to sign the minutes of General meeting. Resolution of the Board may be passed through circulation in accordance with the provisions of section 175.

P. 4 M/s Easy Escape Consultants Ltd. was incorporated in the year 2011 as a Public Limited Company. It made a public issue in the year 2012 and collected substantial funds from the public. However, the company till date, has not filed any Annual Returns or Balance Sheets with the Registrar of Companies, New Delhi. Efforts to locate the directors at their given addresses have not yielded any results. A group of shareholders, who wish to take initiative in this regard seek your advice in respect of the following matters :

(*i*) The nature of defaults committed and the penal action that can be taken against the company and its Directors.

(*ii*) Whether any steps can now be taken to hold a general meeting of the company to elect a new set of Directors in place of the existing Directors.

Hints : (*i*) As per section 92, every company must file with the Registrar a copy of the annual return, within sixty days from the date on which the annual general meeting is held or where no annual general meeting is held in any year within sixty days from the date on which the annual general meeting should have been held together with the statement specifying the reasons for not holding the annual general meeting, with such fees or additional fees as may be prescribed, within the time as specified, under section 403. Section 403 has prescribed a period of two hundred and seventy days from the date by which it should have been filed. Sub-section (5) of section 92 provides that if a company fails to file its annual return, before the expiry of the period specified under section 403 with additional fee, the company shall be

punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakhs rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

(*ii*) The shareholders of Easy Escape Consultants Ltd. can approach the Tribunal as provided in section 97. The Tribunal has the power, on the application of any member of the company, to call or direct the calling of a general meeting of the company and give such ancillary or consequential directions for holding the annual general meeting including a direction that even one member present at the meeting can constitute a quorum for the purpose of the meeting.

12 Investments, Loans, Borrowings and Debentures

12.1 Investments

12.1-1 Meaning of 'investments'

The word 'Investments', in its natural connotation, would include any property or right in which money or capital is invested. However, we shall be using the word 'investments' in a limited sense to mean the investing of money in shares, stock, debentures or other securities. Investment in other assets does not seem to be covered under this head by the various provisions of the Companies Act in this regard.

12.1-2 Investments to be held in company's own name

According to sub-section (1) of section 187, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name. However, a company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

The requirement that the investments made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf. If the company makes investments on behalf of someone else, such investments need not be held in its own name. Thus, where the company is a trustee, the investment is supposed to be made on behalf of the beneficiaries of the trust and not on its own behalf. In such a case, there should be no objection to the investments being made by the company as the trustee but held in the name of the beneficiaries. Conversely, the mere fact that the trustee chooses to hold the shares in its own name cannot give rise to any legal inference that the trustee had made the investments on its own behalf.

12.1-2a EXEMPTIONS [SECTION 187(2)] - In terms of the provisions of section 187(2), section 187(1) does not prevent a company :

(*a*) from depositing with a bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon; or

(*b*) from depositing with, or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof. But, if within a period of six months from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable after the expiry of that period, have the shares or securities re-transferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or

(*c*) from depositing with, or transferring to, any person any shares or securities, by way of security for the repayment of any loan advanced to the company or the performance of any obligation undertaken by it; or

(*d*) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

Where there is an agreement between a company being the seller of any shares held by it and the buyer of such shares, the company may agree with the buyer to transfer the shares temporarily to a designated party for the sole purpose of realising the purchase consideration on its behalf and to pass on the shares, by executing a transfer to the intended buyer. *The designated party must necessarily be either the State Bank of India or a scheduled bank.* However, to take the aforesaid benefit, the buyer and the seller must *complete the transaction within a period of 6 months.*

12.1-2b REGISTER OF INVESTMENTS NOT HELD IN COMPANY'S OWN NAME - Where any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as may be prescribed and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose [Sub-section (3)].

12.1-2c PENALTY - If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five

thousand rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both [Sub-section (4)].

12.1-3 Investments in other companies and bodies corporate/Inter-corporate loans and investments

Section 186 of the Companies Act, 2013 contains provisions with respect to inter-corporate loans and investments. Section 186* provides as follows :

(1) ***Investments not through more than two layers of investment companies (Sec. 186(1))*** - A company shall unless otherwise prescribed, make investment through not more than two layers of investment companies[1]. However, a company may acquire any other company incorporated in a country outside India if such other company has investment subsidiaries beyond two layers as per the laws of such country;

Again, a subsidiary company may have any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

(2) ***Ceiling on loans, guarantees, investments, etc.*** - Section 186(2) provides that no company shall directly or indirectly —

(*a*) give any loan to any person[2] or other body corporate;

(*b*) give any guarantee or provide security in connection with a loan to any other body corporate or person[2]; and

(*c*) acquire by way of subscription, purchase or otherwise, the securities of any other body corporate,

exceeding sixty per cent of its paid-up share capital, free reserves and securities premium account or one hundred per cent of its free reserves and securities premium account, whichever is more.

Approval by way of special Resolution - Where the aggregate of the loans, investment, guarantee or security so far made or provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under sub-section (2), no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorised by a special resolution passed in a general meeting.

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*Provisions of section 186 shall not be applicable to:

(*a*) A Government company engaged in defence production;

(*b*) A Government company, other than a listed company, in case it obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

1. "investment company" means a company whose principal business is the acquisition of shares, debentures or other securities - *Explanation (a)* to section 186.
2. For the purposes of section 186(2), the word 'person' does not include any individual who is in the employment of the company - *Explanation* added by the Companies (Amendment) Act, 2017.

However, where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription, purchase or otherwise of, the securities of its wholly owned subsidiary company, passing of special resolution shall not be necessary.

Further, the company must disclose the details of such loans or guarantee or security or acquisition in the financial statement as provided under sub-section (4).

(3) A company, which is ***registered under section 12 of the Securities and Exchange Board of India Act, 1992*** and covered under such class or classes of companies as may be prescribed, **shall not take** inter-corporate loan or deposits exceeding the prescribed limit and such company shall furnish in its financial statement the details of the loan or deposits [Sub-section (6)].

(4) ***Disclosure in financial statement*** - The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security [Sub-section (4)].

(5) ***Unanimous resolution of the Board and approval of the public financial institutions*** - No loan or investment shall be made or guarantee or security given by the company in pursuance of sub-section (2) unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and where any term loan is subsisting, the prior approval of the concerned public financial institution is obtained [Sub-section (5)].

No prior approval of a public financial institution shall be required where the aggregate of the loans and investments so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed—

- sixty per cent of its paid-up share capital, free reserves and securities premium account, or
- one hundred per cent of its free reserves and securities premium account, whichever is more, and
- there is no default in repayment of loan instalments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution.

(6) ***Rate of interest*** - No loan shall be given under this section at a rate of interest lower than the prevailing yield of one-year, three-year, five-year or ten-year Government Security closest to the tenor of the loan [Sub-section (7)].

Clarification regarding Section 186(7) - The matter has been examined in the Ministry and it is hereby clarified that in cases where the effective yield (effective rate of return) on tax free bonds is greater than the prevailing yield of one year, three years, five years or ten years of Government Security closest to the tenor of the loan, there is no violation of sub-section (7) of

section 186 of the Companies Act, 2013 - General circular No. 6/2015, dated 9 April, 2015.

(7) ***Default in repayment of deposits, etc.***- No company which is in default in the repayment of any deposits accepted before or after the commencement of this Act or in payment of interest thereon shall give any loan or give any guarantee or provide any security or make an acquisition till such default is subsisting [Sub-section (8)].

(8) ***Register of Investment and Loans***[3] - Every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in such manner as may be prescribed [Section 186(9)]. Rule 12 of the Companies (Meetings of Board and its Powers) Rules, 2014 provide that the entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition. Further, the register can be maintained either manually or in electronic mode. The entries in the register (either manual or electronic) shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose. The register shall be kept at the registered office of the company and shall be preserved permanently.

(9) ***Exemptions***[4] - Nothing contained in this section, except sub-section (1), shall apply—

(*a*) to a loan made, guarantee given or security provided by a banking company or an insurance company or a housing finance company in the ordinary course of its business or a company established with the object of and engaged in the business of financing of industrial enterprises or of providing infrastructural facilities;

(*b*) to any investment—

(*i*) made by an investment company[5];

(*ii*) made in shares allotted in pursuance of clause (*a*) of sub-section (1) of section 62 or in shares allotted in pursuance of rights issues made by a body corporate;

(*iii*) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter III-B of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

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3. For details, refer Para 11.11.
4. [Section 186(11)].
5. The expression 'investment company' means a company whose principal business is the acquisition of shares, debentures and other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than fifty per cent of its total assets, or if its income derived from investment business constitutes not less than fifty per cent as a proportion of its gross income - *Explanation* to section 186.

(10) ***Penalty*** - If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees [Sub-section (13)].

12.2 Implied power to borrow ?

Every trading company has an implied power to borrow - *General Auction Estate Co.* v. *Smith* [1891] 2 Ch. 432 but it is wise to include an express power to borrow in the objects clause of the memorandum. The implied power of a trading company to borrow is too indefinite to be relied upon for, and does not always appear easy to decide, whether a company is a trading company or not. Further, the question may also arise whether a borrowing is or is not for the purpose of the company's business. It is, therefore, the usual practice to contain an express power to borrow in the memorandum of association.

In the case of a non-trading company, unless there is something in the Memorandum or Articles to show expressly or by way of necessary inference that the company is empowered to borrow, a power to borrow money cannot be implied - *Baroness Wenlock* v. *River Dee* [1885] 10 App. Cas. 354.

Where memorandum authorises the company to borrow, the articles provide as to how and by whom these powers shall be exercised. It may also fix up the maximum amount which can be borrowed by the company.

12.2-1 Exercise of borrowing powers

The power to borrow money is generally exercised by the directors but articles normally provide for certain restrictions on their power to borrow. Section 179(3)(*d*) requires a resolution of the Board of directors to be passed at a meeting of the Board for exercise of power to borrow. The Board may, however, by a resolution passed at a meeting, delegate this power to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office.

Where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, the Board of directors must seek the approval of the shareholders by way of special resolution [Section 180(1)(*c*)].

The approval of the shareholders, as aforesaid, will not be required for raising temporary loans from the company's bankers in the ordinary course of business.

Again, the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of Section 180(1)(*c*).

12.2-2 Temporary loans

The term 'temporary loans' means loans (*i*) repayable on demand, or (*ii*) repayable within 6 months from the date of the loan such as short term, cash credit arrangements, the discounting of bills, or (*iii*) other short term loans of a seasonal character. The term, however, does not include loans raised for the purpose of financing expenditure of a capital nature [*Explanation* to Section 180(1)(*c*)].

12.2-3 Ultra vires borrowings

Borrowing by a company shall be *ultra vires* where the company borrows in spite of no power to borrow or borrows beyond the limit fixed by the Memorandum or Articles. Any such loan to the company is *null and void* and does not create an actionable debt. Any securities given in respect thereof, are inoperative. Thus, the lender cannot sue the company for the return of the loan and shall be under an obligation to return back the securities, if any. *Ultra vires* borrowings cannot even be ratified by a resolution passed by the company in a general meeting. An *ultra vires* borrowing does not give rise to any indebtedness either at law or equity on the part of the company - *Sinclair* v. *Brougham* [1914] 88 L.J. Ch. 465. However, the lender shall have the following remedies :

1. *Injunction and Recovery* - If the money or assets, property, etc., purchased with such money is identified and are still in the possession of the company, the lender can obtain an injunction to restrain the company from parting with them and seek a tracing order to trace and recover them. Even if the monies advanced by the lender cannot be traced, but if it can be shown that the company has benefited thereby, either by an increase in its assets or in any other manner, the lender can claim repayment of his money from the company.
2. *Subrogation* - If the borrowed money was applied in payment of lawful creditors of the company, the lender shall subrogate to the rights of those creditors, *i.e.,* he will rank as a creditor up to the amount so applied - *Sinclair* v. *Brougham* [1914] 88 L.J. Ch. 465. Subrogation does not, however, confer on the lender the same priority which the original lender had over other creditors - *Re. Wirexhan Mold & Cohmah's Quay Rly.* [1879] 1 Ch. 440.
3. *Suit against the directors* - The lender may claim damages from the directors and sue them personally for a breach of warranty of authority (*Firbank's Executors* v. *Humphreys* [1866] 18 QBD 64). But if the fact that the company has no power to borrow was apparent upon reference to the company's Memorandum or Articles, the lender shall not be entitled to claim damages from directors upon this ground because he is deemed to have knowledge of these public documents - *Rashdall* v. *Ford* [1866] E.R.Q. Fq. Cas. 750.

Borrowing intra vires *the company but* ultra vires *the directors* : If the borrowing is in excess merely of the power of the directors but not of the company, *e.g.,* where the Articles provide that the directors shall have power to borrow only up to Rs. 50 lakhs and for borrowing beyond this amount prior approval of the shareholders in general body meeting must be obtained, any borrowing beyond Rs. 50 lakhs without shareholders' prior approval (*i.e., ultra vires* the directors) can be ratified and rendered valid by the company. If ratified, the loan shall become valid and binding upon the company. However, even where the company refuses to ratify the

directors' act, the 'doctrine of indoor management' (also known as rule in *Royal British Bank* v. *Turquand* [1856] CI&B 327 shall protect a lender provided he can establish that he advanced the money in good faith. The company may in turn seek reimbursement from the directors at fault. Further, the company cannot repudiate its liability to repay if the money borrowed by the directors in excess of their authorisation has been used for the benefit of the company - *Krishan Kumar Rohatagi* v. *State Bank of India* [1980] 50 Comp. Cas. 722. The Patna High Court in this case observed that under the general principles of law when an agent borrows money for a principal without the authority of the principal, but the principal takes the benefit of the money so borrowed, or when the money so borrowed has gone into the coffers of the principal, the law implies that the borrowed money is to be paid by the principal. There is nothing in law which makes the principle inapplicable to the case of joint stock company. In this case, the company borrowed an amount of Rs. 5 lakhs from a bank under the promissory note. The company used to make payments towards the loan and the promissory note used to be renewed from time to time. The repayment of the loan was guaranteed by a person by executing a guarantee in favour of the company. In a suit filed for recovery of the money under the promissory note, both the company and the person who had guaranteed the loan denied their liabilities. It was contended by the company that the pronote was executed by the chairman of the company without there being a resolution of the Board of directors authorising him to execute the said pronote and as such the company is not liable to pay the amount in question. Referring to section 292(1)(*c*) [now section 179(3)(*d*)] of the Companies Act, it was contended that there must be a resolution of the Board of directors authorising the managing director to borrow any amount from the Bank or any other company. The Court rejected these contentions and held the company liable to pay the amount.

12.2-4 Charges under the Companies Act, 2013

Section 2(*16*) of the Companies Act, 2013 provides that for the purposes of registration under the Act, "charge includes mortgage". In the context of advances to companies a charge may be classified as: (*i*) a fixed charge, and (*ii*) a floating charge.

***Fixed charge*:** A charge is fixed when it is made specifically to cover definite and ascertained assets of permanent nature such as land, building or heavy machinery. A fixed charge passes legal title to certain specific assets, and the company loses the right to dispose of the property unencumbered, though the company retains possession of the property. In other words, the creation of fixed charge precludes the company from selling the property charged without the consent of the charge holder.

***Floating charge*:** The floating charge, as a type of security, is peculiar to companies as borrowers.

It is a charge on a class of assets, which may be present or future, and which changes from time to time in the ordinary course of business, *e.g.,* stock-in-trade. The company can deal with the property subject to a floating charge in any manner it likes. It has not to seek permission from the lender of money for disposing it of or converting it into some other assets.

The governing idea of a floating security is to allow a company to carry on its business in the ordinary course, as if no charge has been created. Thus, the company deals with its property so charged in any manner it likes until the charge "attaches" or becomes "fixed" or "crystallises".

Characteristics of a floating charge **:** The characteristics of a floating charge are :

1. it is a charge on a class of assets, present and future;
2. the class of assets charged is one which in the ordinary course of business, is changing from time to time;
3. until some steps are taken to enforce the charge, the company may continue to deal with the assets charged in the ordinary course of business.

No particular form of words is necessary to create a floating charge. Any words which show an intention to allow the company to continue to deal with the assets by sale, lease, mortgage, etc., in the course of its business will create a floating charge. The advantage of such charge is that the company may continue to deal with the property charged.

In *Government Stock Co.* v. *Manila Railway* [1897] A.C. 81, Lord Macnaughten observed : "A floating security is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying conditions in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking ceases to be a going concern or until the person in whose favour the charge is created, intervenes. This right to intervene may of course, be suspended by agreement. But, if there is no agreement of suspension, he may exercise his right whenever he pleases after default."

Whether a charge is a fixed or a floating charge will depend upon the words used in the document creating the charge; the essence of floating charge being the freedom of the borrower to use the assets charged, in the ordinary course of its business. It can even create a specific mortgage of the property, already subject to a floating charge, without the consent of the holders of the charge, and the registered mortgagee shall have priority over the charge - *Wheatley* v. *Sibstone Co.* [1885] 29 Ch.D. 715. But, a company cannot create a further floating charge on the same assets to rank in priority to or *pari passu* with the existing charge unless such power has been reserved by the company - *Re Benjamin Cope & Sons* [1914] 1 Ch. 800. Before crystallisation of the floating charge, a company may even sell the whole of the undertaking if that is one of the objects specified in the memorandum - *Re Borax Co.* [1901] 1 Ch. 326. But "a floating charge is not a future security, it is a present security which presently affects all the assets of the company expressed to be included in it. . . . (However) . . . . the holder cannot affirm that the assets are specifically mortgaged to him" - *Evans* v. *Rival Granite Quarries* [1910] 2 K.B. 979. Where, however, a specific charge is made expressly subject to floating charge, the former is postponed as from the date when the latter is crystallised - *Re Robert Stephenson & Co. Ltd.* [1913] 107 L.T. 33.

A floating charge can be created only by an incorporated body. It is created by a deed and must be registered with the Registrar of Companies.

Crystallisation of a floating charge: Lord Macnaughten in *Illingworth* v. *Holdsworth* (1904) A.C. 355 observed : "A floating charge is ambulatory and shifting in its nature

hovering over and so to speak floating with the property which it is intended to affect until some event occurs or act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp."

When the floating charge crystallises it becomes fixed and the assets comprised therein are subject to the same restrictions as the fixed charge. It was said in *Maturi U. Rao* v. *Pendyala* AIR 1970 A.P. 225, "the essence of a floating charge is that the security remains dormant until it is fixed or crystallised."

A floating charge crystallises and the security becomes fixed in the following cases :—

(*a*) when the company goes into liquidation;

(*b*) when the company ceases to carry on the business;

(*c*) when the creditors or the debenture-holders take steps to enforce this security, *e.g.*, by appointing receiver to take possession of the property charged;

(*d*) on the happening of the event specified in the deed.

In the aforesaid circumstances, the floating charge is said to become fixed or to crystallise. Until the charge crystallises or attaches or becomes fixed the company can deal with the property so charged in any manner it likes. The company may even sell its whole undertaking if that is otherwise permissible as per the objects specified in the memorandum.

Although a floating charge is a present security, yet it leaves the company free to create a specific mortgage on its property having priority over the floating charge. In *Government Stock Investment Co. Ltd.* v. *Manila Railway Co. Ltd.* [1897] A.C. 81, the debentures created a floating charge. Three months' interest became due but the debenture-holders took no steps and so the charge did not crystallise but remained floating. The company then made a mortgage of a specific part of its property. *Held*, the mortgagee had priority. The debentures remained merely a floating security as the debenture-holders had taken no steps to enforce their security.

Effects of winding-up on floating charge **(Section 332)**

Where a company is being wound-up, a floating charge on the undertaking or property of the company created within 12 months immediately preceding the commencement of the winding-up shall be void unless :

1. the company was solvent immediately after the charge was created, and
2. the amount was paid to the company in cash at the time of or subsequently to the creation of, and in consideration for, the charge together with interest on that amount at the rate of 5 per cent per annum or such other rate as may be notified by the Central Government.

The object of the above provision is to prohibit insolvent companies from creating any floating charge on their assets with a view to secure past debts to the prejudice of unsecured creditors.

12.2-5 Registration of charges (Sec. 77)

A company having power to borrow money is empowered also to create a charge on its assets, subject however, to any limitations in its Memorandum or Articles.

Even uncalled capital may be charged but for this purpose the company's Articles must give the power and there must be nothing in the Memorandum to the contrary.

A holder of a debenture issued against charge on an immovable property does not acquire an interest in the property concerned.

Further, section 77 requires a company creating a charge within or outside India, on its property or assets or any of its undertakings, whether tangible or otherwise, and situated in or outside India, to register the particulars of the charge together with the instruments, if any, creating such charge. The particulars of the charge shall be signed by the company and the charge-holder.

The company must file the particulars of the charge with the Registrar within thirty days of its creation. It shall be filed in the prescribed form along with the prescribed fees and in the prescribed manner.

In A.P. State Financial Corpn. v. *Guruvayurappan Swamy Oils, Foods and Fats Ltd. (In Liquidation)* [2011] 16 taxmann.com 102 (AP), the High Court of Andhra Pradesh held that no further charge is required to be placed with ROC for interest due on term loans for which charge had already been created.

However, as per the Companies (Amendment) Act, 2019, the Registrar, with payment of additional fees, may allow:

(*a*) ***Charges created before commencement of Ordinance, i.e., 2 November, 2018*** - To register charges within 300 days of such creation and in case the charge is not registered within this time, then the charge shall be registered within 6 months from the date of commencement of Ordinance.

(*b*) ***Charges created after commencement of Ordinance, i.e., 2nd November, 2018*** - To register charges within 60 days of such creation. In case the charge is not registered within this time, then RoC may on application, allow the registration of the charge within a period of further 60 days on payment of *ad valorem* fees.

If registration is not made within a period of three hundred days of such creation, the company shall seek extension of time in accordance with section 87 by filing an application with the Central Government.

But, where liquidation of a company is imminent at time of application for granting extension for filing particulars of charges accorded on its assets, application should be refused [*Karnataka Telecom Ltd.* v. *Ravi Constructions, Engineers and Contractors* [2000] 28 SCL 289 (CLB - Chennai)].

However, any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered. Thus, the charge before the same is actually registered shall not be void against a purchaser of the properties charged.[6]

As per the amendment made by the Companies (Amendment) Act, 2017, the aforesaid provisions of section 77 shall not apply to such charges as may be prescribed in consultation with RBI.

On registration of the charge, the Registrar shall issue a certificate of registration of such charge in such form and in such manner as may be prescribed to the

6. *State Bank of India* v. *Vishwanirayat (P.) Ltd.* [1987] 3 Comp. L.J. 171; [1989] Comp. Cas. 698.

company and, as the case may be, to the person in whose favour the charge is created [Section 77(2)].

Who should effect registration **:** Where a company fails to register the charge within the period of 30 days as specified in section 77, without prejudice to its liability in respect of any offence under this Chapter, the person in whose favour the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge, within such time and in such form and manner as may be prescribed and the Registrar may, on such application, within a period of fourteen days after giving notice to the company, unless the company itself registers the charge or shows sufficient cause why such charge should not be registered, allow such registration on payment of such fees, as may be prescribed [Section 78]. The person so effecting the registration shall be entitled to recover from the company the amount of any fees or additional fees paid by him to the Registrar for the purpose of registration of charge.

Effects of non-registration **-** In case a registrable charge is not registered within the prescribed time and a certificate of registration of such charge is not given by the Registrar, it shall become void (*i*) against the liquidator, and (*ii*) any creditor of the company [Sec. 77(3)].

In *Deutsche Bank* v. *S.P. Kale* [1999] 20 SCL 340 (Bom.), it was held that where in respect of overdraft facility granted by plaintiff-bank to the company, charged on company's movables and book debts, prescribed particulars of charge were not filed with ROC within 30 days after its creation and plaintiff bank had not moved for condonation of delay in filing charge, the said charge would be void by virtue of the first proviso to section 125 [now section 77(3)] of the Act against the Official Liquidator and no relief could be granted in respect of the same against the Official Liquidator.

(2) The debt, in respect of which the charge was created remains valid, that is, it can always be recovered as an unsecured debt [Sec. 77(4)].

(3) The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to ten lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both [Section 86].

As per the Companies (Amendment) Act, 2019, wilful furnishing of false or incorrect information or knowingly suppressing any material information pertaining to registration of charges shall be liable to fraud and attract action under section 447.

Date of notice of charge (Sec. 80) **:** Where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration. *For example,* if a charge was created by company A on its building in favour of X and the charge was registered, then 'Y' the buyer of the building at a subsequent date will be deemed to have notice of the charge.

12.2-6 Register of charges to be kept by Registrar [Sec. 81]

The Registrar shall, in respect of every company, keep a register containing particulars of the charges registered with him. The register shall be kept in such form and in such manner as may be prescribed.

Rule 7 of the Companies (Registration of Charges) Rules, 2014 states that the particulars of charges maintained on the Ministry of Corporate Affairs portal (www.mca.gov.in/MCA21) shall be deemed to be the register of charges for the purposes of section 81 of the Act.

A register, as aforesaid, shall be open to inspection by any person on payment of such fees as may be prescribed for each inspection.

12.2-7 The memorandum of satisfaction [Secs. 82 and 83]

On payment or satisfaction of any charge in full, the company must notify the fact to the Registrar within 30 days from the date of such payment or satisfaction.

However, the Registrar may, on an application by the company or the charge holder, allow such intimation of payment or satisfaction to be made within a period of three hundred days of such payment or satisfaction on payment of such additional fees as may be prescribed.

The Registrar shall, on receipt of such intimation, cause a notice to be sent to the holder of the charge calling upon to show cause within a time specified in such notice (but not exceeding 14 days) as to why payment or satisfaction should not be recorded as intimated to the Registrar. If no cause is shown, the Registrar shall order that a memorandum of satisfaction shall be entered in the register of charges kept under section 81.

But if cause is shown, the Registrar shall record a note to that effect in the Register, and shall inform the company that he has done so.

However, the notice, as aforesaid, shall not be required to be sent, in case the intimation to the Registrar in this regard is in the specified form and signed by the holder of charge.

Power of Registrar to make entries of satisfaction and release in absence of intimation from the company [Section 83]- Again, section 83(1) provides that the Registrar may, on evidence being given to his satisfaction with respect to any registered charge,—

(*a*) that the debt for which the charge was given has been paid or satisfied in whole or in part; or

(*b*) that part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking,

enter in the register of charges a memorandum of satisfaction in whole or in part, or of the fact that part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking, as the case may be, notwithstanding the fact that no intimation has been received by him from the company.

The Registrar shall inform the affected parties within thirty days of making the entry in the register of charges kept under sub-section (1) of section 81.

12.2-8 Rectification by Central Government in register of charges [Sec. 87]

Section 87, *as amended by the Companies (Amendment) Act, 2019* provides that the Central Government on being satisfied that—

(*a*) the omission to give intimation to the Registrar of the payment or satisfaction of a charge, within the time required under this Chapter; or

(*b*) the omission or misstatement of any particulars, in any filing previously made to the Registrar with respect to any charge or modification thereof or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83,

was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company, it may, on the application of the company or any person interested and on such terms and conditions as it deems just and expedient, direct that the time for the giving of intimation of payment or satisfaction shall be extended or, as the case may require, that the omission or misstatement shall be rectified.

The Central Government is not empowered to go into the validity of a charge [*Times Bank Ltd.* v. *Sri Sharada Textiles Ltd.* [2000] 27 SCL 381 (CLB - Chennai)]. However, an application of a kind permitted under section 141 [Now section 87] cannot be received after an order of winding-up of concerned company has been made - *ICICI Ltd.* v. *Official Liquidator of Usha Automobiles of Engg. Co. Ltd. (In Liquidation)* [2009] 89 SCL 55 (Cal.).

Where the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

12.2-9 Company's register of charges[7] [Sec. 85]

Every company shall keep at its registered office a register of charges in such form and in such manner as may be prescribed, which shall include therein all charges and floating charges affecting any property or assets of the company or any of its undertakings, indicating in each case the prescribed particulars.

A copy of the instrument creating the charge shall also be kept at the registered office of the company along with the register of charges.

Inspection of the register of charges and instrument of charges - The register of charges and instrument of charges, kept under sub-section (1) shall be open for inspection during business hours—

(*a*) by any member or creditor without any payment of fees; or

(*b*) by any other person on payment of such fees as may be prescribed, subject to such reasonable restrictions as the company may, by its articles, impose.

12.2-10 Modification of charges

As per section 79 of the Act, whenever the terms or conditions, or the extent or operation, of any charge registered are modified, it shall be the duty of the company

7. For a detailed discussion *register of charges, see Para 11.4*

to send to the Registrar the particulars of such modification in the same manner as are applicable for registration of a charge under section 77 [Discussed above].

12.3 Debentures

12.3-1 Meaning and definition

Section 2(*30*) of the Companies Act, 2013 defines the term 'debenture' as follows:

> *"Debenture includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not."*

However, as per Companies (Amendment) Act, 2017, (*a*) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and (*b*) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company, shall not be treated as debenture.

If we go by the aforesaid definition of 'debenture', bills of exchange or other negotiable instruments, deeds of covenant and many other documents in which a company stipulates to pay a sum of money will also qualify to be called as debentures. But, as Palmer rightly puts it, commercial men and lawyers would certainly not use this term when referring to such instruments.

The term 'debenture' is not a technical term. Lindley J.* in *British India, etc. Co.* v. *IRC* [1881] 7 QBD 165 observed :

> "…. What the correct meaning of debenture is I do not know. I do not find anywhere any precise definition of it. We know that there are various kinds of instruments commonly called debentures. You may have mortgage debentures, which are charges of some kind on property. You may have debentures which are bonds;. . .You may have a debenture which is nothing more than an acknowledgement of indebtedness. And you may have a thing like this, which is something more; it is a statement by two directors that the company will pay a certain sum of money on a given day, and will also pay interest half-yearly at certain times and at a certain place, upon production of certain coupons by the holder of the instrument."

According to Chitty, J. : "Debenture means a document which either creates a debt or acknowledges it, and any document which fulfils either of those conditions is a debenture - *Levy* v. *Abercorris Co.* [1888] 37 Ch. D. 260-264.

According to Gower, L.C.B.,* "Debenture is a name applied to certain types of documents evidencing an indebtedness which is normally but not necessarily secured by a charge over property".

Thus, the term 'debenture' simply means a document acknowledging a loan made to the company and providing for the payment of interest on the sum borrowed until the debenture is redeemed, *i.e.,* the repayment of the principal sum. It may or may not be under seal and so does not necessarily imply that any charge is given on the company's assets, though such a charge usually exists.

The meaning of the term 'debenture' is thus very wide, it would go too far to assert that every document creating or acknowledging an indebtedness of the company is a debenture, commercial men and lawyers would certainly not use this term when referring to bills of exchange or other negotiable instruments, deeds of covenant and many other documents in which a company stipulates to pay a sum of money [*Palmer's Company Law,* 1987 edn., para 44-03].

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*Section 44.

12.3-2 Characteristic features of a debenture

The characteristic features of a debenture are as follows :

1. It is a movable property.
2. It is issued by the company and is in the form of a certificate of indebtedness.
3. It usually specifies the date of redemption. It also provides for the re-payment of principal and interest at specified date or dates.
4. It generally creates a charge on the undertaking or undertakings of the company.

Usually the words *'pari passu'* appear in the terms and conditions of debentures. This means that all the debentures of a particular class will receive the money proportionately in case the company is unable to discharge the whole obligation. In the absence of this clause the debenture-holders would rank in accordance with the rank of the issue and if issued on the same date then in the order of time when they were issued (which is known by the serial number of the debenture).

12.3-3 Debenture stock

A company, instead of issuing individual debentures, evidencing separate and distinct debts, may create one loan fund known as "debenture-stock" divisible among a class of lenders each of whom is given a debenture-stock certificate evidencing the parts of the whole loan to which he is entitled.

This debenture-stock, which is analogous to the loan stocks of Governments and local and public authorities, is then the indebtedness itself, and the certificate evidences the stockholder's interest in it. A consequence of the distinction is that whereas a debenture is a single thing which can be legally transferred only as one entity, debenture-stock can be sub-divided and transferred in any fractions which the holder wishes. One more distinction between the two is that while "debenture-stock" must be fully paid, debenture may or may not be fully paid.

However, for the purposes of the Companies Act, 'debenture' includes 'debenture-stock'.

12.3-4 Distinction between 'shareholder' and 'debenture-holder'

The points of distinction between 'shareholder' and 'debenture-holder' may be noted as follows :

1. A shareholder is a member of the company. A debenture-holder is a lender to the company.
2. A shareholder has a right to vote. A debenture-holder does not enjoy such a right. Sub-section (2) of Section 71 of the Companies Act, 2013 declares that no company shall issue any debentures carrying voting rights. "Voting right" means the right of a member of a company to vote in any meeting of the company or by means of postal ballot[8].
3. Income on shares depends on the profits. Shareholders are entitled to get dividend only out of profits. Debentureholders are entitled to a fixed rate of interest which the company must pay irrespective of profits, *i.e.*, profits or no profits.

8. Section 2(*93*) of the Companies Act, 2013.

4. In the event of winding-up, shareholders cannot claim payment unless all outside creditors have been paid in full. Debenture-holders, normally being secured lenders, have prior claim for repayment.
5. Dividend on shares is not a charge against profit. Interest on debentures, on the other hand, is a charge against the profits and is deducted from revenues for the purpose of calculating tax liability.

12.3-5 Issue of debentures

Debentures are commonly issued in a similar manner as shares by means of a prospectus inviting applications, the money being usually payable by instalments on application, allotment and on specified dates.

Time within which Debenture certificate to be issued

Section 56(4) of the Companies Act, 2013 provides that the debenture certificate must be issued to the allottee within a period of six months from the date of allotment.

In case of default, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees [Section 56(6)].

Section 71 of the Companies Act, 2013 contains the following provisions with respect to issue of debentures:

(1) A company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption provided the same is approved by a special resolution passed at a general meeting.

(2) No company shall issue any debentures carrying any voting rights.

(3) Secured debentures may be issued by a company subject to such terms and conditions as may be prescribed.

As per Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 *as amended* vide *notification No. G.S.R. 704(E) dated 19th July, 2016*, only secured redeemable debentures can be issued and that too subject to the following conditions, namely:

(*a*) An issue of secured debentures may be made, provided the date of its redemption shall not exceed ten years from the date of issue. However, the following classes of companies may issue secured debentures for a period exceeding ten years but not exceeding thirty years :

(*i*) Companies engaged in setting up of infrastructure projects;

(*ii*) 'Infrastructure Finance Companies' as defined in clause (*viia*) of sub-direction (1) of direction 2 of Non-Banking Financial (Non-Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

(*iii*) 'Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (*b*) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011.

(*iv*) Companies permitted by a Ministry or Department of the Central Government or by RBI or by National Housing Bank or by any other statutory authority.

(*b*) such an issue of debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associates companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon;

(*c*) the company shall appoint a debenture trustee[9] before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest of the debenture holders ; and

(*d*) the security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on—

(*i*) any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise;

(*ii*) any specific immovable property wherever situate, or any interest therein.

(4) Where debentures are issued by a company under this section, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilised by the company except for the redemption of debentures.

Debenture Redemption Reserve (DRR) - As per Rule 18(7) of the Companies (Share Capital and Debentures) Rules, 2014 the company shall create a Debenture Redemption Reserve for the purpose of redemption of debentures, in accordance with the conditions given below—

(*a*) the Debenture Redemption Reserve shall be created out of the profits of the company available for payment of dividend;

(*b*) the company shall create Debenture Redemption Reserve (DRR) in accordance with following conditions:—

(*i*) No DRR is required for debentures issued by All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies for both public as well as privately placed debentures. For other Financial Institutions (FIs) within the meaning of clause (*72*) of section 2 of the Companies Act, 2013, DRR will be as applicable to NBFCs registered with RBI.

(*ii*) For NBFCs registered with the RBI and for Housing Finance Companies registered with the National Housing Bank 'the adequacy' of DRR will be 25% of the value of outstanding debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities) Regulations, 2008, and no DRR is required in the case of privately placed debentures.

9. For a detailed discussion on 'Debenture Trustee', see Para 12.4-7.

(*iii*) For other companies including manufacturing and infrastructure companies, the adequacy of DRR will be 25% of the value of outstanding debentures issued through public issue as per present SEBI (Issue and Listing of Debt Securities), Regulations 2008 and also 25% DRR is required in the case of privately placed debentures by listed companies. For unlisted companies issuing debentures on private placement basis, the DRR will be 25% of the value of outstanding debentures.

However, where a company intends to redeem its debentures prematurely, it may provide for transfer of such amount in Debenture Redemption Reserve as is necessary for redemption of such debentures even if it exceeds the limits specified in this sub-rule.

(*c*) every company required to create Debenture Redemption Reserve shall on or before the 30th day of April in each year, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent, of the amount of its debentures maturing during the year ending on the 31st day of March of the next year, in any one or more of the following methods, namely:—

(*i*) in deposits with any scheduled bank, free from any charge or lien;

(*ii*) in unencumbered securities of the Central Government or of any State Government;

(*iii*) in unencumbered securities mentioned in sub-clauses (*a*) to (*d*) and (*ee*) of section 20 of the Indian Trusts Act, 1882;

(*iv*) in unencumbered bonds issued by any other company which is notified under sub-clause (*f*) of section 20 of the Indian Trusts Act, 1882;

(*v*) the amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above:

Provided that the amount remaining invested or deposited, as the case may be, shall not at any time fall below fifteen percent of the amount of the debentures maturing during the year ending on the 31st day of March of that year;

(*d*) in case of partly convertible debentures, Debenture Redemption Reserve shall be created in respect of non- convertible portion of debenture issue in accordance with this sub-rule.

(*e*) the amount credited to the Debenture Redemption Reserve shall not be utilised by the company except for the purpose of redemption of debentures.

(5) No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees[10].

10. For a detailed discussion on 'Debenture Trustee', see Para 12.4-7.

(6) A debenture trustee shall take steps to protect the interests of the debenture-holders and redress their grievances in accordance with the prescribed rules.

(7) Any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void insofar as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

However, the liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

(8) A company shall pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

(9) Where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

(10) Where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

(11) If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both.

(12) A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

(13) The Central Government may prescribe the procedure, for securing the issue of debentures, the form of debenture trust deed, the procedure for the debenture-holders to inspect the trust deed and to obtain copies thereof, quantum of debenture redemption reserve required to be created and such other matters.

The Rules framed in this regard, *inter alia* provide :

(*a*) A trust deed in Form No. SH.12 or as near thereto as possible shall be executed by the company issuing debentures in favour of the debenture trustees within three months of closure of the issue or offer.

(*b*) A trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company.

A copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within seven days of the making thereof, on payment of fee.

Provisions of Rule 18, as discussed above, shall not apply to rupee denominated bonds issued exclusively to overseas investors*.

12.3-6 Kinds of debentures

Debentures may be of the following kinds:

(*i*) ***Bearer debentures*** - Bearer debentures are similar to share warrants in that they too are negotiable instruments, transferable by delivery.

According to Perrins and Jeffreys, "By making debentures payable to bearer they are invested with the character of a negotiable instrument, so as :

1. to make them transferable free from equities;
2. to render the delivery of a debenture and any interest coupon a good discharge to the company;
3. to enable the bearer to sue the company in his own name, if necessary;
4. to ensure a good title to any person who acquires the debenture *bona fide* for valuable consideration, notwithstanding any defect in the title of the person from whom he acquires it."

The interest on 'bearer debentures' is paid by means of attached coupons. On maturity, the principal sum is paid to the bearers.

(*ii*) ***Registered debentures*** - These are debentures which are payable to the registered holders, *i.e.*, persons whose names appear in the Register of debentureholders. Such debentures are transferable in the same way as shares or in accordance with the conditions endorsed on their back. The debenture itself consists of two parts:

(*a*) The covenants by the company to pay the principal and interest, and

(*b*) The endorsed conditions, *e.g.*, the term of the loan.

The endorsed conditions vary, but they normally contain a provision that the debenture is one of a series all ranking *pari passu*. Where debentures rank *pari passu*, they will be discharged in proportion to the amount due in respect both of capital and interest, *i.e.*, in the event of a deficiency of assets, if the interest on some debentures is paid down to a later date than others, the interest due on each is added to the capital thereof, and a proportionate

*W.e.f. 12-8-2016.

distribution of the assets made. If there were no such provision, the debentures would rank in the order of issue regarding the assets charged by the company.

(*iii*) ***Perpetual or irredeemable debentures*** - A debenture which contains no clause as to payment or which contains a clause that it shall not be paid back is called a perpetual or irredeemable debenture. Though irredeemable debentures were allowed under Section 120 of the Companies Act, 1956, no corresponding provision has been made under the Act of 2013. Thus, no fresh irredeemable debentures may be issued by the companies.

(*iv*) ***Redeemable debentures*** - Redeemable debentures are to be redeemed as per the terms of the issue. Section 71 and the rules framed thereunder regulate issue of such debentures and the same have been discussed in the aforesaid paragraphs.

(*v*) ***Naked debentures*** - Normally, debentures are secured by a mortgage or a charge on the company's assets. However, debentures may be issued without any charge on the assets of the company. Such debentures are called 'Naked or unsecured debentures'. They are mere acknowledgements of a debt due from the company, creating no rights beyond those of ordinary unsecured creditors. Unsecured debentures are treated as deposits and should, therefore, conform to requirements applicable to public deposits accepted by a company.

(*vi*) ***Convertible debentures*** - A company may also issue convertible debentures, in which case an option is given to the debenture-holders to convert them into equity or preference shares at stated rates of exchange, after a certain period. Section 71 requires the company to pass a special resolution for issue of convertible debentures whether wholly or partly. Such **debentures once converted into shares cannot be reconverted into debentures.**

According to convertibility, debentures are further classified into three categories :

1. Fully Convertible Debentures (FCDs)
2. Non-Convertible Debentures (NCDs)
3. Partly Convertible Debentures (PCDs).

Fully convertible debentures **:** Fully convertible debentures are those debentures that are converted into equity shares of the company on the expiry of specified period or periods. Where the conversion is to be made at or after 18 months from the date of allotment but before 36 months, the conversion is optional on the part of the debenture holders in terms of SEBI guidelines.

Non-convertible debentures **:** Non-convertible debentures are those debentures that do not confer any option on the holder to convert the debentures into equity shares and are redeemed at the expiry of a specified period(s).

Partly convertible debentures **:** Partly convertible debenture consists of two parts, *viz.*, convertible and non-convertible. The convertible portion(s) is/are convertible into equity shares at the expiry of specified period(s). Non-convertible portion, on the other hand, is redeemed at the expiry of a certain period(s). Where the

conversion takes place at or after 18 months, as per SEBI's guidelines, the conversion is optional at the discretion of the debenture-holder.

Features of convertible debentures **:** The main features of convertible debentures may be noted as follows :

1. The debentures are converted into specified or unspecified number of equity shares at the end of a specified period. The ratio at which the convertible debentures are exchanged for equity shares is known as conversion price or conversion ratio. Conversion ratio is worked out by dividing the face value of a convertible debenture by its conversion price. *For example,* if the face value of the convertible debenture is Rs. 100 and it is convertible into two equity shares of Rs. 10 each, the conversion price is Rs. 50 and the conversion ratio is 2. Since the difference between the conversion price and the face value of the equity share is Rs. 40, the conversion premium per share is Rs. 40.
2. Convertible debentures may be fully or partly convertible. In case of fully convertible debentures, the entire face value is converted into equity shares at the expiry of certain period(s).

   In case of partly convertible debentures, the convertible portion is converted into equity shares at the expiry of certain period(s), and the non-convertible portion is redeemed at the expiry of certain period.
3. Convertible debentures, whether fully or partly convertible, may be converted into equity shares at the end of specified period or periods in one or more stages.

   In terms of SEBI guidelines, fully convertible debentures, with a conversion period of more than 36 months can be issued only with put and call option. If the conversion is at or after 18 months, but within 36 months, conversion will be at the option of the debenture-holder; otherwise, conversion is compulsory. The premium amount, if any, should be determined at the outset and the lower and the upper limits of premium should be stated in the offer document.
4. If one or more parts of debentures are convertible after 18 months, the company should get a credit rating of debentures done by a credit rating agency.
5. Interest on debentures may be paid as per the market forces. With effect from 1-8-1991 interest rates on debentures have been de-regulated and companies are permitted to pay any interest they consider reasonable. Debentures can also be issued as zero interest debentures where no interest is payable on the debentures.
6. Convertible debentures are listed on the stock exchanges. However, in practice, convertible debentures are not actively traded in the stock exchanges in India excepting those of reputed companies.

12.3-7 Debenture trust deed

When debentures are issued for public subscription, involving a considerable number of debenture-holders, it is not feasible to create a separate charge in favour

of thousands of debenture-holders. Therefore, the most common and convenient form of securing them is to execute a Trust Deed conveying the property of the company to the trustees and declaring a trust in favour of the debenture-holders. A trust deed normally grants the trustees a fixed charge over the company's freeholds and leaseholds and a floating charge over the rest of the property.

The trust deed contains the terms and conditions endorsed on the debentures and defines the rights of the debenture-holders and the company. A trust deed normally contains clauses giving the trustees the following powers:

1. To take a mortgage over the company's property in which case the title deeds are transferred to them and the company is thereafter prevented from creating further charges ranking in priority to debentures.
2. To sell or lease the property and to renew leases.
3. To exchange the mortgaged property for other suitable property.
4. To modify subsisting contracts applying to any part of the property.
5. To compromise claims.
6. To commence and defend actions.
7. To appoint a receiver on the security becoming enforceable.

The advantage of trust deed is that it becomes the function of the trustees to watch the interest of the debenture-holders who are bound to act honestly and with due care and diligence. In fact, any clause in the trust deed exempting them from liability for breach of their duty as trustees or which indemnifies them against liability is void.

Other advantages are :

1. The trustees have a legal mortgage over the company's property, so that persons who subsequently lend money to the company cannot gain priority over the debenture-holders.
2. If and when, the company makes a default, the trustees can take action for enforcing the security on behalf of the debenture-holders.
3. The trustees can ensure that the property is kept insured and properly maintained. It would not be practicable for a large and fluctuating body of debenture-holders to do this.

The Companies Act, 2013 *vide* Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 contains the following provisions in this regard:

1. Appointment of Debenture Trustee: The company shall appoint a debenture trustee before the issue of prospectus or letter of offer for subscription of its debentures and not later than sixty days after the allotment of debentures, execute a debenture trust deed in Form No. SH.12 or as near thereto as possible to protect the interest of the debenture holders.

2. Creation of Security: The security for the debentures by way of a charge or mortgage shall be created in favour of the debenture trustee on—

(*i*) any specific movable property of the company (not being in the nature of pledge); or

(*ii*) any specific immovable property wherever situate, or any interest therein.

3. Consent of Debenture Trustee: (a) the names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;

(b) before the appointment of debenture trustee or trustees, a written consent shall be obtained from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of debentures;

4. Disqualifications of Debenture Trustee: A person shall not be appointed as a debenture trustee, if he—

(*i*) beneficially holds shares in the company;

(*ii*) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(*iii*) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(*iv*) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(*v*) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(*vi*) has any pecuniary relationship with the company amounting to two per cent or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(*vii*) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.

5. Casual Vacancy in the office of Debenture Trustee: The Board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act. However, where such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.

6. Removal of Debenture Trustee: Any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three-fourth in value of the debentures outstanding, at their meeting.

7. Duties of Debenture Trustee: It shall be the duty of every debenture trustee to—

(*a*) satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed;

(*b*) satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;

(*c*) call for periodical status or performance reports from the company;

(*d*) communicate promptly to the debenture holders defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor;

(*e*) appoint a nominee director on the Board of the company in the event of—

(*i*) two consecutive defaults in payment of interest to the debenture holders; or

(*ii*) default in creation of security for debentures; or

(*iii*) default in redemption of debentures.

(*f*) ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach;

(*g*) inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;

(*h*) ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;

(*i*) ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;

(*j*) do such acts as are necessary in the event the security becomes enforceable;

(*k*) call for reports on the utilization of funds raised by the issue of debentures;

(*l*) take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;

(*m*) ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;

(*n*) perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

8. Meeting of Debenture-holders: The meeting of all the debenture holders shall be convened by the debenture trustee on—

(*a*) requisition in writing signed by debenture holders holding at least one-tenth in value of the debentures for the time being outstanding;

(*b*) the happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

9. The provisions of sub-rules (2) to (5) of rule 18 shall not be applicable to the public offer of debentures.

12.3-8 Rights/Remedies of debenture-holders

As per Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014, the Debenture Trustee shall communicate promptly to the debenture-holders defaults,

if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor. Besides, he will appoint a nominee director on the Board of the company in the event of two consecutive defaults in payment of interest to the debenture holders or default in redemption of debentures.

Again, section 71 provides that where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon [Section 71(10)].

If any default is made in complying with the order of the Tribunal under this section, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than two lakh rupees but which may extend to five lakh rupees, or with both [Section 71(11)].

12.3-9 SEBI Regulations, 2009 pertaining to convertible debt instruments[11]

In addition to the requirements laid down in SEBI Regulations, 2009 relating to Issue of Capital and Disclosure Requirements[12] an issuer making a public issue or rights issue of convertible debt instruments must comply with the following conditions:

(*a*) it has obtained credit rating from one or more credit rating agencies;

(*b*) it has appointed one or more debenture trustees in accordance with the provisions of section 71 of the Companies Act, 2013 and Securities and Exchange Board of India (Debenture Trustees) Regulations, 1993;

(*c*) it has created debenture redemption reserve in accordance with the provisions of section 71 of the Companies Act, 2013 and the rules made thereunder;

(*d*) if the issuer proposes to create a charge or security on its assets in respect of secured convertible debt instruments, it shall ensure that:

  (*i*) such assets are sufficient to discharge the principal amount at all times;

  (*ii*) such assets are free from any encumbrance;

  (*iii*) where security is already created on such assets in favour of financial institutions or banks or the issue of convertible debt instruments is proposed to be secured by creation of security on a leasehold land, the consent of such financial institution, bank or lessor for a second or *pari passu* charge has been obtained and submitted to the debenture trustee before the opening of the issue;

  (*iv*) the security/asset cover shall be arrived at after reduction of the liabilities having a first/prior charge, in case the convertible debt instruments are secured by a second or subsequent charge.

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11. Sections pertaining to the Act of 1956 have been replaced with the sections of the Companies Act, 2013.

12. For SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 see Para 9.6-1.

(2) The issuer shall redeem the convertible debt instruments in terms of the offer document.

Roll Over of non-convertible portion of partly convertible debt instruments - (1) The non-convertible portion of partly convertible debt instruments issued by a listed issuer, the value of which exceeds fifty lakh rupees, may be rolled over without change in the interest rate, subject to the following conditions:

(*a*) seventy five per cent of the holders of the convertible debt instruments of the issuer have, through a resolution, approved the rollover through postal ballot;

(*b*) the issuer has, along with the notice for passing the resolution, sent to all holders of the convertible debt instruments, an auditors' certificate on the cash flow of the issuer and with comments on the liquidity position of the issuer;

(*c*) the issuer has undertaken to redeem the non-convertible portion of the partly convertible debt instruments of all the holders of the convertible debt instruments who have not agreed to the resolution;

(*d*) credit rating has been obtained from at least one credit rating agency registered with the Board within a period of six months prior to the due date of redemption and has been communicated to the holders of the convertible debt instruments, before the rollover;

(2) The creation of fresh security and execution of fresh trust deed shall not be mandatory if the existing trust deed or the security documents provide for continuance of the security till redemption of secured convertible debt instruments :

Provided that whether the issuer is required to create fresh security and to execute fresh trust deed or not shall be decided by the debenture trustee.

Conversion of Optionally Convertible Debt Instruments into Equity Share Capital - (1) An issuer shall not convert its optionally convertible debt instruments into equity shares unless the holders of such convertible debt instruments have sent their positive consent to the issuer and non-receipt of reply to any notice sent by the issuer for this purpose shall not be construed as consent for conversion of any convertible debt instruments.

(2) Where the value of the convertible portion of any convertible debt instruments issued by a listed issuer exceeds fifty lakh rupees and the issuer has not determined the conversion price of such convertible debt instruments at the time of making the issue, the holders of such convertible debt instruments shall be given the option of not converting the convertible portion into equity shares:

Provided that where the upper limit on the price of such convertible debt instruments and justification thereon is determined and disclosed to the investors at the time of making the issue, it shall not be necessary to give such option to the holders of the convertible debt instruments for converting the convertible portion into equity share capital within the said upper limit.

(3) Where an option is to be given to the holders of the convertible debt instruments in terms of sub-regulation (2) and if one or more of such holders do not exercise the

option to convert the instruments into equity share capital at a price determined in the general meeting of the shareholders, the issuer shall redeem that part of the instruments within one month from the last date by which option is to be exercised, at a price which shall not be less than its face value.

(4) The provision of sub-regulation (3) shall not apply if such redemption is in terms of the disclosures made in the offer document.

Issue of Convertible Debt Instruments for Financing - No issuer shall issue convertible debt instruments for financing replenishment of funds or for providing loan to or for acquiring shares of any person who is part of the same group or who is under the same management:

Provided that an issuer may issue fully convertible debt instruments for these purposes if the period of conversion of such debt instruments is less than eighteen months from the date of issue of such debt instruments.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/PE-II/IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. "All investments made by a company must be held by it in its own name". Are there any exceptions to this rule.
2. Discuss the provisions of the Companies Act, 2013 relating to inter-corporate investments.
3. What are the provisions of the Companies Act, 2013 as regards purchase by a company of shares of other companies ?
4. Discuss the law and state the procedure relating to inter-company loans.
5. State the provisions of the Companies Act, 2013 regarding maintenance of Register of Loans and Investments. What particulars are required to be entered into such register ?
6. What are the legal requirements which a company must comply with while borrowing ?
7. What is *ultra vires* borrowing ? What remedies are open to a lender if a company resorts to *ultra vires* borrowing ?
8. What are the restrictions imposed on the borrowing powers of the Board of Directors ?
9. Distinguish between a 'fixed' and a 'floating' charge.
10. Comment on the characteristics of a floating charge. When does such a charge crystallise into a fixed charge ?

    OR

    When does a 'floating charge' become a 'fixed charge' ?
11. What charges are to be registered under the Companies Act, 2013? What is the effect of non-registration of a registrable charge ?
12. State the provisions of the Companies Act, 2013 with respect to satisfaction of a charge.
13. What is a debenture ? What are the different kinds of debentures that may be issued by a company ?

14. Distinguish between 'Shareholder' and 'Debenture-holder'.

15. Write a short note on : (*i*) Debenture trust deed.

(*ii*) Debenture Redemption Reserve

16. What are the remedies available to debenture-holders for the realisation of their security ?

PRACTICAL PROBLEMS

P.1 ACE Automobiles Limited is a company engaged in the manufacture of Cars. The company's investment in the shares of other bodies corporate and the loans made to other bodies corporate exceed 60 per cent of its paid-up share capital, free reserves and securities premium amount and also 100 per cent of its free reserves and securities premium amount. The company has obtained a term loan from the Industrial Credit and Investment Corporation of India Limited. The company proposes to increase its investment in the equity shares of ACE Forgings Limited from 60 per cent to 70 per cent of the equity share capital of ACE Forgings Limited by purchase of shares from the Forgings Collaborator.

State the legal requirements to be complied with by ACE Automobiles Limited under the Companies Act to give effect to the above proposal. Will your answer be different if the company has defaulted in repayment of matured deposits accepted from the public.

Hints: As the aggregate of the loans and investments so far made by ACE Automobiles Ltd. exceeds 60% of the paid-up share capital, free reserves and securities premium amount; it is necessary for the company to follow the following procedure:

(*i*) Pass a resolution of the Board of directors at a meeting of the Board approved by all the directors present at the meeting [Section 186(5)].

(*ii*) Pass a special resolution in the General Body Meeting [Sub-section (2) of section 186].

(*iii*) Obtain prior approval of ICICI Ltd. since ACE Automobiles Ltd. has obtained the term loan from ICICI Ltd. which is a public financial institution as per section 2(*72*) of the Companies Act, 2013 and, therefore, the provisions of sub-section (5) are also attracted.

(*iv*) Enter the prescribed particulars of the investment in a register within seven days of making the investment [Section 186(9) read along with Rule 12 made thereunder].

In case the company has not repaid the matured public deposits, then the section 186(8) disallows the company to make any inter-company investment till such default is subsisting. Therefore, in such a situation, the company must make good the default before it can give effect to the proposed additional investment in the subsidiary company.

P.2 The Board of Directors of M/s. Greenfield Projects Limited, a company whose shares are listed on the Delhi Stock Exchange proposes to give loans to a sister company in excess of the limit prescribed under section 186(2) of the Companies Act, 2013. The next annual general meeting of the company is due only after six months. Since the Board is anxious to complete the formalities quickly without waiting for the date of next annual general meeting, advise the Board about the steps to be taken to comply with the legal requirements under the Companies Act, 2013.

Hints : As per section 186, following steps shall be necessary:

1. Prior approval by way of unanimous resolution of the Board of directors.
2. Prior approval of concerned public financial institution.
3. Passing of special resolution.
4. Interest must not be lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

5. Enter the prescribed particulars in the Register of Loans and Investments maintained by the company.
6. File copy of the special resolution with ROC within 30 days of its passing (section 117).

P.3 A charge in favour of a public financial institution created by a public company to secure a sum of Rs. 200 crore was not created within the statutory period and the Central Government on an application made by the company did not grant the extension of time. Is it possible to revive the said charge?

Hints: Section 77 provides that every charge created by a company to which the section applies shall so far as any security on the company's property or undertaking is conferred thereby, be void against the liquidator and any creditor of the company, unless the prescribed particulars of the charge, together with the instrument, if any, by which the charge is created or evidenced or a verified copy thereof are filed with the Registrar of Companies within 30 days of its creation. However, on sufficient cause been shown, the Registrar may allow such filing within thirty days next following the expiry of the said 30 days, with additional fees. Section 460 (2) of the Act provides that where any document which is required to be filed with the Registrar under any provision of this Act is not filed within the time specified therein, the Central Government may for reasons to be recorded in writing condone the delay. However, under section 87, the Central Government has been vested with discretionary powers to condone the delay in filing the particulars of charge, or modification or satisfaction thereof in the prescribed time. In view of the specific provisions contained in section 77 and power given to Central Government for condonation of delay under section 87, the Central Government cannot exercise its power under section 460(2). As the Central Government, in the present case, has not granted extension, the charge stands as void and cannot be revived. A new charge may, however, be created.

P.4 Following information is available from the audited Balance Sheet as at 31st March, 2014 of ASK Ltd.:

Share Capital:	*Rs.*
Equity Share Capital (5,00,000 shares of Rs. 10 each fully paid up in cash)	50,00,000
Less: Calls in arrear	50,000
	49,50,000
Preference Share Capital	15,00,000
Share Application Money	10,00,000
Reserves and Surplus:	
Securities Premium	15,00,000
Capital Redemption Reserve	12,00,000
Fixed Assets Revaluation Reserve	10,50,000
Sinking Fund Reserve	11,00,000
General Reserve	40,00,000
Profit and Loss Account	22,00,000
Dividend Equalisation Reserve	6,00,000
Secured Loans:	
Cash Credit facility from Bank	1,00,00,000

You are required to find out, explaining the relevant provisions of the Companies Act, 2013, the amount up to which the Board of Directors can invest in securities of other bodies corporate and/or give loans.

Ans. Inter-company Loans/Investments

- *Ceiling of Loans, Guarantees, Investments, etc* - Section 186 has prescribed a ceiling with respect to inter-company loans and investments. Company shall not, directly or indirectly,—
  - (*a*) make any loan to any other body corporate;
  - (*b*) give any guarantee, or provide security, in connection with a loan made by any other person to, or to any other person by, any body corporate; and
  - (*c*) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

  60 per cent of its paid-up share capital, free reserves and securities premium amount or 100 per cent of its free reserves and securities premium amount, whichever is more.
- Provisions relating to Inter-company Loans/Guarantees, etc. and investments may be grouped under the following two heads:
  - (1) Within the prescribed ceiling
  - (2) Beyond the prescribed ceiling

Within the Prescribed Ceiling

Procedure

1. Pass a resolution at a meeting of the Board of directors with the consent of all the directors present at the meeting.
2. Obtain prior approval of the concerned Public Financial Institution (PFI) where a default has been made in the repayment of the loan or payment of interest to the concerned PFI and the default is subsisting.

Beyond the Prescribed Ceiling

1. Pass a resolution at a meeting of the Board of Directors with the consent of all the directors present at the meeting.
2. Obtain prior approval of the concerned Public Financial Institution (PFI), if any term loan is subsisting and the total amount of loan and investments (including the proposed one) exceeds 60 per cent of its paid-up share capital, free reserves and securities premium amount or 100 per cent of its free reserves and securities premium amount, whichever is more.
3. Obtain prior approval of the shareholders by way of Special Resolution.

In the given case, the total paid up share capital of the company is equal to Rs. 49,50,000 (Equity) + Rs. 15,00,000 (Preference) = Rs. 64,50,000. The total amount of free reserves + Securities Premium; Balance in Profit and Loss Account and Dividend Equalisation Reserve works out to Rs. 83,00,000. Aggregate of paid-up share capital, free reserves and securities premium works out to Rs. 1,47,50,000. 60 per cent of this amounts to Rs. 88,50,000 which is higher than the 100 per cent of free reserves, namely Rs. 83,00,000. *Since company has already borrowed Rs. 1,00,00,000, it shall be required to follow the procedure stated under 'Beyond the ceiling'.*

P.5 Gomez, the chairman of a company, borrowed Rs. 5 lakh from the State Bank of India, Patna, under a promissory note. A suit was filed for the recovery of debts on the basis of the promissory note executed by the chairman. The company refused to accept the liability on the plea that the chairman had borrowed funds without authorization from the company. Will the company succeed? Explain.

Hints : The facts given in the question are based on the case of *Kumar Krishna Rohatgi* v. *State Bank of India* [1980] 50 Comp. Cas. 722. In this case, the company borrowed an amount

of Rs. 5 lakh from the State Bank of India under a promissory note guaranteeing the repayment by executing a guarantee in favour of the company. The promissory note was renewed from time to time. In suit for the recovery, the company contended that the promissory note was executed by the chairman without Board resolution authorizing him to execute the promissory note as required under section 179(3)(*d*) of the Companies Act, 2013. The Patna High Court held that in cases where the directors borrowed funds without proper authorization from the company and the amount borrowed was utilized for the benefit of the company, the company cannot then repudiate its liability to repay, since general law implied a promise to be paid by the principal when the money so borrowed by an agent had gone into the coffins of the principal. Hence, the principal had taken the benefits of the amount borrowed. Hence, the company's contention was rejected by the Patna High Court. Accordingly, the decision shall apply to the case in question *mutatis mutandis*.

13 Divisible Profits and Dividend

13.1 Meaning of Dividend

The dictionary meaning of 'dividend' is "sum payable as interest on loan or as profit of a company to the creditors of an insolvent's estate or an individual's share of it". In commercial usage, however, 'dividend' is the share of the company's profits distributed among the members (*Barjor Hoshangi Vakil* v. *Mettur Chemical & Industrial Corporation Ltd.* [1963] 33 Comp. Cas. 932).

Thus, we may say that corporate earnings and profits not retained in the business, and when distributed among shareholders, are known as 'dividend'.

The term 'dividend' is also used to include distribution of the company's assets, in cash or *in specie,* which remain with the liquidator after he has realised all the assets and discharged all the liabilities, in the event of its winding up.

In *CIT* v. *Girdhar Das & Co. (P.) Ltd.* [1967] 21 Comp. L. J., the Supreme Court defined the expression 'dividend' as follows:

> "As applied to a company which is a going concern, it ordinarily means the portion of the profits of the company which is allocated to the holders of shares in the company.
>
> In the case of winding-up, it means a division of the realised assets among creditors and contributories according to their respective rights."

Section 2(*35*) defines 'dividend' to include any 'interim dividend'.

This definition assumes that the term should be understood only in its commercial sense and has only widened its scope to include "interim dividend".

However, issue of bonus shares by capitalising accumulated profits is not construed as dividend.

The Institute of Chartered Accountants of India has defined 'dividend' as "a distribution to shareholders out of profits or reserves available for this purpose". (*Vide -Guidance Note on Terms used in Financial Statements*).

13.2 Concept of Profit

'Profit' may be defined "as the increase in the net value of the assets of a business over their net value at the commencement of a given period which has arisen other than by capital adjustment".

For an accountant, the profit is the difference between the operating income and the associated outgoings as related to a given period of time. In a business, revenue arises on account of sales, services rendered, and other factors. On the other hand, a number of expenses (salaries, rent, depreciation, etc.) are to be incurred in order to earn the revenue. *The profit is the difference between the revenues and the expenses for a given period.*

13.3 Profits *v.* Divisible Profits

13.3-1 Meaning of Divisible Profits

All the profits of a company cannot be said to be divisible. Only those profits which can legally be distributed to the shareholders of the company in the form of dividend are called as 'divisible profits'. However, specific definition of 'divisible profits' has not been laid down even by the Companies Act.

In *Buenos Ayres Great Southern Rly. Co.*, In re [1947] Ch. 384 'divisible profits' were described to mean the profits which the directors consider should be distributed after making provision for past losses, reserves and for other purposes.

The following four considerations may govern the determination of divisible profits :

- Principles of Accounting,
- Provisions of Memorandum and Articles,
- Provisions of the Companies Act, and
- Legal Decisions.

13.3-2 'Profits available for Distribution' *v.* 'Profits available for dividend'

The term 'profits available for distribution' and 'profits available for dividend' have different meanings and should not be confused. The first term means the maximum profits which the law allows a company to distribute to the shareholders by way of dividend. The latter term implies the profits which the directors consider should be distributed after making provision for past losses, for transfer to reserve or for other purposes.

If the directors have on some fair basis taken a decision as to the proportion of profits which should be distributed by way of dividend, the Courts do not interfere in this matter even if there are larger profits and more dividend could have been paid (*Stewart* v. *Sashalite Ltd.* [1936] 2 All ER 1481). The Courts do not compel directors to declare a dividend against their judgment*.

Lambert v. *New Chatel Asphalt Company* [1852] 51 L.J. Ch. 882.

13.4 Sources out of which dividends may be paid

According to section 123(1) No dividend shall be declared or paid by a company for any financial year[1] except out of:

1. Current profits.
2. Past reserves created out of profits or credit balance in the profit and loss account brought forward.
3. Out of moneys provided by the Central Government or a State Government.

A company which fails to comply with the provisions of sections 73 and 74[2] shall not, so long as such failure continues, declare any dividend [Section 123(6)].

13.4-1 Out of current profits

Dividends may be declared out of the profits of the company for the current year after providing for depreciation as per Schedule II[3]. A company may, however, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.

13.4-2 Out of past reserves

Dividends may be declared out of the profits of the company for any previous financial year or years arrived at after providing for depreciation as per Schedule II and remaining undistributed[3] or out of the reserves. But no dividend shall be declared or paid by a company from its reserves other than free reserves[4].

As per Companies (Declaration and Payment of Dividend) Rules, 2014 [*as amended vide Notification No. G.S.R. (E) dated 12th June, 2014*].

In the event of inadequacy or absence of profits in any year, a company may declare dividend out of surplus subject to the fulfilment of the following conditions*, namely:-

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1. According to section 2(*41*) of Companies Act, 2013 "financial year", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

   Provided that on an application made by a company or body corporate, which is *a holding company or a subsidiary of a company incorporated outside India* and is required to follow a different financial year for consolidation of its accounts outside India, the Tribunal may, if it is satisfied, allow any period as its financial year, whether or not that period is a year:
   Provided further that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.
2. Sections 73 and 74 relate to acceptance of deposits.
3. As per the Companies (Amendment) Act, 2017, in computing profits any amount representing unrealised gains, notional gains or revaluation of assets and any change in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair value shall be excluded.
4. According to Section 2(*43*) of Companies Act, 2013 "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend.

*These conditions shall not apply to a Government company in which entire paid up share capital is held by the Central Government or by any State Government(s) or by the Central Government and State Government(s).

(1) The rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year.

The aforesaid rule shall, however, not apply to a company, which has not declared any dividend in each of the three preceding financial year.

(2) The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.

(3) The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.

(4) The balance of reserves after such withdrawal shall not fall below fifteen per cent of its paid up share capital as appearing in the latest audited financial statement.

(5) *No company shall declare dividend unless carried over previous losses and depreciation not provided in previous year or years are set off against profit of the company of the current year.

13.4-3 Monies provided by Government

A company can also declare dividends out of the monies provided by the Central Government or a State Government for payment of such dividend in pursuance of a guarantee given by that Government.

13.4-4 Depositing dividend declared in a scheduled bank in a separate account

As per sub-section (4) of section 123 any dividend *i.e.*, whether interim or annual, when declared, the amount thereof shall have to be deposited in a separate bank account within five days of declaration**.

13.5 Provision for depreciation

According to section 123, depreciation must be provided before any dividend can be declared out of profits of any financial year.

As to how much depreciation should be provided for determining the divisible profits, section 123(2) provides that depreciation must be provided as per Schedule II.

13.6 Declaration of dividend on preference and equity shares

The Companies Act does not give any specific power to the companies registered thereunder to declare and pay any dividend. The power to pay dividend is inherent

*This requirement was earlier contained in the Rules but had been inadvertently omitted from the Act. Now, the Companies (Amendment) Act, 2015 also contains this requirement.

**A Government Company in which entire paid up share capital is held by the Central Government or by any State Government(s) or by the Central Government and State Government(s) or by one or more Government Company need not deposit the dividend in a scheduled bank in a separate account within five days of its declaration.

in a company and is not derived from the Companies Act or the Memorandum or Articles of Association although the Articles of Association generally regulate the manner in which dividends are to be declared.

It may, however, be noted that a company may issue non-voting equity shares with differential rights as to dividend.

13.6-1 Dividend on preference shares

The distinguishing feature of a preference share is that its holder is entitled to a dividend of a fixed amount, usually expressed as a percentage of the nominal or paid up value of the share, before any dividend is paid on the ordinary shares. If there are two or more classes of preference shares, the shareholders of the class which has priority are similarly entitled to their preferential dividend before any dividend is paid in respect of the other class. But these rights in respect of dividends are subject to two qualifications. *In the first place,* preference shares are part of the company's share capital, and are not loans; consequently, preference dividends can be paid only if the company has earned sufficient profits. *Secondly,* a dividend becomes payable to the shareholder only when it is declared in the manner laid down by the company's articles. Thus, unless the preference dividends for the year or other period is properly declared, the preference shareholders cannot sue the company for it.

Cumulative preference dividend - Preference dividend is usually expressed to be cumulative by the terms of issue of the shares. This means that if the profits available for dividend in one year are insufficient to pay the preference dividend in full, the unpaid balance of the dividend is carried forward and is payable out of the profits of later years. In other words, no dividend may be paid on the equity shares or junior classes of preference shares until the preference dividends for all past years and the current year have been paid in full to the preference shareholders having a prior claim. If preference shares of the same class have been issued at different times and the dividend is in arrear in respect of some shares for more years then it is in respect of others, the total arrears must be satisfied rateably when a dividend is eventually paid.

Preference dividends are presumed to be cumulative even though the terms of issue do not in any way indicate that they shall be.

Non-cumulative preference dividend - The terms of issue of preference shares may, of course, provide that the preference dividend shall be non-cumulative, but this is rare in practice. If the dividend is non-cumulative, it is payable only out of the profits for the year in question so that if those profits are for any reason insufficient, the unpaid balance of the dividend for that year is not carried forward to be paid out of the profits of future years. Even where the terms of issue do not expressly provide that the preference dividend shall be non-cumulative, it may be so construed if the terms of issue when read as a whole so suggest. Thus, the dividend was held to be non-cumulative where it was expressed to be payable 'out of the net profits each year' - *Staples* v. *Eastman Photographic Materials Company* [1896] 2 Ch. 303.

Participation in residual profits - A preference shareholder as such is entitled only to his fixed preference dividend out of the company's distributed profits, and there is no implication that he is also entitled to a share in the residual profits of the company left after that dividend has been paid. However, when preference

shareholders are expressly given the right to share in distribution of residual profits after payment of their preference dividend, their shares are known as participating preference shares. The participation then may be limited to the profits of the company remaining after it has paid both the current year's preference dividend and a specified dividend of its equity shares, or it may extend to the whole of the residual profits after payment of the fixed preference dividend.

13.6-2 Dividend on equity shares

Equity shareholders are entitled to be paid a dividend on their shares only after all preference dividends have been paid to date. Although the equity shareholder stands behind in priority for payment of the dividend, he generally enjoys the privilege of higher dividends. The preference dividend is fixed and cannot be increased, however large the company's profits may be, unless the preference shares carry the right to participate in surplus profits. Except in that case, therefore, the whole of the residual profits of the company after paying the preference dividend may be paid out as a dividend to the equity shareholders either immediately or in later years (including the bonus issue). The equity shareholders are further compensated by enjoying the voting power at general meetings.

Declaration of dividend - Articles commonly contain provisions on the declaration of dividend, and it is the usual practice to leave it to the general meeting to sanction or declare the final dividend. Section 102(2) of the Companies Act, 2013 also requires that the declaration of the dividend should be shown as an ordinary business at an annual general meeting of a company. Similarly, there is a reference to dividend in section 134(3)(*k*) whereunder directors are required to mention in their report to the shareholders the amount, if any, which they recommend should be paid by way of dividend. Therefore, it could be assumed that the intention of the legislature is to empower the annual general meeting to declare dividend. In *Raghu Nandan Neotia* v. *Swadeshi Cloth Dealers Ltd.* [1964] 34 Comp. Cas. 570 (Cal.), the Calcutta High Court held that the cumulative effect of all the provisions of the Act is that declaration of dividend should be made at the annual general meeting. Likewise in *Kanti Lal* v. *Commissioner of Income-tax* [1956] 26 Comp. Cas. 357 (Bom.), the Bombay High Court held that it is well established and the law is clear that a dividend can only be declared by the shareholders of the company. Articles of companies usually contain provisions with regard to declaration of dividend on the pattern of regulations 80 to 88 of Table F of the Companies Act. Under Regulation 80, *the power to declare a dividend vests with the general meeting, but it has no power to declare a dividend exceeding the amount recommended by the Board of directors.*

Should the dividends be declared only at an annual general meeting? - From the aforesaid discussion, it is clear that dividend is usually declared at an annual general meeting of the company. However, a company which could not declare dividend at an annual general meeting may do so at a subsequent general meeting. But if a dividend is so declared at the general meeting, neither the company nor the directors can declare a further dividend for the same year (*Circular No. 22, issued by Department of Company Affairs*, dated 25-10-1975*). Also, there can be no declaration of dividend for past years, in respect of which the accounts have already been closed at previously held annual general meeting - *Raghu Nandan Neotia* v. *Swadeshi Cloth Dealers Ltd.* (*supra*).

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*Now, Ministry of Corporate Affairs.

Revocation of final dividend - Ordinarily, a dividend once declared, cannot be revoked, except with the consent of the shareholders, for a declaration of dividend creates a debt to the shareholders in whose favour it is declared. Thus, if a dividend is declared and the amount is credited or paid to the shareholders as dividend, the character of the credit or payment as dividend cannot be altered by a subsequent resolution - *Kishinchand Chellaram* v. *CIT* [1962] 32 Comp. Cas. 1046, 1050 (SC).

But, where a dividend has been illegally declared, or where, events like war, imposition of fresh taxes, fire to properties etc. intervene after the declaration and it is advisable to conserve the remaining assets, the Board of directors will be justified in revoking the declaration of dividend.

13.6-3 Interim dividend

A part of profits may be distributed before the accounts are finally passed and the declaration of the dividend sanctioned in the annual general meeting. Such dividends are called 'Interim dividend'. The 'interim dividend' is thus a dividend paid between two annual general meetings of the company. Following provisions relating to interim dividend, as contained in section 123(3) may be noted:

1. The Board of Directors of a company may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account or out of profits of the financial year in which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend*.
2. In case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of interim dividend, such interim dividend shall not be declared at a rate higher than the average dividends declared by the company during the immediately preceding three financial years.
3. The amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

Can interim dividend be revoked? - Interim dividend, like final dividend, should be considered as a debt due and thus 'not revocable' except under certain circumstances under which final dividend may be revoked.

Thus, declaring interim dividend, the Board should carefully assess the adequacy of profits since in the event of absence or inadequacy of profits, the distribution would amount to reduction of capital. The opinion of the auditors, therefore, be obtained in this regard.

A general meeting cannot pass a resolution for payment of interim dividend - *Scott* v. *Scott* [1943]. It may, however, rescind the declaration of interim dividend before payment has been made.

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* *Vide* Companies (Amendment) Act, 2017.

13.7 Payment of dividend

13.7-1 Dividend payable to whom

Section 123(5) provides that no dividend shall be paid by a company in respect of any share therein except to the registered shareholder of such share or to his order or to his banker.

Thus, if a shareholder has issued a mandate for the payment of dividend on his shares to a bank, the company paying the dividend to the bank accordingly, would get a good discharge for the payment so made and the dividend shall be deemed to have been paid to the shareholder in cash as contemplated under sub-section (5) of section 123 of the Act.

Payment of dividend in case of sale of shares - As noted above, the dividend is required to be paid to the registered shareholder. The company, therefore, does not recognise anybody except the person whose name is shown as the shareholder in the Register of Members of the company and is not bound to pay the dividends to the purchaser even though the transaction between the seller and purchaser has been completed - *Chuni Lal Khusaldas Patel* v. *H.K. Adhyaru* [1956] 26 Comp. Cas. 168 (SC). Section 126, in this regard, provides as follows:

Where any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, it shall, notwithstanding anything contained in any other provision of this Act,—

(*a*) transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer; and

(*b*) keep in abeyance in relation to such shares, any offer of rights shares under clause (*a*) of sub-section (*1*) of section 62 and any issue of fully paid-up bonus shares in pursuance of first proviso to sub-section (*5*) of section 123.

13.7-2 Dividend is to be paid in cash

Sub-section (5) of section 123 of the Companies Act, 2013 contain guidelines for payment of dividend. Sub-section (5) provides that no dividend shall be payable except in cash. However, the sub-section does not prohibit the capitalisation of profits or reserves of a company for the purpose of issuing fully paid up bonus shares or paying up any amount, for the time being unpaid on any shares held by the members of the company.

Sub-section (5) further lays down that any dividend payable in cash may be paid by cheque or warrant or in any electronic mode to the shareholder entitled to the payment of the dividend.

In *Indian Seamless Enterprises Ltd., In re* [2015] 61 taxmann.com 289 (Bombay), the Bombay High Court held that gift of shares held in another company under a scheme of arrangement amounts to payment of dividends. The Court held that not only distribution of cash but the distribution of properties or rights having monetary value by a company amongst its shareholders will constitute dividend. Since distribution of dividends otherwise than in cash is prohibited under section 123, the same shall not be valid.

In the case of joint shareholders, Regulation 85 of Table F provides that the dividend warrant may be sent to the registered address of that one of the joint shareholders who is first named in the Register of Members or to such person and to such address as the shareholder or the joint shareholders may in writing direct.

13.7-3 Time within which dividends to be paid

Section 123(4) provides that the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend.

Section 124 casts an obligation on the company to pay dividend, which is declared to the shareholder entitled therein within 30 days from its declaration. The term 'payment' implies the act of posting of dividend warrant or cheque as provided under the law irrespective of the fact whether the shareholder concerned receives it or not. Thus, the offence under the section takes place when there is failure to pay or a cheque or a warrant therefor is not posted to the registered address of the shareholder. The section makes the failure to post within 30 days and not the non-receipt of the warrant by a shareholder, an offence. Therefore, the obligation to pay within the prescribed time is satisfied once the dividend is paid or a cheque or a warrant therefor is posted at the registered address of the shareholder. On such posting, the post office becomes the agent of the shareholder and the loss of the dividend warrant during transit thereafter is at the risk of the shareholder - *Hanuman Prasad Gupta* v. *Hira Lal* [1970] 40 Comp. Cas. 1058 (SC).

Where shares are lodged for registration of transfer, as long as shares are not transferred, complaint for non-payment of dividends can be lodged by transferor and not by transferee [*G.R. Desai* v. *Registrar of Companies* [1998] 18 SCL 55 AP].

Penalty for default - Section 127 provides for penalty for non-payment of dividend or non-posting of warrant in respect thereof within the prescribed period of 30 days. As per the section, every director of the company shall, if he is knowingly a party to the default, be punishable with imprisonment which may extend to two years and with fine which shall not be less than one thousand rupees for every day during which such default continues and the company shall be liable to pay simple interest at the rate of eighteen per cent per annum during the period for which such default continues.

It may be noted that the provision under section 207 [now section 127] contemplates the implication of any director of the body corporate only in the event of such director being knowingly a party to the default - *N. Kumar* v. *M.O. Roy, Assistant Director, S.F.I.O.* [2007] 80 SCL 55 (Mad.).

In *NEPC India Ltd.* v. *ROC* [1999] 97 Comp. Cas. 500 (Mad.), it was held that to invoke penal provisions of section 207 [now section 127], the complaint must have been filed within one year of the issue of show-cause notice. In view of section 408 of Criminal Procedure Code, 1973, a complaint under section 207 [now section 127] filed more than one year after the date of issue of show-cause notice shall *prima facie* be time-barred.

When default is excusable - The proviso to section 127 provides for certain circumstances where the default shall be excusable. These circumstances are :

(*a*) Where the dividend could not be paid by reason of the operation of any law. However, if dividend cannot be paid by operation of law, its non-deposit in the special account shall be an offence - *Consolidated Pneumatic Tools Co. (P.) Ltd.* v. *ROC* [1989] 65 Comp. Cas. 259 (Bom.).

(*b*) Where a shareholder has given direction to the company regarding the payment of the dividend and those directions cannot be complied with.

(*c*) Where there is a dispute regarding the right to receive the dividend.

(*d*) Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder.

(*e*) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.

13.8 Dividend warrants

Clause (*b*) of sub-section (5) of section 123 specifically provides that any dividend payable in cash may be paid by cheque or warrant and it shall be deemed to have been paid when the cheque or warrant therefor is posted to the registered address of the shareholder entitled to the payment of dividend.

'Dividend warrant' is an order by the company to its banker to pay the amount specified therein to the shareholder whose name is written therein. The warrant is crossed as "payee's account only" and, therefore, the banker makes the payment to the shareholder not in cash but by crediting his banker's account. The shareholder may, at his discretion thereafter draw the amount of the warrant from his account that his banker is maintaining and with whom he deposits the warrant for collection.

Loss of dividend warrant - If a dividend warrant issued to but not received by a shareholder is encashed by an unauthorised person either directly or through a banker, the company is not protected, however, *bona fide* the payment may have taken place, because in such case the dividend cannot be said to have been paid to the registered holder within the meaning of section 123(5). Thus, the consequences of loss through wrong payment will fall on the company.

13.9 Dividend mandate

The shareholders who desire that their dividends be credited direct to their bank accounts have to make the request in prescribed form supplied by the company. The aforesaid form when duly filled and sent to the company is known as 'Dividend Mandate'. The shareholder fills in the form and puts his signature authorising the company to pay dividends direct to his banker. This form is also used for similar requests for payment of interest on debentures or other types of securities. The advantages of 'dividend mandate' are :

(*a*) It reduces the amount of unclaimed dividends which the company has to carry forward from year to year.

(*b*) It enables the use of one dividend warrant for the payment of dividends due to several shareholders having accounts with the same bank.

A specimen form of 'Dividend mandate' is given below :

Dividend Mandate

(Specimen)

To

The ABC Co. Ltd.

.....

Mumbai

I/We hereby request and authorise you to pay all dividends from time to time falling due, and becoming payable on any shares now or hereafter to be registered in my/our name(s) in the books of the company, to Allahabad Bank, Anand Lok, New Delhi (Saving Bank A/c 5534) whose acknowledgement shall be a sufficient discharge to the company.

Dated this .....day of .....20.....

NB : In case shares are held in joint names, this form must be signed by all the registered holders.

Signature(s) of Shareholder(s)

Dividends so mandated are transferred to the shareholder's account through ECS.

13.10 Unpaid and unclaimed dividends

13.10-1 Unpaid dividends

According to section 124, where a dividend has been declared by a company but has not been paid or claimed within 30 days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall within 7 days from the date of expiry of the said period of 30 days transfer the total amount of dividend which remains unpaid or unclaimed within the said period of 30 days to a special account to be opened by the company in that behalf in any scheduled bank to be called "Unpaid Dividend Account".

Sub-section (2) of section 124 requires that the company shall, within a period of ninety days of making any transfer of an amount under sub-section (1) to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the website of the company, if any, and also on any other website approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

If any default is made in transferring the total amount referred to in sub-section (1) or any part thereof to the Unpaid Dividend Account of the company, it shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account, at the rate of 12% per annum and the interest accruing on such amount shall enure to the benefit of the members of the company in proportion to the amount remaining unpaid to them.

Any person claiming to be entitled to any money transferred under sub-section (1) to the Unpaid Dividend Account of the company may apply to the company for payment of the money claimed [Section 124(4)]

13.10-2 Transfer of unpaid dividend to Investor Education and Protection Fund [Fund]

Section 124(5) provides that any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Fund established under sub-section (1) of section 125 and the company shall send a statement in the prescribed form of the details of such transfer to the Authority which administers the said Fund and that Authority shall issue a receipt to the company as evidence of such transfer.

All shares in respect of which dividends have not been paid or claimed for seven consecutive years or more shall be* transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed [Sub-section (6)].

However, any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

If a company fails to comply with any of the requirements of this section, the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees [Sub-section (7)].

13.11 Establishment of Investor Education and Protection Fund [Sec. 125]

The Central Government shall establish a fund to be called the Investor Education and Protection Fund (hereafter in this section referred to as the "Fund") [Sec. 125(1)].

Amounts to be credited [Sec. 125(2)] - There shall be credited to the Fund the following amounts, namely :—

(*a*) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(*b*) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

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*As per Companies (Amendment) Act, 2015 (w.e.f. 29-5-2015).

For the removal of doubts it is hereby clarified that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall not be transferred to Investor Education and Protection Fund.

(*c*) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124;

(*d*) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956, as it stood immediately before the commencement of the Companies (Amendment) Act, 1999, and remaining unpaid or unclaimed on the commencement of this Act;

(*e*) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(*f*) the interest or other income received out of investments made from the Fund;

(*g*) the amount received under sub-section (4) of section 38;

(*h*) the application money received by companies for allotment of any securities and due for refund;

(*i*) matured deposits with companies other than banking companies;

(*j*) matured debentures with companies;

(*k*) interest accrued on the amounts referred to in clauses (*h*) to (*j*);

(*l*) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(*m*) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(*n*) such other amount as may be prescribed:

But no such amount referred to in clauses (*h*) to (*j*) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

As per the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, the following amounts shall be credited to the Fund, namely:—

(*a*) all amounts payable as mentioned in clauses (*a*) to (*n*) of sub-section (2) of section 125 of the Act [stated here above];

(*b*) all shares in respect of which dividends have not been paid or claimed for seven consecutive years or more;

(*c*) all the resultant benefits arising out of shares held by the Authority under clause (*b*);

(*d*) all grants, fees and charges received by the Authority under these rules;

(*e*) all sums received by the Authority from such other sources as may be decided upon by the Central Government;

(*f*) all income earned by the Authority in any year;

(*g*) all amounts payable as mentioned in sub-section (3) of section 10B of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970

and section 10B of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980; and

(*h*) all other sums of money collected by the Authority as envisaged in the Act.

In case of term deposits and debentures of companies, due unpaid or unclaimed interest shall be transferred to the Fund along with the transfer of the matured amount of such term deposits and debentures.

No money shall be transferred to Investor Protection Fund under section 125 if a person makes a claim within seven years from date amount became due and payable - *Nivedita Sharma* v. *Industrial Credit & Investment Corporation of India* [2012] 21 taxmann.com 14 (Delhi).

Any person claiming to be entitled to the amount referred in sub-section (2) may apply to the Authority constituted under sub-section (5) for the payment of the money claimed [Section 125(4)].

No claims shall, however, lie against the Fund or the company in respect of individual amounts which were unclaimed or unpaid for a period of seven years from the dates that they first became due for payment and no payment shall be made in respect of such claims.

Purposes for which monies to be used - As per section 125(3), the Fund shall be utilised for— (*a*) the refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;

(*b*) promotion of investors' education, awareness and protection;

(*c*) distribution of any disgorged amount[5] among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;

(*d*) reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal; and

(*e*) any other purpose incidental thereto, in accordance with such rules as may be prescribed.

However, the person whose amounts referred to in clauses (*a*) to (*d*) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

Administration of the Fund - The Central Government shall constitute, by notification, an Authority for administration of the Fund consisting of a chairperson and such other members, not exceeding seven and a chief executive officer, as the Central Government may appoint.

The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal with power to acquire, hold and dispose of property,

5. According to *Explanation* to section 125 the disgorged amount refers to the amount received through disgorgement or disposal of securities.

both movable and immovable, and to contract and shall, by the said name, sue or be sued.

The Authority shall administer the Fund and maintain separate accounts and other relevant records in relation to the Fund in such form as may be prescribed after consultation with the Comptroller and Auditor-General of India.

It shall be competent for the authority or committee appointed under sub-section (5) to spend moneys out of the Fund for carrying out the objects for which the Fund has been established.

The accounts of the Fund shall be audited by the Comptroller and Auditor- General of India at such intervals as may be specified by him and such audited accounts together with the audit report thereon shall be forwarded annually by the authority to the Central Government.

13.12 Can dividends be paid out of capital ?

Dividends, as per section 123, may be paid out of the following three sources only :

- out of current profits,
- out of profits for any previous financial year or years, and
- out of moneys provided by the Central or State Government for the payment of dividend.

Accordingly, dividends are not allowed to be declared out of capital. If the memorandum or articles give power to the company to pay dividends out of capital, such a power shall be invalid - *Verner* v. *General & Commercial Investment Trust Ltd.* [1894] 2 Ch. 239.

Consequences of payment of dividend out of capital - In case dividends have been paid out of capital, the following consequences follow :

1. Directors who knowingly paid dividends out of capital shall be held personally liable to make good the amount to the company - *Oxford Benefit Building & Investment Society, In re* [1886] 35 Ch. D. However, directors shall incur no liability where such payment was made on the faith of *bona fide* valuation of a company's assets which subsequently proved to be an over-estimate - *Stringer's* case [1869] 9 QBD 436.
2. If the members who receive dividends know that they have been paid out of capital, the directors may have a right of indemnity against such members to the extent that they have respectively received dividends - *Moxham* v. *Grant* [1900] 1 QB 88 (CA).
3. Where an interim dividend has been paid out of capital owing to a *bona fide* mistake and the directors propose to recoup such dividend out of profits before distributing any further dividends, a member who has received such dividend cannot maintain an action against the directors - *Towers* v. *African Tug Co.* [1904] 1 Ch. 558.
4. When dividends improperly paid out of capital have been made good out of subsequent profits, liability ceases to attach to the directors - *Boaler* v. *The Watchmaker's Alliance and Others* [1903].

13.13 Payment of dividend out of capital profits

The term 'capital profits' may be defined to mean those profits which arise otherwise than in the normal course of the business. Thus, capital profits would arise where a company sells part of its fixed assets at a price higher than the original cost of such assets or where it receives premium on issue of shares, etc. Such profits may be realised or take the form of book figures only created by such matters as revaluation. Whether such profits can be distributed as dividends or not has not been specifically dealt with in the Companies Act.

However, the position in this regard in our country has been the same as that in England, based, as it is, on the decision in the undermentioned two important cases:

(1) *Lubbock* v. *British Bank of South America* [1892] 2 Ch. 198

(2) *Foster* v. *The New Trinidad Lake Asphalt Co. Ltd.* [1901] 1 Ch. 208.

Following the decisions of these two cases, capital profits are not considered as available for distribution as dividend unless :

(*i*) the Articles of Association permit such a distribution;

(*ii*) the surplus is realised; and

(*iii*) such surplus remains after a valuation of the whole of the assets and liabilities has been fairly taken.

The position in our country, regulated more by convention than by any law as regards unrealised capital profits, is that the same can be applied for writing off past capital losses. As regards the application of revaluation reserve to write off past revenue losses, the position is not clear. It seems, having regard to the provisions of section 123 of the Companies Act, that revaluation reserve should not be applied to write off past revenue losses because that will facilitate a distribution of dividend without being required to earn a revenue surplus for the purpose. Such profits also cannot be applied by a listed company in issuing bonus shares as per the Bonus Issue Guidelines issued by the Securities and Exchange Board of India (SEBI) nor in paying up debentures or loan stock or calls on partly paid shares.

However, in regard to *availability of revaluation reserve for issue of bonus shares by a non-listed company,* the Supreme Court has in *Bhagwati Developers* v. *Peerless General Finance & Investment Co. Ltd.* [2005] 62 SCL 574 held that subject to the provisions, if any, on matter of issue of bonus shares, in the Articles of the company, this reserve is available for issue of bonus shares in view of the proviso to section 205(3) [now section 123(5)] of the Act which allows capitalisation of profits or reserves of a company.

Previous capital losses - Though companies do write off capital losses, both unrealised and realised, either in the year in which they occur or in convenient instalments out of revenue profits, it is not obligatory for them to do so.

The Jenkins Committee also was of the view that there should not be any statutory requirement to make good either realised or unrealised capital losses before revenue profits were distributed.

The Institute of Company Secretaries of India (ICSI) in the SS-3 on Dividends has stated that dividend should not be declared out of the Securities Premium A/c or

the Capital Redemption Reserve A/c (*Vide* section 55 of the Act on redemption of Preference shares) or Revaluation Reserve or Amalgamation Reserve (Capital Reserve Component only) or out of profits on re-issue of forfeited shares or out of pre-incorporation profit.

Appropriation out of the amount available for distribution as dividend - Although the whole of the amount standing to the credit of the Profit and Loss Account, provided it represents revenue profits or capital profits which are available for distribution on the conditions aforementioned is distributable as dividend, it is often necessary to make appropriations out of the same on various grounds to arrive at the amount which may be distributed as a dividend. Some of these grounds are the following :

(*a*) **For credit to general reserve** - Apart from the amount transferred to general reserve, if any part of the profits has been utilised for meeting a capital expenditure or is invested in book debts or stocks, it should not be available for distribution as a dividend. On this account, the amount so invested as well as that proposed to be further invested similarly must be credited to the General Reserve Account. Otherwise, the amount proposed to be distributed will be in excess of the amount actually available for distribution in cash or securities readily convertible into cash. It would give rise to an anomalous position; the company having stocks which it cannot sell or books debts it cannot realise, on account of which it will not be able to pay dividend within the time allowed (30 days) which shall result in the management being penalised (section 127).

In the case of companies governed by certain special laws, it is sometimes obligatory to credit annually a part of the profits to the General Reserve or some other reserve. *For example,* the Banking Regulation Act provides that 20% of the annual profits of a banking company should be credited to the General Reserve before any dividend is distributed (unless exempted by the Reserve Bank). Similarly, the provisions contained in Schedule VI to the Electricity (Supply) Act require that certain specified sums should be credited to the Contingencies Reserve and to the Tariffs and Dividend Control Reserve before the profit is distributed as dividend.

The Articles of Association of a company may also require that a part of the profits should be credited to the general reserve before any dividend is distributed.

In all such cases it would be necessary for the directors to appropriate proper amounts out of profits to comply with the legal necessity.

(*b*) **Amortisation of a debt** - At times, a company, while raising a loan, may undertake that it would create a fund out of its profits for its payment. *For example,* the Debenture Trust Deed in respect of a debenture issue made by a company may stipulate that a fixed percentage of profits will be credited annually to the Debenture Redemption Reserve Fund. In such a case, the amount of such an appropriation for credit to the Fund would be a prior appropriation of the profits.

(*c*) **Provision for preferential payments** - If a company has issued preference capital, there must be provision to pay the dividend on preference shares at the stipulated rate before any dividend is paid on equity shares. Moreover, if the shares are cumulative, a provision for all the arrears of dividend payable thereon must be first made.

In addition, the directors in any year may decide to appropriate a part of the profits considered extraordinary or excessive to the credit of a Dividend Equalization Reserve so as not to raise the rate of dividend distributed beyond what the company could be expected to maintain in the future.

Certain legal cases on divisible profits - There have been many important legal decisions regarding divisible profits. Some of them are briefly discussed below :

1. *Bolton* v. *Natal Land & Colonisation Co. Ltd.* [1892] 2 Ch. 124.

   Held: That a company may declare a dividend out of current profits without making good loss of capital.

   The business of the company mainly consisted of dealing with land in South Africa. In 1882, the company charged against revenue £ 70,000 in respect of a bad debt which had been incurred, and at the same time, adjusted the profit and loss account by crediting to it practically the same amount in respect of an increase in value attributed to lands held by them.

   In 1885, the company made a profit and a dividend was declared. The plaintiff sought to restrain the payment of this dividend on the ground that the book value of the lands was much higher than the true value and must be written down before profit can be distributed. Held that a loss of capital not subsequently made good does not afford a sufficient ground for restraining the payment of dividend.

2. *Bond* v. *Barrow Haematite Steel Co. Ltd.* [1902] 1 Ch. 353.

   Held : That where the articles empower to put sums to reserves before the payment of a dividend, preference shareholders cannot compel directors to declare a dividend without making such reserves as the directors consider necessary.

   In this case the preference shareholders brought the suit on the ground that the directors' decision to appropriate profits to the reserves or to carry them forward without paying dividends on preference shares was not valid. They argued that, by contract, they were entitled to be paid a preferential dividend out of the balance to the credit of profit and loss account in each year and that the company cannot appropriate any part of such balance to reserves or to carry over even one shilling until they had been paid in full. On a consideration of the construction of the Articles of Association of the company as well as that of the special resolution creating preference shares, the Court held that the balance to the credit of profit and loss account for any year was not necessarily such profits of the company as were properly applicable to dividend. The Court also held that it would not compel the directors to pay dividends when they had expressed an opinion that the state of accounts did not admit of any such payment.

3. *Verner* v. *The General & Commercial Investment Trust Ltd.* [1842] 2 Ch. 239.

   Held : That subject to its Articles, a company may pay dividends out of current profits without making good loss of capital.

   The company had issued share capital to the extent of £ 6,00,000 and had borrowed £ 3,00,000 on the security of debenture stock. These proceeds had been invested in various securities authorised by the Memorandum of Association. The market value of such investments fell to £ 75,000 and seemed to represent the amount of which there was no prospect of recovering. On the revenue account however, the current income from investments had exceeded the current expenditure by more than £ 23,000. The company sought to distribute dividends before making good the loss arising from the diminution in the value of the investments, Justice Lindley held that. . . .

   > "The broad question raised by this appeal is whether a limited company which had lost part of its capital, can lawfully declare or pay a dividend without first making good the capital which has been lost. I have no doubt it can - that is to say, there is no law which prevents it in all cases and under all circumstances. Such may be perfectly legal and may yet be opposed to sound commercial principles. We, however, have only to consider the legality or illegality of what is complained of. There is no law which prevents a company from sinking its capital in the purchase or production of money making property or undertaking, and in dividing the money annually yielded by it without preserving the capital sunk so as to be able to reproduce it intact, either before or after the winding-up of the company."

4. *Lee* v. *Neuchatel Asphalt Co. Ltd.* [1889] 41 Ch. 1.

   Held : That a company, if so authorised by its Articles, may distribute dividends without making good the depreciation of wasting assets.

   The contention in this case was that the company had proposed to distribute the dividends without providing for depreciation on company's properties, and therefore injunction was sought to restrain the company from doing so. The Articles of the company provided that the directors should not be bound to reserve money for the renewal or replacement of any lease, or of the company's interest in any property or concession, though as a matter of fact the company did from time to time write off considerable amounts but had not made any such provision in the year during which the profit which it was proposed to distribute had arisen.

   Lindley, L.J., in the course of his judgment said :

   > "The respondent-company was formed for the purpose of working certain asphalte mines of which it had got a lease. It was quite obvious that with respect to such a property, every ton of stuff got out of that which was bought with capital represented a portion of capital. It was said that a division of the profit arising from the sale of such was a return of capital. If that was so, it is not, at all events, such a return of capital as is prohibited by the Companies Act. There is nothing in the Companies Act prohibiting anything of the kind. . . . It has been very judicially and properly left to the commercial world to settle how the accounts were to be kept. The Acts do not say what expenses are to be charged to Capital Account and what to Revenue Account."

Test Your Knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/IPC, C.A. FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. (*a*) What is dividend?

(*b*) Can all companies declare dividend?

(*c*) Can dividend be declared out of profits?

(*d*) What provisions and rules have to be observed by a company before declaring dividend ?

2. (*a*) Distinguish 'Divisible profit' from 'Distributable profit'.

(*b*) Subject to what conditions dividend can be paid out of reserves.

(*c*) What are the provisions regarding transfer of profit to reserve before declaring dividend?

3. Comment on the following :

(*a*) Decision by the directors to pay an interim dividend does not create a debt.

(*b*) Preference shareholders have an inherent right to the fixed dividend.

(*c*) Payment of dividend can be effected by credit to the shareholder's account.

4. The company of which you are the secretary has suffered a trading loss during the year just ended. Your directors intend to recommend payment of a dividend partly out of profits realised on sale of some fixed assets and partly out of the accumulated profits and revenue reserves. They seek your opinion in the matter. Prepare a note giving your opinion.

5. (*a*) The Board of a company wants to pay interim dividend. Set out the procedure including resolution as may be necessary. Can the payment of interim dividend be annulled.

(*b*) A shareholder who was abroad for seven years claims that he has not received the dividend declared by the company during his absence from the country. Advise the steps to be taken by the shareholder for recovery of the dividend not so received.

6. State the conditions and procedure for the payment of interim dividend.

(*i*) Can the decision for payment of interim dividend be revoked ?

(*ii*) What is the time limit, if any, for the payment of interim dividend?

7. (*a*) Explain the provisions of the Companies Act, 2013, relating to unpaid and unclaimed dividend and its payment.

(*b*) When can dividend be kept in abeyance and how can such dividend be withdrawn by the transferee ?

8. The Board of Directors of PQR Ltd. failed to make payment of dividend within the stipulated time. How would you deal with it under the provisions of the Companies Act, 2013.

9. The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that recommended by the directors. Discuss the validity of the resolution.

10. The articles of association of a public limited company provide that dividend can be declared at an extraordinary general meeting. Examine the validity of such a provision in the articles.

11. Is it possible for a company to declare dividend without providing for depreciation? Discuss the relevant provisions of the Companies Act in this regard.

12. State the procedure to be followed by a company, whose shares are listed at a stock exchange:

(*i*) for declaration of dividend; and

(*ii*) for payment of dividend.

13. Discuss the law relating to the following with reference to payment of dividend:

(*i*) Adjustment of loss incurred in the previous years against the profit for the current year.

(*ii*) Past profits retained in the profit and loss account.

(*iii*) Dividend on shares transferred in respect of which transfer deeds have been lodged with the company but the transfer has not been registered.

14. Examine the provisions of law relating to the following :

(*i*) Declaration of further dividend at an extraordinary general meeting after the declaration of dividend for a financial year at an annual general meeting.

(*ii*) The amount represented by dividend warrants not encashed by the shareholders being used by the company for business purposes.

15. Explain the provisions of the Companies Act, 2013 relating to the payment of dividend in respect of :

Utilisation of past profits retained in the Profit and Loss Account of the company, in view of inadequacy of profits for the current year for proposed payment of dividend.

16. The Board of Directors of M/s. PQ Pharma Ltd. have met on 10-10-2013 to consider the half-yearly Accounts of the company for the period ending 30-9-2013. Though the accounts have shown that the company has made profits, the overall working results are not very encouraging as compared to the previous years. The Board in the past has always recommended payment of interim dividend to its shareholders and they would like to continue the same this year also. The Board is confident that the overall performance for the full year will be good. The following questions have been raised :

(*i*) Can the Board declare interim dividend in such circumstances?

(*ii*) Is it necessary for the purpose of payment of interim dividend that provisions relating to depreciation should be complied with?

Advise the Board of Directors, keeping in view the relevant provisions of the Companies Act, 2013.

17. S. Ltd. has earned a profit of Rs.1.4 crore for the year ended 31-3-2013 before providing for depreciation of Rs.1.5 crore resulting in a net loss of Rs. 10 lakh. For the year ended 31-3-2014 S. Ltd. has earned a net profit of Rs. 1 crore after providing for depreciation for the current year. Is this net profit of Rs. 1 crore available entirely for dividend purposes assuming no other loss or unabsorbed depreciation exists [**Hints:** No; *See* Para 13.4-2].

18. The Board of Directors of K. Ltd. in its meeting held on 24th April, 2013 had declared interim dividend. Subsequently, the Board came to know that draft accounts for the year 2013-14 were not made properly and accordingly the interim dividend declared was not justifiable and it is necessary to revoke the interim dividend. What steps would take to revoke the payment of interim dividend? [**Hints:** Interim dividend, like final dividend, should be considered as a debt due and thus 'not revocable' except under certain circumstances under which final dividend may be revoked. As per SS-3 also, it cannot be revoked].

PRACTICAL PROBLEMS

1. The shareholders at an annual general meeting of a public limited company unanimously resolved for payment of dividend though the Board of directors did not recommend payment of any dividend. State the legal position.

Hints : Unless articles provide otherwise, declaration of dividends though a prerogative of shareholders is allowed only if the directors so recommend. *See* **para 13.5-2.**

2. The agenda for the meeting of the Board of Directors of M/s. Successful Enterprises Ltd. held on 20-3-2014 for adopting the annual accounts for the year ended 31-12-2013 included an item relating to payment of dividend. At the meeting it became apparent that the profits made during the year ended 31-12-2013 were inadequate to declare dividend. The Board was keen to maintain the rate of 20% dividend on the equity shares as declared in the previous years so as to maintain the image of the company. The company has some accumulated profits earned in previous years, which were transferred to reserves. Advise the company as to how it should go about to achieve the objective to pay dividend at the rate of 20% on the equity shares.

Hints : Dividends out of past profits/reserves can be declared As per Companies (Declaration and Payment of Dividend) Rules, 2014 [as amended vide **Notification No. G.S.R. (E) dated 12th June, 2014]**. These Rules, *inter alia*, provide that the rate of dividend declared shall not exceed the average of the rates at which dividend was declared by it in the three years immediately preceding that year. *For details, see para 13.4-2.*

3. Your company has a paid up capital of Rs. 200 crore. It has not paid dividend for past several years due to paucity of profits. It also does not have any significant balance in general reserve. The company has earned a net profit of Rs. 2 crore in the current year after providing for depreciation of Rs. 75 crore. It intends to pay dividend of 10%. How can it do so?

[**Hints:** *See* Para 13.4-1]

4. A resolution was passed by the shareholders in an annual general meeting approving final dividend @ 20% for the financial year 2013-14 and one month later the Board of directors decided to pay further dividend @ 5% for the financial year 2007-08. Comment.

[Hints: It cannot declare additional dividend after declaration of final dividend]

5. Under section 123, depreciation will have to be provided for working out distributable profit. Though, the present value of land of a company, dealing with land, is much less than the book value, the difference between the book value and market value was not amortized before declaring dividend. Discuss.

[**Hints:** A loss of capital need not be made good before declaring or payment of dividend out of capital profits [*Botton* v. *Natal Land & Colonization Co. Ltd.* (1892) 124 Ch.].

SPECIMEN RESOLUTIONS

1. **Specimen resolution for declaration of final dividend** - "Resolved that the dividend as recommended by the Board of directors for the year ended 31st March, 2014 at the rate of Rs.....per share on the equity capital of the company subject to deduction of tax at source, if applicable, be and is hereby declared for payment to those shareholders whose names appeared on the Register of Members as on.....2014."

   Type of resolution required : Ordinary resolution

   Type of meeting : Annual General Meeting

2. **Specimen resolution for opening a dividend account with a scheduled bank** - "Resolved that pursuant to the applicable provision of the Companies Act, an account styled as BSF Ltd. dividend account [2014] be opened with State Bank of India, R.K. Puram, New Delhi and that the said bank be and is hereby authorised to honour dividend warrant of the company for the year ended 31st March, 2014 issued under the lithographed signatures of M/s. X&Y, authorised signatories and to act on any instruction so given by the stated signatories relating to the said account of the company."

   Type of meeting required : Meeting of the Board of Directors

   Resolution required : Simple majority resolution

14 Company Management

14.1 Meaning of a Director

Section 2(*34*) of the Companies Act, 2013 defines a 'director' to mean a director appointed to the Board of a company.

Under the scheme of the Companies Act, the company itself and its directors or the Board of directors are primary agents of the company to transact its operations. The Companies Act specifies where the company itself is to act both as principal and the agent and where the Board of directors is to act on its behalf. In respect of the properties and assets of the company the directors or the Board of directors act as Trustees. Therefore, the directors have different attributes in relation to the company depending upon the facts of each case.

As stated earlier, directors apart from being trustees for the assets and properties of the company are also the agents of the company as it is the directors, collectively as Board, act on behalf of the company on all matters except those specifically reserved for the company to act. However, it may be noted that even though the directors for certain purposes can be considered as the agent of the company, yet in respect of such matters for which the directors (*i.e.*, the Board) are empowered to take a decision, the company in any manner, including in the general meeting, cannot direct the directors to take a particular decision. *For example,* allotment of shares, transfer of shares, investments etc. If the body of the shareholders did not approve the decision, they are free to change the directors in the manner given in the Act. As stated elsewhere in the chapter a director apart from being the agent and trustee of the company, can also be treated as officer of the company, hence an employee for purposes specified in the Act.

The articles of a company may designate its directors as governors, members of the governing council or the board of management, or give them any other title, but so far as the law is concerned they are simply directors.

Similarly, in the case of associations or other bodies registered as companies under section 8 (that is companies whose object is not profit making but furtherance of art, science, commerce, culture, etc.), the members of the executive committee or the governing body are directors for purposes of the Act, though they may not be called by that name.

A manager or any other managerial personnel, is however, not a director - Andhra Pradesh High Court in *Deen Dayalu* v. *Sri B.P. Reddy* [1984] 2 Comp. LJ 396.

According to section 2(*59*) of the Act, the definition of an "officer" includes a director as well as any person under whose directions or instructions the Board or any one or more of the directors are accustomed to act.

14.2 Who may be appointed as a Director ?

Section 149 of the Companies Act provides that only an individual can be appointed as director. Thus, no body corporate, association or firm can be appointed director of a company.

However, no person shall be appointed as a director of the company unless he has been allotted a Director Identification Number (DIN) or such other number as may be prescribed under section 153. Section 153, as amended by the Amendment Act, 2017 provides that the Central Government may prescribe any identification number which shall be treated as Director Identification Number for the purposes of this Act. [Section 152(3)].

Section 153 requires that every individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number to the Central Government in such form and manner and along with such fees as may be prescribed. However, the Central Government may prescribe any other identification number as a DIN.

Application for allotment of Director Identification Number before appointment in an existing company:

As per the Companies (Appointment and Qualification of Directors) Amendment Rules, 2018,

(*a*) every applicant, who intends to be appointed as director of an existing company shall make an application electronically in Form DIR-3, to the Central Government for allotment of a Director Identification Number (DIN) along with such fees as provided under the Companies (Registration Offices and Fees) Rules, 2014. However, in case of proposed directors not having approved DIN, the particulars of maximum three directors shall be mentioned in Form No. INC-32 (SPICe) and DIN may be allotted to maximum three proposed directors through Form INC-32 (SPICe).

(*b*) Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by a company secretary in full time employment of the company or by the managing director or director or CEO or CFO of the company in which the applicant is intended to be appointed as director in an existing company.

The Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number to an applicant in such manner as may be prescribed [Section 154].

No individual, who has already been allotted a Director Identification Number under section 154, shall apply for, obtain or possess another Director Identification Number [Section 155].

If any individual or director of a company makes any default in complying with any of the provisions of section 152 or section 155, such individual or director of the company shall be liable to a penalty which may extend to fifty thousand rupees and where the default is a continuing one, with a further penalty which may extend to five hundred rupees for each day after the first during which such default continues [*Section 159, as amended by Companies (Amendment) Act, 2019*]

Company is required to inform DIN of a director to the Registrar within 15 days [Section 157].

14.3 Qualifications for Directors

The Companies Act has not prescribed any academic or professional qualifications for directors. Also, the Act imposes no share qualification on the directors. So, unless the company's articles contain a provision to that effect, a director need not be a shareholder unless he wishes to be one voluntarily. But the articles usually provide for a minimum share qualification.

14.4 Disqualifications of a Director

Section 164(1) of the Companies Act, 2013 provides that a person shall not be eligible for appointment as a director of a company, if —

(*a*) he is of unsound mind and stands so declared by a competent court;

(*b*) he is an undischarged insolvent;

(*c*) he has applied to be adjudicated as an insolvent and his application is pending;

(*d*) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months. However, this disqualification will last only up to five years from the date of expiry of the sentence.

But, if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

(*e*) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

(*f*) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

(*g*) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years;

(*h*) he has not complied with sub-section (3) of section 152; or

(*i*) he has not complied with the provisions of sub-section (1) of section 165.

Section 165(1) limits the number of directorships to 10 public companies and total companies to 20.

After 2017 amendment, the disqualifications referred to in clauses (*d*), (*e*) and (*g*) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

Sub-section (2) of section 164 further provides that no person who is or has been a director of a company which—

(*a*) has not filed financial statements or annual returns for any continuous period of three financial years; or

(*b*) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

However, as per the 2017 amendment, he shall not incur the disqualification for a period of 6 months from the date of his appointment.

Additional disqualifications for directors of a private company - A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified above.

14.5 Legal position of directors

It is difficult to define the exact legal position of the directors of a company. The Companies Act makes no effort to define their position. They have at various times been described by judges as agents, trustees or managing partners. In the words of *Bowen, L.J.* :

> "Directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not as exhaustive of their powers and responsibilities but as indicating useful points of view from which they may for the moment and for the particular purpose to be considered."

14.5-1 Directors as agents

Directors may correctly be described as agents of the company. Cairns, L.J. observed : "The company itself cannot act in its own person; it can only act through directors, and the case is, as regards those directors, merely the ordinary case of principal and agent". The ordinary rules of agency will, therefore, apply to any contract or transaction made by them on behalf of the company. Where the directors contract in the name and on behalf of the company it is the company which is liable on it and not the directors.

Thus, where chief executive of company executed promissory note and borrowed amount for company's sake, it could not be said that amount was borrowed by him, in his personal capacity - *Kirlampudi Sugar Mills Ltd.* v. *G. Venkata Rao* [2003] 42 SCL 798 (AP).

But, where surety was furnished by directors in their personal capacities and not for and on behalf of company, company could not be sued for amount of surety -

H.P. State Electricity Board v. *Shivalik Casting (P.) Ltd.* [2003] 115 Comp. Cas. 310 (H.P.).

Directors as agents make the company liable even for contempt of court [*Vineet Kumar Mathur* v. *Union of India* [1996] 20 CLA 213 (SC)]. However, directors incur a personal liability in the following circumstances :

1. where they contract in their own names;
2. where they use the company's name incorrectly, *e.g.,* by omitting the word 'Limited';
3. where the contract is signed in such a way that it is not clear whether it is the principal (the company) or the agent who is signing; and
4. where they exceed their authority, *e.g.,* where they borrow in excess of the limits imposed upon them - *Weeks* v. *Propert* [1873] LR 8 CP 427.

Ratification of unauthorised acts of Directors

A transaction by the directors which is beyond their powers but within the powers of the company can be ratified by a resolution of the company or even by acquiescence - *Bhajekar* v. *Shinkar* [1934] 4 Comp. Cas. 434 (Bom.).

Shareholders can by their assent ratify acts of directors which are *intra vires* company, though they may not be *intra vires* the board of directors - *Sri Balasaraswathi Ltd.* v. *A. Parameswara Aiyer* [1956] 26 Comp. Cas. 298 (Mad.).

A non-existent entity cannot ratify any action which it could not have initiated. Therefore, where on the date of presentation of the suit, the company was admittedly struck off the register and dissolved, there could be no question of ratification of an action which a non-existent entity could not have initiated in the first instance - *Floating Services Ltd.* v. *MV 'San Fransceco Dipalola'* [2004] 52 SCL 762 (Guj.).

14.5-2 Directors as trustees

A trustee is a person in whom is vested the legal ownership of the assets which he administers for the benefit of another or others. Directors are regarded as trustees of the company's assets, and of the powers that vest in them because they administer those assets and perform duties in the interest of the company and not for their own personal advantage. In *Ramaswamy Iyer* v. *Brahmayya & Co.* [1966] 1 Comp. LJ 107 (Mad.), the Madras High Court held that "The directors of a company are trustees for the company, and with reference to their power of applying funds of the company and for misuse of the power they could be rendered liable as trustees and on their death the cause of action survives against their legal representatives".

Besides, almost all the powers of directors, *e.g.*, of allotting shares, making calls, forfeiting shares, accepting or rejecting transfers, etc., are powers in trust. "They have been made liable to make good money which they have misapplied, upon the same footing as if they were trustees."

Fiduciary capacity, within which directors have to act, enjoins upon them a duty to act on behalf of a company with utmost good faith, utmost care and skill and due diligence and in interest of company they represent - *Dale & Carrington Investment (P.) Ltd.* v. *P.K. Prathapan* [2004] 54 SCL 601 (SC).

14.5-3 Directors as managing partners

The persons holding this view consider a company as large partnership, directors being charged with the responsibility of managing the affairs. The other shareholders are virtually dormant partners. By virtue of the various provisions in the Memorandum and Articles, they enjoy vast powers of management and act as the supreme policy and decision making body.

14.5-4 Are directors employees of the company?

Ordinarily, a director is elected by the shareholders in general meeting, and once so elected, he enjoys well-defined rights and powers under the Act or the articles. Even the shareholders who elect them cannot interfere with their rights or powers except under certain circumstances. An employee appointed by the company under a contract of service is a servant of the company. He does not enjoy any powers other than those vested in him by the employer, who can always direct his actions and interfere in his work.

In *Lee Behrens & Co., Re* [1932] 2 Comp. Cas. 588, it was observed that directors are elected representatives of the shareholders engaged in directing the affairs of the company on its behalf. As such directors are agents of the company but they are not employees or servants of the company. However, there is nothing in law to prevent a director from accepting employment under the company under a special contract which he may enter into with the company - *R.R. Kothandaraman* v. *CIT* (1957).

Accordingly, where a director accepts employment under the company under a separate contract of service, in addition to the directorship, he is also treated as an employee or servant of the company. He shall, in such a case, be entitled to remuneration and other benefits admissible to employees, in addition to his remuneration as Director under the Act.

Besides, directors are also treated as officers of the company for certain matters and are bracketed with the manager, secretary, etc. for this purpose. As 'officers in default', they are liable to certain penalties for failure to comply with the provisions of the Act.

To sum up, we may quote *Jessel, M.R.,* in *Forest of Dean Coal Mining Co., Re* [1878] 10 Ch. D. 450, who observed : "Directors have sometimes been called as trustees or commercial trustees, and sometimes they have been called managing partners; it does not matter much what you call them so long as you understand what their real position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and of all the shareholders in it. They stand in a fiduciary position towards the company in respect of their powers and capital under their control."

14.6 Full time *v.* Part time Director

Companies Act makes no distinction between a full time and a part time director. In *Jagjivan Hiralal Doshi* v. *Registrar of Companies* [1989] 65 Comp. Cas. 553 (Bom.), the Bombay High Court observed that the plain meaning of director is the person occupying the position of director - call him a part time director or a full time director. The rules of construction do not call for any modification or qualification of this meaning. 'Any director' is an officer of the company. The Legislature which defined the word 'officer' has made no distinction based on full time and part time performance of duty.

The powers of the company are exercised by the Board of directors. It shall not exercise any power or do any act which is required to be exercised or done by the company in general meeting. Here again, no distinction founded on part time participation as member of the Board is discernible. The meeting of the Board of directors shall be held at least once in three months. In such meeting, every member participates in voting and takes decision without distinction as to whether he is a part time or full time director.

At every annual general meeting of the company held in pursuance of section 96, the Board of directors is enjoined to lay before the company a balance sheet. Every balance sheet and every profit and loss account of a company shall be signed on behalf of the Board of directors by not less than two directors of the company, one of whom shall be the managing director where there is one. In this signing requirement also no distinction has been made as regards full time or part time director. In other words, where there is a managing director, he should be one of the signatories and the other being any director. Where there is no managing director, both the signatories can be any director.

In the matter of proceedings of negligence, default, breach of duty, misfeasance and breach of trust, the Act and the rules admit of no distinction between members of the Board of directors based on their part time or full time performance of duties. Their liability for any proceedings for such acts is equal. While all the directors are, in law, liable for their acts, the question of relieving them is still one of discretion.

When the responsibility of all the directors, both performing part time duties or full time duties is equal, should any of the directors be relieved from the liability in respect of negligence, breach of trust, misfeasance, etc., is always a question of judicial discretion.

What are the cases in which part time directors should be relieved ? The answer would depend upon the circumstances of each case and no rigid formula can be laid down. In some cases the directors who perform part time functions may be relieved from liability if no evidence of the fact that they had exercised any control in the particular matter has been brought forth. But, in a given case, evidence about their knowledge of the facts which constitute negligence, breach of trust, misfeasance, etc., may be brought forth. In such cases, they should not be relieved from liability for acts of negligence, misfeasance, etc. Part time directors, by reasons of their part

time status, are not invariably, to be relieved from the liability of negligence, breach of duty, misfeasance, breach of trust, etc.

14.7 Appointment of Directors

The discussion on appointment of a director may be dealt with under the following heads :

1. Appointment of first Directors,
2. Appointment at general meeting,
3. Appointment by the Board of Directors,
4. Appointment of Resident Director
5. Appointment of Independent Directors

14.7-1 Appointment of first directors [Section 152]

The first directors are usually appointed by name in the articles or in the manner provided therein. Where the articles do not provide for the appointment of first directors, the subscribers to the memorandum, who are individuals, shall be deemed to be the first directors of the company until the directors are duly appointed. In case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.

Where, for any reason, for example, death, the persons named in the list of first directors do not assume office, it will be necessary for the subscribers of the Memorandum (who will then be the only members) to convene a meeting for the appointment of directors. To the extent to which the articles do not make any other provisions in that behalf, subscribers who would be entitled to requisition a meeting may call the meeting. Notice of the meeting must be served on every subscriber in the manner in which notices are required to be served by the Act[1]

No appointment without DIN - No person shall be appointed as a director of a company unless he has been allotted the Director Identification Number (DIN) under section 154 [Sub-section (3)].

Every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number and a declaration that he is not disqualified to become a director under this Act.

Consent to act as Director - A person appointed as a director shall not act as a director unless he gives his consent to hold the office as director. The consent must be filed with the Registrar within thirty days of his appointment in the prescribed manner [Section 152(5)]*.

In the case of appointment of an independent director in the general meeting, an explanatory statement for such appointment, annexed to the notice for the general

1. A. Ramaiya, Guide to the Companies Act, 12th Edition, page 1215

*Not applicable to Government companies in respect of directors appointed by the Central Govt./State Govt. as well as directors appointed in section 8 companies—*Vide MCA Notification dated 5-6-2015.*

meeting, shall include a statement that in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment [Proviso to section 152(5)].

14.7-2 Appointment of directors at general meeting

According to section 152(2) every director shall be appointed by the company in general meeting except where the Act provides otherwise.

Sub-section (6) of section 152 provides that unless the articles provide for the retirement of all directors at every annual general meeting, **not less than two-thirds** of the total number of directors[2] of **a public company** shall—

(*i*) be persons whose period of office is liable to determination by retirement of directors by rotation[3]; and

(*ii*) be appointed by the company in general meeting except where otherwise expressly provided in this Act.**

The remaining directors in the case of such a company (i.e. public company) shall, in default of, and subject to any regulations in the articles of the company, also be appointed by the company in general meeting.

Appointment of directors in case of a private company - In case of a private company if the articles are silent as to the appointment of directors, or do not specifically provide for appointment of directors otherwise than in a general meeting, then the directors are to be appointed in general meeting by the shareholders - Calcutta High Court in the case of *Swapan Das Gupta* v. *Navin Chand Suchanti* [1988] 3 Comp. LJ 76 (Cal.).

Manner of rotation -Section 152(6)(*c*) provides that at the first annual general meeting of **a public company** held next after the date of the general meeting at which the first directors are appointed and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office.

The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot [Section 152(6)(*d*)].

If the directors do not hold a general meeting in time, can they continue till the meeting is held? - The Delhi High Court in *B.R. Kundra* v. *Motion Pictures*

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2. For the purposes of this sub-section, "total number of directors" shall not include independent directors, whether appointed under this Act or any other law for the time being in force, on the Board of a company.
3. In other words, only one-third of the total number of directors can be non-rotational directors.

**The aforesaid requirement of section 152(6) shall not apply to:

(*a*) a Government company in which entire paid up share capital is held by the Central Government or by any State Government(s) or by the Central Government and State Government(s);

(*b*) A subsidiary of a Government company, as aforesaid, in which entire paid up share capital is held by that Government company.

Association [1976] 46 Comp. Cas. 339 held that directors cannot prolong their tenure by not holding a meeting in time. The directors due to retire by rotation must vacate office at the latest on the last day on which an annual general meeting ought to have been held. Retiring directors are, however, eligible for re-election.

14.7-3 Deemed re-appointment of a retiring director [Sec. 152]

At the annual general meeting at which a director retires as aforesaid, the company may fill up the vacancy by appointing the retiring director or some other person thereto [Section 152(6)(*e*)].

Section 152(7) provides that if the vacancy of the retiring director is not so filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

If at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, except in the following cases :

1. at any previous meeting, a resolution for his re-appointment was put to vote, but was lost; or
2. the retiring director has, in writing, expressed his unwillingness to continue; or
3. he is not qualified or is disqualified for appointment; or
4. a special or ordinary resolution is necessary for his appointment; or
5. it is resolved to fill two or more vacancies by a single resolution (Sec. 162).

14.7-4 Rotational and non-rotational directors vis-a-vis private company

In reply to a query: "Whether under the law it is compulsory for the private companies to have rotational directors?", the Department of Company Affairs [Now Ministry of Corporate Affairs] expressed the following views :

In the case of a private company which is not a subsidiary of a public company, it is not compulsory under the law that they must have rotational directors unless the Articles of Association of the company so require.

In the absence of any provision in the Articles, directors of an independent private company are entitled to continue until removed under section 284 [Now section 169] (*i.e.*, through general body resolution) - *S. Labh Singh* v. *Panaser Mech. Works (P.) Ltd.* [1987] 61 Comp. Cas. 618.

14.7-5 Appointment of a director other than a retiring director [Sec. 160]*

Section 160 along with Rule 13 of Companies (Appointment and Qualification of Directors) Rules, 2014 lay down the procedure of appointment of a person other than retiring director.

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*A private company has been exempted from the provisions of section 160— *Vide MCA Notification dated 5-6-2015.*

If any person, other than the retiring director wishes to stand for directorship or any member proposes a person for directorship, he must signify his intention to do so by giving 14 days' notice to the company before the general meeting and the company must inform the members at least seven days before the general meeting. The information shall be given:

(1) by serving individual notices, on the members through electronic mode to such members who have provided their email addresses to the company for communication purposes, and in writing to all other members; and

(2) by placing notice of such candidature or intention on the website of the company, if any:

However, it shall not be necessary for the company to serve individual notices upon the members as aforesaid, if the company advertises such candidature or intention, not less than seven days before the meeting at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and circulating in that district, and at least once in English language in an English newspaper circulating in that district.

Also, the candidate or the member who intends to propose him as director has to deposit a sum of Rs. 1 lakh or such higher amount as may be prescribed which shall be refunded to such person or, as the case may be, to the member, if the person proposed gets elected as a director or gets more than twenty-five per cent of total valid votes cast either on show of hands or on poll on such resolution.

However, requirements of deposit of amount shall not apply in case of appointment of an independent director or a director recommended by the Nomination and Remuneration Committee, if any, constituted under sub-section (1) of section 178 or a director recommended by the Board of Directors of the Company, in the case of a company not required to constitute Nomination and Remuneration Committee.

Time of tender of nomination - Since section 160 does not say that tender of nomination should be before a particular time on last day; rejection of nomination on ground that deposit was tendered one minute later than 3.30 p.m., *i.e.*, office hours for cash transactions, would be erroneous inasmuch as it contravened provisions of section 257 [Now section 160] - *Oriental Benefit and Deposit Society Ltd.* v. *Bharat Kumar K. Shah* [2001] 30 SCL 246 (Mad.).

An additional director, or a director who has been appointed to a casual vacancy or an alternate director or a director nominated by any financial institution or any other similar body or by the Tribunal, if he seeks appointment by the shareholders at a general meeting he must satisfy the requirements of section 160, as any such director is not a 'director retiring by rotation'. The expression 'director retiring by rotation' refers only to a director appointed by a company in general meeting and retiring.

Appointment of directors to be voted on individually - Section 162 prescribes the mode of voting on appointment of directors. No motion can be made at the general

meeting of a company for the appointment[4] of two or more persons as directors by a single resolution, unless a resolution is first unanimously passed that it shall be so made. A resolution moved in contravention of this provision shall be void, whether or not any objection was taken when it was moved*.

14.7-6 Appointment by Board of directors [Section 161]

The Board of directors can exercise the power to appoint directors in the following three cases :

(*i*) Additional Directors

(*ii*) Filling up the Casual Vacancy

(*iii*) Alternate Directors

(*iv*) Nominee Directors

14.7-6a *Appointment of Additional Director* - The articles of a company may confer on its Board of Directors the power to appoint any person as an additional director at any time. However, a person who fails to get appointed as a director in a general meeting cannot be so appointed.

It may thus be noted that without a power given by the Articles, the Board cannot appoint additional directors. The section applies to all companies, public as well as private - *Needle Industries (India) Ltd.* v. *Needle Industries Newey (India) Holdings Ltd.* AIR 1981 SC 1298.

Tenure of additional director - The person appointed as additional director shall hold office up to the date of the next annual general meeting or the last date, on which the annual general meeting should have been held, whichever is earlier.

The provision for an additional director is one which is meant to enable the companies to have the benefit of the services of a person, who otherwise is suitable for serving on the board, and whose presence in the board is desirable in the interests of the company, till the time the next AGM is scheduled to be held. That provision is not meant to enable the company to keep on its board a person as additional director for an indefinite period of time by not holding the AGM. Section 260 [now section 161], therefore, must necessarily be read with section 166 [now section 96] which stipulates that the AGM be held every year and not more than fifteen months shall elapse between the date of one AGM and the next - *P. Natarajan* v. *Central Government* [2004] 51 SCL 76 (Mad.).

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4. According to sub-section (3) a motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

*A private company has been exempted from the requirement of section 162. Accordingly, it may appoint two or more directors by passing a single resolution—*Vide MCA Notification dated 5-6-2015.* Again, (*a*) a Government company in which entire paid up share capital is held by the Central Government or by any State Government(s) or by the Central Government and State Government(s); or

(*b*) A subsidiary of a Government company, as aforesaid, in which entire paid up share capital is held by that Government company,

may appoint two or more directors by passing a single resolution.

Powers of Additional Directors - Additional directors will enjoy the same powers and rights as other directors. Through this route, the Board of directors can therefore appoint competent persons on the Board who may find it difficult to come through election.

Is a resolution passed at Board meeting necessary for appointment of Additional Directors? - Unlike in case of filling a casual vacancy which can be done only in a regular meeting of the Board [Section 161(4)], the appointment of additional directors may be made either at a meeting of the Board or by passing a resolution by circulation as provided in section 175.

Can an Additional Director be appointed as a Managing/Whole time Director? - A managing director or whole time director, unless the articles of a company provide otherwise, is to be appointed by the Board of directors. However, since any director can be appointed as a managing or whole time director and there being nothing in the Companies Act suggesting that an additional director cannot be appointed as the managing/whole time director, there should be no objection to the appointment of an additional director as a managing or whole time director. But the tenure of an additional director being limited to the holding of the Annual General Meeting and if the company at the Annual General Meeting does not re-appoint him as a director, he will automatically vacate his office as managing or whole time director also. It is because no person who is not a director can function as a managing or whole time director. The aforesaid view has also been endorsed by the *Department of Company Affairs [Now Ministry of Corporate Affairs].*

14.7-6b *Filling up Casual Vacancy* - Section 161(4) as amended by the Amendment Act, 2017, empowers the Board to fill casual vacancies in the case of any company including a private company. A casual vacancy is one that arises otherwise than by retirement or the expiration of the time fixed for an appointment. Thus, if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, subject to any regulations in the articles of the company, be filled by the Board of Directors **at a meeting of the Board**.

Tenure - It has to be noted that as per sub-section (4) of section 161, if the director fills up a casual vacancy and the same has been approved in the immediately next general meeting, then the person appointed will hold office not until the next Annual General Meeting only but for the entire period for which the person in whose place he was appointed would have held office. Thus, if Ram had been elected a director and died a month later, Bharat appointed in his place would continue for the whole period for which Ram, if he had not died, would have continued. But though Bharat would continue for the whole of the unexpired term for which Ram had been appointed; on the expiry of that term, Bharat will not be eligible for re-appointment as 'a director retiring by rotation'.

Director appointed in general meeting not assuming office - No casual vacancy arises if a director appointed by the company in general meeting does not assume office because it cannot be said that a casual vacancy arises by efflux of time. There is no question of someone vacating any office if he had never assumed that office. The words "director appointed by the company in general meeting" used in section

161(4) must be read with the words following, *i.e.,* "is vacated before his term of office expires in the normal course" - *M.K. Srinivasan* v. *W.S. Subrahmanya Ayyar* [1932] 2 Comp. Cas. 147.

Vacancy in the office of a non-rotational director - Whether a casual vacancy - A vacancy in the office of a non-rotational director appointed otherwise than through general meeting cannot be regarded as a casual vacancy under section 161 and thus cannot be filled up by the Board of directors.

14.7-6c *Alternate Director* - The Board of directors of a company may, if so authorised by its articles or by a resolution passed by the company in general meeting, appoint an alternate director to act for a director during his absence for a period of not less than three months from India. However, a person holding any alternate directorship for any other director in the company shall not be appointed. Again, a person who is already a director of the company cannot be appointed as an alternate director for another director in the same company.

No person shall be appointed as an alternate director for an **independent director** unless he is qualified to be appointed as an independent director under the provisions of this Act.

An alternate director is not an agent of the original director.

Consent: It seems that an alternate director appointed as such for the first time shall be required to file his consent with the Registrar. However, on his regular appointment as a director in continuation, it would not be necessary to file the consent [*Sec. 152(5)*].

When does an alternate director vacate his office - An alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed and shall vacate the office if and when the director in whose place he has been appointed returns to India.

Where the original director is a non-retiring director, an alternate director appointed in his place can continue indefinitely subject only to the condition that he shall vacate the office as and when the original director returns to India.

If the term of office of the original director is determined before he so returns to India, any provision for the automatic re-appointment of retiring directors in default of another appointment shall apply to the original, and not to the alternate director.

14.8 Resident Director

For the first time the Companies Act, 2013 has introduced the concept of resident director. Sub-section (3) of section 149 provides that every company shall have at least one director who stays in India for a total period of not less than one hundred and eighty-two days during the previous financial year.

However, in case of a newly incorporated company the requirement shall apply proportionately at the end of the financial year in which it is incorporated.

14.9 Independent Director*

Sub-section (4) of section 149 requires every listed public company to have at least one-third[5] of the total number of directors as independent directors and the Central Government may prescribe the minimum number of independent directors in case of any class or classes of public companies.

The Central Government vide Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 has prescribed as follows:

The following class or classes of companies shall have ***at least two directors*** as independent directors -

(*i*) the Public Companies having paid up share capital of ten crore rupees or more; or

(*ii*) the Public Companies having turnover of one hundred crore rupees or more; or

(*iii*) the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees.

However, in case a company covered under this rule is required to appoint a higher number of independent directors due to composition of its audit committee, such higher number of independent directors shall be applicable to it.

Any intermittent vacancy of an independent director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy, whichever is later:

Explanation - For the purposes of this rule, it is hereby clarified that, the paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account.

14.9-1 Who is an Independent Director

Section 149(6) of the Companies Act, 2013 defines independent director as under:

An independent director in relation to a company, means a director other than a managing director or a whole-time director or a nominee director,—

(*a*) who, in the opinion of the Board**, is a person of integrity and possesses relevant expertise and experience;

(*b*) (*i*) who is or was not a promoter of the company or its holding, subsidiary or associate company;

(*ii*) who is not related to promoters or directors in the company, its holding, subsidiary or associate company;

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*Provisions of sections 149 and 150 relating to appointment of independent directors shall not apply to a section 8 company—*Vide MCA Notification dated 5-6-2015.*

**In case of a Government Company for the word 'Board', the words shall be Ministry or Department of the Central Government which is administratively in charge of the company, or as the case may be, the State Government.

5. Any fraction contained in such one-third number shall be rounded off as one - Explanation.

(*c*) who has or had no pecuniary relationship, other than remuneration as such director, with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year*. However, remuneration not exceeding 10% of his total income or such amount as may be prescribed will not be considered as a disqualification for appointment as independent director**.

(*d*) none of whose relatives-

(*i*) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year:

However, the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

(*ii*) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;

(*iii*) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or

(*iv*) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (*i*), (*ii*) or (*iii*).

(*e*) who, neither himself nor any of his relatives—

(*i*) holds or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed.

However, in case of a relative who is an employee, the restriction under this clause shall not apply for his employment during preceding three financial years.

(*ii*) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of—

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*Clause (*c*) is not applicable to Government Companies—*Vide MCA Notification dated 5-6-2015.*

**_Vide_ Companies (Amendment) Act, 2017.

(*A*) a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(*B*) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent or more of the gross turnover of such firm;

(*iii*) holds together with his relatives two per cent or more of the total voting power of the company; or

(*iv*) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives twenty-five per cent or more of its receipts from the company, any of its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power of the company; or

(*f*) who possesses such other qualifications as may be prescribed.

Thus, nominee directors of Banks or Financial Institutions will not be considered as independent directors as per the Companies Act, 2013.

14.9-2 Selection of Independent Director

As per Section 150 of the Companies Act, 2013, an independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors. The responsibility of exercising due diligence before selecting a person as an independent director shall lie with the company making such appointment. The appointment of independent director shall be approved by the company in general meeting and the explanatory statement annexed to the notice of the general meeting called to consider the said appointment shall indicate the justification for choosing the appointee for appointment as independent director. Further, the explanatory statement for such appointment, annexed to the notice for the general meeting, shall include a statement that "in the opinion of the Board, he fulfils the conditions specified in this Act for such an appointment."

No person shall be appointed as an alternate director for an independent director unless he is qualified to be appointed as an independent director.

Schedule IV to the Companies Act, 2013 has very elaborately given the manner of appointment of independent directors, their re-appointment, tenure, resignation, removal and separate meetings of the independent directors as well as their evaluation. A summary of these provisions is being given hereunder.

14.9-3 Manner of Appointment

(1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively.

(2) The appointment of independent director(s) of the company shall be approved at the meeting of the shareholders.

(3) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management.

(4) The appointment of independent directors shall be formalised through a letter of appointment, which shall set out :

(*a*) the term of appointment;

(*b*) the expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;

(*c*) the fiduciary duties that come with such an appointment along with accompanying liabilities;

(*d*) provision for Directors and Officers (D and O) insurance, if any;

(*e*) the *Code of Business Ethics* that the company expects its directors and employees to follow;

(*f*) the list of actions that a director should not do while functioning as such in the company; and

(*g*) the *remuneration*, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.

(5) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.

(6) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

14.9-4 Re-appointment

The re-appointment of independent director shall be on the basis of report of performance evaluation.

14.9-5 Remuneration

Sections 149(9) and 197(7) read together provide that subject to the provisions of section 197, an independent director may receive remuneration by way of sitting fees for attending meetings of the Board or Committees thereof, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members. He shall, however, be not entitled to any stock option.

14.9-6 Resignation or Removal

(1) The resignation or removal of an independent director shall be in the same manner as is provided in sections 168 and 169 of the Act.

(2) An independent director who resigns or is removed from the Board of the company shall be replaced by a new independent director within a period of not

more than 3 months* from the date of such resignation or removal, as the case may be.

(3) Where the company fulfils the requirement of independent directors in its Board even without filling the vacancy created by such resignation or removal, as the case may be, the requirement of replacement by a new independent director shall not apply.

14.9-7 Separate Meetings

(1) The independent directors of the company shall hold *at least one meeting in a financial year***, without the attendance of non-independent directors and members of management;

(2) All the independent directors of the company shall strive to be present at such meeting;

(3) The meeting shall:

(*a*) review the performance of non-independent directors and the Board as a whole;

(*b*) review the performance of the Chairperson of the company, taking into account the views of executive directors and non-executive directors;

(*c*) assess the quality, quantity and timeliness of flow of information between the company management and the Board that is necessary for the Board to effectively and reasonably perform their duties.

14.9-8 Evaluation Mechanism

(1) The performance *evaluation of independent directors* shall be done by the entire Board of Directors, excluding the director being evaluated.

(2) On the basis of the report of performance evaluation, it shall be determined whether to extend or continue the term of appointment of the independent director.

14.9-9 Term of office

As per sub-sections (10) and (11) of Section 149, an independent director shall hold office for a term up to five consecutive years on the Board of a company and shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's report. No independent director shall hold office for more than two consecutive terms, but such independent director shall be eligible for appointment after the expiration of three years of ceasing to become an independent director. The provisions of section 152 in respect of retirement of directors by rotation shall not be applicable to appointment of independent directors.

14.9-10 Liability of Independent Directors

Sub-section (12) of Section 149 makes an independent director liable only in respect of such acts of omission or commission by a company which had occurred with his

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* *Vide* MCA Notification dated 5th July, 2017 (Substituted for 'one hundred and eighty days').

** *Vide* MCA Notification dated 5th July, 2017 (Substituted for 'year').

knowledge, attributable through Board processes, and with his consent or connivance or where he had not acted diligently.

14.9-11 Compliance with the Company's Code of Conduct[6]

As members of the Board, Independent Directors should, not only comply with the code of conduct and set an example for others but also establish, implement, monitor its adherence by other senior management.

The Companies Act, 2013, for the first time, laid down a code for independent directors in Schedule IV as follows:

I. Guidelines of professional conduct: An independent director shall:

(1) uphold ethical standards of integrity and probity;

(2) act objectively and constructively while exercising his duties;

(3) exercise his responsibilities in a bona fide manner in the interest of the company;

(4) devote sufficient time and attention to his professional obligations for informed and balanced decision making;

(5) not allow any extraneous considerations that will vitiate his exercise of objective independent judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;

(6) not abuse his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;

(7) refrain from any action that would lead to loss of his independence;

(8) where circumstances arise which make an independent director lose his independence, the independent director must immediately inform the Board accordingly;

(9) assist the company in implementing the best corporate governance practices.

II. Role and functions: - An independent director shall:

(1) help in bringing an *independent judgment* to bear on the Board's deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;

(2) bring an objective view in the evaluation of the *performance of board and management*;

(3) scrutinise the performance of management in meeting agreed goals and objectives and monitor the reporting of performance;

6. The Code is a guide to professional conduct for independent directors. Adherence to these standards by independent directors and fulfilment of their responsibilities in a professional and faithful manner will promote confidence of the investment community, particularly minority shareholders, regulators and companies in the institution of independent directors.

(4) satisfy themselves on the *integrity of financial information*; financial controls and the systems of risk management are robust and defensible;

(5) safeguard the interests of *all stakeholders*, particularly the *minority shareholders*;

(6) balance the conflicting interest of the stakeholders;

(7) determine appropriate levels of *remuneration of executive directors*, key managerial personnel and senior management and have a prime role in *appointing and where necessary recommend removal* of executive directors, key managerial personnel and senior management;

(8) moderate and arbitrate in the interest of the company as a whole, in situations of conflict between management and shareholder's interest.

III. Duties : The independent directors shall—

(1) undertake appropriate induction and regularly update and refresh their skills, knowledge and familiarity with the company;

(2) seek appropriate clarification or amplification of information and, where necessary, take and follow appropriate professional advice and opinion of outside experts at the expense of the company;

(3) strive to attend all meetings of the Board of Directors and of the Board committees of which he is a member;

(4) participate constructively and actively in the committees of the Board in which they are chairpersons or members;

(5) strive to attend the general meetings of the company;

(6) where they have concerns about the running of the company or a proposed action, ensure that these are addressed by the Board and, to the extent that they are not resolved, insist that their concerns are recorded in the minutes of the Board meeting;

(7) keep themselves well informed about the company and the external environment in which it operates;

(8) not to unfairly obstruct the functioning of an otherwise proper Board or committee of the Board;

(9) pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company;

(10) ascertain and ensure that the company has an adequate and functional vigil mechanism and to ensure that the interests of a person who uses such mechanism are not prejudicially affected on account of such use;

(11) report concerns about unethical behaviour, actual or suspected fraud or violation of the company's code of conduct or ethics policy;

(12) acting within their* authority, assist in protecting the legitimate interests of the company, shareholders and its employees;

**Vide* MCA Notification dated 5th July, 2017 (Substituted for 'his').

(13) not disclose confidential information, including commercial secrets, technologies, advertising and sales promotion plans, unpublished price sensitive information, unless such disclosure is expressly approved by the Board or required by law.

14.10 Appointment of directors by proportional representation [Section 163]

Ordinarily, directors are appointed by simple majority vote on the resolutions moved for their appointment. As a result majority shareholders controlling 51 per cent or more votes may elect all directors and a substantial minority, as high as 49 per cent, may find no representation on the Board. In order to enable the minority shareholders to have a proportionate representation on the Board, section 163 of the Companies Act, 2013 gives an option to companies to appoint directors through a system of proportional representation. The section provides that a company may provide in its Articles for the appointment of not less than 2/3rd of the total directors according to the principle of proportional representation by single transferable vote or some system of cumulative voting or otherwise. Such appointment shall be made once in every three years (Section 163).

Casual vacancies of such directors shall be filled as provided in sub-section (4) of section 161, *i.e.* by the Board of directors.

14.10-1 Single transferable vote

Under the system of single transferable vote, a quota of votes is fixed. A person gets elected if he gets the required number of votes fixed as quota. Quota is fixed in the following manner:

Suppose in an election 600 votes are cast and there are 5 seats. The quota shall be obtained by dividing the total number of votes cast by the total number of seats *plus* one and adding one to the result. Thus, the quota in this case will be 101 votes, calculated as follows:

$$\frac{600}{5+1} + 1 = 101 \text{ votes}$$

Now, let us see how this system works. Suppose there are seven candidates, *viz.*, A, B, C, D, E, F & G. The voters shall cast their votes by giving preference as preference 1, say, to A, preference 2 to B, preference 3 to C, and so on. At the first instance first preference votes are counted. All those candidates who get 101 or more first preference votes get elected. Let us suppose, on counting of first preferences, the following tally emerges:

A	gets	190 votes
B	gets	90 votes
C	gets	85 votes
D	gets	75 votes
E	gets	60 votes

F	gets	58 votes
G	gets	42 votes
Total votes polled		600 votes

Since A gets more than the quota, he shall be declared elected. We find that A has surplus 89 first preferences. His papers are scrutinised and the second preference found in them is counted. The second preferences in A's papers are noted as follows:

D -	30
E -	10
F -	15
G -	120
Total	175*

Accordingly, surplus of 1st preferences of A, *i.e.*, 89 votes shall be transferred to D, E, F and G in the ratio of their second preferences, *viz.*, 30:10:15:120. It shall come to :

$$D = \frac{30 \times 89}{175} = 15$$

$$E = \frac{10 \times 89}{175} = 5$$

$$F = \frac{15 \times 89}{175} = 8$$

$$G = \frac{120 \times 89}{175} = 61$$

Now the tally is :

A -	190
B -	90
C -	85
D -	$75 + 15 = 90$
E -	$60 + 5 = 65$
F -	$58 + 8 = 66$
G -	$42 + 61 = 103$

G gets the quota and is therefore elected. Now, since there are no surplus votes in any account; the elimination round starts. E, who has got the lowest adjusted number of first preference votes is eliminated. His 60 papers are scrutinised to note the second preferences therein and they are:

In favour of B - 11

In favour of C - 5

In favour of D - 15

In favour of F - 25

After transferring second preference in E's papers, the tally is :

A - 190

B - 90 + 11 = 101

C - 85 + 5 = 90

D - 90 + 15 = 105

E - 65

F - 66 + 25 = 91

G - 103

B and D get elected having obtained quota or more votes. Now, C has the next lowest and is therefore eliminated. His ballot papers shall now be scrutinised. It is found that there are 15 second preference in favour of F. These will be added to F's tally of 91 votes who then stands elected. Thus, A, B, D, F and G get elected.

14.10-2 Cumulative voting

As per the cumulative voting system, the total number of votes cast would be equal to the total number of shares multiplied by the number of directors to be elected. Again, each share carries that many votes as are the vacancies. Thus, if there are 1000 shares and ten directors are to be elected, the total number of votes cast would be equal to 10,000. A candidate getting 1000 votes should be declared elected. Now assuming that the minority holds 10 per cent of shares, *i.e.*, 100 shares, the total votes which the minority can therefore cast in favour of one or more candidate would be equal to $100 \times 10 = 1000$. In case, the minority is bent upon having at least one of its representatives on the Board, it can do so by casting all the votes in favour of that single candidate and in that event its representative would get elected.

14.11 Appointment of Directors by third parties (Nominee Directors)

There may be occasions when directors represent certain third parties in the Board. This usually happens when the Government, foreign collaborators, holding companies, financial institutions or other lenders, etc., nominate a director to represent their interest on the Board. The phenomenon of nominee directors has become an important feature of the modern Indian corporate scene. It is primarily because of the role of the various lending institutions like banks, mutual funds, public financial institutions, State financial corporations, etc. These lending institutions, in the modern corporate world have assumed a pivotal role in financing the various projects of the companies. Because of their heavy commitments, such providers of money naturally desire to safeguard their interests. Besides, they will also like to ensure that the money is invested in the stipulated purposes only. The right to nominate the directors on the Boards of financed companies is usually contained in the contract itself. However, the special legislations governing certain public

financial institutions and State financial corporations envisage the appointment of certain directors on the Boards of borrowing companies and such a provision has an overriding applicability in spite of the normal regulatory provisions of the Companies Act, the Memorandum of Association and the Articles of Association.

Except where a statute provides for nomination of directors on the Board of a company, nominee directors can be appointed only if a provision to that effect exists in the Memorandum of Association or Articles of Association of the company. It is because section 152 of the Companies Act, 2013 provides that unless the Articles provide for the retirement of all directors at every annual general meeting, not less than 2/3rds of the total number of directors of a public company shall be liable to retire by rotation. Sub-section (6) of section 152 provides that the remaining directors shall, in default of and subject to any regulation in the Articles of the company, also be appointed by the company in general meeting. Therefore, it would be necessary for the company to specifically provide in its Articles, or amend its Articles to provide, for appointment of a non-rotational director by the assisting financial institution(s) except those created by special Acts and having the overriding provision in this regard. Therefore, if the Articles do not contain a provision in this regard, they shall have to be first amended and only then the appointment can be made. It may be mentioned that in the case of statutes governing certain statutory financial institutions like the LIC, SFCs, etc. empower them to appoint nominee directors. Therefore, in their cases, the above procedure need not be followed as these special statutes override the provisions of the Companies Act and the Articles of Association.

It should be ensured that the total number of non-rotational directors does not exceed 1/3rd of the total strength of the Board.

What if a company refuses to accept a nominee director - Sometimes a company may not approve of a director nominated by the third party. The question that may then arise is that can the third party insist that the director nominated by it must be accepted and may thus refuse to provide an alternative. In this regard Perrins and Jeffreys in their *Company Law* observe, "it is doubtful whether the Court will grant either specific performance or an injunction in such case, and probably the third party's only remedy in case of breach is an action for damages, since the Court is loath to force on a company directors of whom the members do not approve".

However, in *British Murac Syndicate Ltd.* v. *Alperton Rubber Co. Ltd.* [1915] 2 Ch. 186, it was held that the company shall be compelled to accept the appointment unless the appointee is unfit to act as director, *e.g.*, where he has conflicting interests. This being a very old ruling, it seems the views expressed by the learned authors Perrins and Jeffreys may be the more acceptable position.

Liability of nominee directors - Nominee directors are in the same position and they owe same duties to the company as any other director.

However, by virtue of special provisions in the respective Acts governing different financial institutions, the directors nominated by the financial institutions have been given immunity from action for any liability as a director in the company.

Remuneration and sitting fee for Nominee Director - As the Act treats all the directors alike, there is no doubt that nominee directors are equally entitled to remuneration and sitting fee for Board and Committee Meetings. But the question

is whether the remuneration and the fee earned is personal to such director or through the director the amounts are payable to the nominating body/authority. The Act does not deal with the issue of nominee director; it is a matter either in the Articles of the company or in the statute governing the body/authority making the nomination. But as all directors in the company are recognized by the Act as individual persons, presumably there will not occur irregularity if nominee directors receive these payments in their personal capacity in the absence of a provision in the Articles or in any relevant statute. On the other hand, nominee directors are there in the company not by virtue of their personal standing but only because their employing body/authority has nominated them and as such, such directors have no right to appropriate the money. Till a court decision comes in this regard, the issue will remain open. Safer course for the company will be to obtain a written instruction from the nominating body/authority in this regard.

Common director/dual director - In the context of interlocked directorships prevalent in India as also in many other countries, the responsibility of a common director (*e.g.* director of the holding company as well as of the subsidiary company as a nominee of the holding company) needs closer examination. Here also a common director has to see that the *bona fide* interests of the company in which he is the nominee director does not suffer to benefit the nominating company. Apart from holding and subsidiary relationship this type of directorship is common in groups of companies.

14.12 Assignment of office by Director [Section 166(6)]

Section 166(6) prohibits assignment of his office by a director and sub-section (7) makes the assignment of office by a director punishable. The section applies to all companies. Section reads :

> *"(6) A director of a company shall not assign his office and any assignment so made shall be void.*
>
> *(7) If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees."*

Distinction between 'assignment' and 'appointment' - The Supreme Court has made a distinction between 'assignment' and 'appointment' and has held that where in the case of a private company a managing director who was holding his office for life and was empowered by the Articles to appoint a successor, appointed by will of one G to succeed him as managing director after his death, the 'appointment' of the successor did not come within the prohibition of the section. The Court observed : "The section talks of assignment of his office by a director". The word "his" would indicate that the office contemplated was one held by the director at the time of assignment. It is legitimate, therefore, to infer that by using the word 'his' the Legislature indicated that an appointment by a director to the office which he previously held but did not hold at the date of the appointment, was not to be included within the word 'assignment'. - *Oriental Metal Pressing* v. *Bhasker Kashinath Thakoor* [1961] 31 Comp. Cas. 143 : AIR 1961 SC 573. (*Reversing Oriental Metal Pressing Works (P.) Ltd.* v. *Bhaskar Kashinath Thakoor* [1960] 30 Comp. Cas. 682 (Bom.) see also *Thakur Paper Mills Ltd., In re* 1875 Tax LR 1656 (Pat.).

Again, where under an agreement of the directors of a private limited company and also a resolution passed at their meeting, one of them was appointed as the managing director and was given sole charge of the company's management and the other directors were given only an advisory role, it was held that this did not amount to an assignment. *Parmanand Choudhury* v. *Smt. Shukla Devi Mishra* [1988] 1 Comp. LJ 109 : [1990] 67 Comp. Cas. 45 (MP).

14.13 Minimum and maximum number of directors*

Section 149(1) provides that every company shall have a Board of Directors consisting of individuals as directors and shall have—

(*a*) a minimum number of three directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company; and

(*b*) a maximum of fifteen directors:

However, a company may appoint more than fifteen directors after passing a special resolution.

Again, a Government company may have more then 15 directors**

Besides, such class or classes of companies, as may be prescribed, shall have at least one woman director[7].

14.14 Appointment of woman director on the Board

Second proviso to section 149(1) read along with Rule 3 of Companies (Appointment and Qualifications of Directors) Rules, 2014 require appointment of at least one woman director on the Board of the following class of companies –

(*i*) every listed company;

(*ii*) every other public company having -

(*a*) paid-up share capital of one hundred crore rupees or more; or

(*b*) turnover of three hundred crore rupees or more[8] :

Compliance by new companies - A company, which has been incorporated under the Act and is covered under the aforesaid criteria, shall appoint at least one woman director within a period of six months from the date of its incorporation.

Casual vacancy - Any intermittent vacancy of a woman director shall be filled-up by the Board at the earliest but not later than immediate next Board meeting or three months from the date of such vacancy whichever is later.

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7. Every company existing on or before the date of commencement of this Act shall within one year from such commencement comply with the requirements of the provisions of sub-section (1).

8. Explanation - The paid up share capital or turnover, as the case may be, shall be taken as on the last date of latest audited financial statements.

*Provisions of section 149 relating to appointment of minimum and maximum number of directors shall not apply to section 8 company-*Vide MCA Notification dated 5-6-2015.*

***Vide MCA Notification dated 5-6-2015.*

Where there was delay in appointing woman director and prosecution against company and its officers was instituted by ROC before Special Court for said violation, on company's application for compounding of offence, same was to be permitted by levying compounding fees even though prosecution launched against company and its directors was pending before Special Court for said violation - *Tejas Networks Ltd., In re* [2017] 77 taxmann.com 255 (NCLT - Bangalore)

14.15 Appointment of director elected by small shareholders [Section 151]

A listed company may have one director elected by such small shareholders in such manner and with such terms and conditions as may be prescribed.

'Small shareholder' means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

The Ministry of Corporate Affairs, in this regard, has prescribed the rules. Rule 7 of Companies (Appointment and Qualification of Directors) Rules, 2014, *inter alia*, provides:

(1) A listed company, may upon notice of not less than one thousand small shareholders or one-tenth of the total number of such shareholders, whichever is lower, have a small shareholders' director elected by the small shareholders.

A listed company may opt to have a director representing small shareholders *suo motu*. In such a case the provisions of sub-rule (2) shall not apply for appointment of such director.

(2) The small shareholders intending to propose a person as a candidate for the post of small shareholders' director shall leave a notice of their intention with the company at least fourteen days before the meeting under their signatures specifying the name, address, shares held and folio number of the person whose name is being proposed[9] for the post of director and of the small shareholders who are proposing such person for the office of director.

(3) The notice shall be accompanied by a statement signed by the person whose name is being proposed for the post of small shareholders' director stating -

(*a*) his Director Identification Number or any other identification number notified by the Central Government;

(*b*) that he is not disqualified to become a director under the Act; and

(*c*) his consent to act as a director of the company

(4) Such director shall be considered as an independent director and should, therefore, meet the requirements of section 149 relating to independent directors.

(5) The appointment of small shareholders' director shall be subject to the provisions of section 152 except that-

9. If the person being proposed does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

(*a*) such director shall not be liable to retire by rotation;

(*b*) such director's tenure as small shareholders' director shall not exceed a period of three consecutive years; and

(*c*) on the expiry of the tenure, such director shall not be eligible for re-appointment.

(6) A person shall not be appointed as small shareholders' director of a company, if the person is not eligible for appointment in terms of section 164[10].

(7) A person appointed as small shareholders' director shall vacate the office if -

(*a*) the director incurs any of the disqualifications specified in section 164;

(*b*) the office of the director becomes vacant in pursuance of section 167;

(*c*) the director ceases to meet the criteria of independence as provided in sub-section (6) of section 149.

(8) No person shall hold the position of small shareholders' director in more than two companies at the same time.

The second company in which he has been appointed must not be in a business which is competing or is in conflict with the business of the first company.

(9) A small shareholders' director shall not, for a period of three years from the date on which he ceases to hold office as a small shareholders' director in a company, be appointed in or be associated with such company in any other capacity, either directly or indirectly.

14.16 Number of directorships

(1) As per section 165 of the Companies Act, 2013 a person, after the commencement of this Act, cannot hold office at the same time as a director in more than **twenty companies** except where members, by passing a special resolution, fix a lesser number. Out of the total number of twenty companies, his directorships in **public companies** cannot exceed **ten** including directorships in private companies that are either holding or subsidiary company of a public company. However, while counting 20 companies, directorship of dormant company shall not be included.

(2) As per sub-section (3) any person holding office as director in companies more than the specified limits immediately before the commencement of this Act shall, within a period of one year from such commencement,—

(*a*) choose, not more than the specified limit, companies in which he wishes to continue to hold the office of director;

(*b*) resign his office as director in the other remaining companies; and

(*c*) intimate the choice made by him:

(*i*) to each of the companies in which he was holding the office of director before such commencement; and

(*ii*) to the Registrar having jurisdiction in respect of each such company.

10. Section 164 contains disqualifications of a director.

Resignation, as above, shall become effective immediately on the despatch thereof to the company concerned [sub-section (4)].

Further, no such person shall act as director in more than the specified number of companies,—

(*a*) after despatching the resignation of his office as director or non-executive director thereof, in pursuance of clause (*b*) of sub-section (3); or

(*b*) after the expiry of one year from the commencement of this Act, whichever is earlier.

Penalty: If a person accepts an appointment as a director in contravention of sub-section (1), he shall be liable to a penalty of five thousand rupees for each day after the first during which such contravention continues.

14.17 Vacation of office of a director [Section 167]

Section 167 provides for the office of a director becoming vacant on the happening of certain events. Sub-section (1) of section 167 provides that the office of a director shall become vacant if:

(*a*) he incurs any of the disqualifications specified in section 164. However, where he incurs disqualification under sub-section (2) of section 164, the office of the director shall become vacant in all the companies other than the company that is in default under that sub-section*

(*b*) he absents himself from all the meetings of the Board of Directors held during a period of twelve months **with or without** seeking leave of absence of the Board;

(*c*) he fails to disclose or acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

(*d*) he becomes disqualified by an order of a court or the Tribunal;

(*e*) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months.

(*f*) he is removed in pursuance of the provisions of this Act;

Please note that the office shall not be vacated by the director in case of orders referred to in clauses (*e*) and (*f*) above—

(*i*) for thirty days from the date of conviction or order of disqualification;

(*ii*) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

*For disqualification u/s 164(2), *see* para 14.4.

(*iii*) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.

(*g*) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

Penalty: If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified above, he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees, or with both.

Disqualification of all the directors : Where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

A private company may, by its articles, provide any other ground for the vacation of the office of a director in addition to those specified in sub-section (1).

14.18 Removal of a director

The discussion on removal of a director may be grouped under the following two heads:

1. Removal by shareholders
2. Removal by Tribunal.

14.18-1 Removal by shareholders

Section 169 recognises the inherent right of shareholders to remove the directors appointed by them. It is not even necessary that there should be proof of mismanagement, breach of trust, misfeasance or other misconduct on the part of the directors. Where the shareholders feel the policies pursued by the directors or any of them are not to their liking, they have the option to remove the directors by passing an ordinary resolution in the same way as they have the right to appoint directors by passing an ordinary resolution.

Section 169 provides that a company may, by ordinary resolution of which special notice as per section 115 has been given, passed in general meeting, remove a director before the expiry of his term of office. However, the following directors cannot be so removed:

(*i*) Directors appointed by the Tribunal; and

(*ii*) Directors appointed under the system of proportional representation.

In *Queen Kuries & Loans (P.) Ltd.* v. *Sheena Jose* [1993] 76 Comp. Cas. 821 (Ker.), it was held that the notice must disclose the ground on which the director is proposed to be removed.

On receipt of the special notice for removal of a director, the company must forthwith send a copy thereof to the director concerned and the director, whether

or not he is a member of the company, shall be entitled to be heard on the resolution at the meeting.

If he makes a representation in writing and requests the company to notify it to the members, the company must, if the time permits it to do so,—

(*a*) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(*b*) send a copy of the representation to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representation by the company).

In case a copy of the representation is not sent as aforesaid due to insufficient time or for the company's default, the director may besides being heard orally require that the representation shall be read out at the meeting.

The copy of the representation of the director sought to be removed need not be circulated nor the concerned director be allowed the right to have the representation read out in the general meeting, if the company or any other person claiming to be aggrieved, the Tribunal is satisfied that the rights conferred by this sub-section are being abused to secure needless publicity for defamatory matter.

***Where Articles of Association of a company confer power on board of directors to remove a director* - Whether such power shall be affected by the provisions of section 169? -** In *Ravi Prakash Singh* v. *Venus Sugar Ltd.* [2008] 84 SCL 75, the Delhi High Court held that power to remove a director contained in the Articles is not affected by the provisions of section 284 [Now section 169]. In this case, since Articles of the company provided that co-promoters could remove or withdraw their nominees from Board of directors, co-promoters were held to be well within their rights to withdraw nomination of plaintiff as director of co-promoters.

Where petitioner-managing director by virtue of employment agreement himself agreed to get terminated by company on notice with 90 days time, he was estopped to say that he was not bound by agreement he entered into - *Gautam Bhardwaj* v. *Invest India Micro Pension Services (P.) Ltd.* [2015] 55 taxmann.com 208 (CLB - New Delhi).

In *Cyrus Investment (P.) Ltd.* v. *Tata Sons Ltd.* [2017] 78 taxmann.com 96 (NCLT), National Company Law Appellate Tribunal (NCLAT) dismissed appeals filed by family companies of Cyrus Mistry against orders of NCLT rejecting contempt application and refusing to pass interim order to restrain respondents from removing Mistry as director of respondent company at an Extraordinary meeting.

***Filling vacancy caused by removal of a director* -** A vacancy created by the removal of a director under this section may, if he had been appointed by the company in general meeting or by the Board, be filled by the appointment of another director in his place at the meeting at which he is removed. However, a special notice of the intended appointment must have been given.

A director so appointed shall hold office till the date up to which his predecessor would have held office if he had not been removed.

If vacancy is not filled by the company in general meeting, the Board of directors may fill it as if it were a casual vacancy in accordance with section 161. However, the Board cannot appoint the removed director [Section 169(7)].

Compensation for loss of office - Clause (*a*) of sub-section (8) of section 169 provides that removal of a director would not deprive the person of any compensation or damage for the termination of appointment as a director or for an appointment terminating with that as director. However, section 202 does not provide for payment of compensation for loss of office held by the director except in the capacity of managing director, whole time director or manager. Further, the managing or whole time director or manager *would not be entitled to any compensation:*

(*a*) where the director resigns his office in view of the reconstruction of the company, or of its amalgamation with any other body corporate or bodies corporate, and is appointed as the managing director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation;

(*b*) where the director resigns his office otherwise than on the reconstruction of the company or its amalgamation as aforesaid;

(*c*) where the office of the director is vacated under sub-section (1) of section 167;

(*d*) where the company is being wound up, whether by an order of the Tribunal or voluntarily, provided the winding up was due to the negligence or default of the director;

(e) where he has been guilty of fraud or breach of trust in relation to, or gross negligence in or, gross mismanagement, in the conduct of the affairs of the company or any subsidiary or holding company thereof;

(*f*) where as a director he had instigated or taken part directly or indirectly in bringing about the termination of his office.

(*g*) where the winding up of the company commences, before or at any time within twelve months after, the date on which he ceased to hold office, if the assets of the company on the winding up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital, including the premiums, if any, contributed by them.

Amount of compensation - Sub-section (3) of section 202 puts a ceiling on the amount of compensation payable to a director for loss of office. The sub-section provides that any payment made to a managing or other director in pursuance of sub-section (1) shall not exceed the remuneration which he would have earned if he had been in office for the unexpired residue of his term or for three years, whichever is shorter.

The amount payable shall be calculated on the basis of the average remuneration actually earned by him during the period of three years immediately preceding the date on which he ceased to hold the office. But, where he held the office for a lesser period than three years, the amount shall be calculated with reference to the period he actually worked.

14.18-2 Removal by Tribunal [Section 242]

Where an application has been made to the Tribunal under section 241 against oppression and mismanagement of a company's affairs, the Tribunal may order for

the termination or setting aside of an agreement which the company might have made with any of its directors. It may also order the removal of any of the directors of the company. A director so removed shall not be entitled to claim any compensation from the company for the loss of office [Section 243(1)(a)].

Besides, such a director shall not be entitled to serve as a manager, managing director or director of the company without leave of the Tribunal for a period of five years from the date of Tribunal's order terminating or setting aside his contract with the company [Section 243(1)(b)]. However, the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

Penalty: *Sub-section (2) of section 243 provides that* any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (*b*) of sub-section (1), and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to five lakh rupees, or with both.

14.19 Resignation by a Director

A director may resign from his office by giving a notice in writing to the company [Section 168(1)] on receipt of such notice, the Board shall take note of the same and the company shall intimate the Registrar in such manner, within such time and in such form as may be prescribed and shall also place the fact of such resignation in the report of directors laid in the immediately following general meeting by the company:

The director may also forward a copy of his resignation along with detailed reasons for the resignation to the Registrar within thirty days of resignation in such manner as may be prescribed.

The resignation of a director shall take effect from the date on which the notice is received by the company or the date, if any, specified by the director in the notice, whichever is later.

It may be noted that sub-section (2) of section 168 provides that the director who has resigned shall be liable even after his resignation for the offences which occurred during his tenure.

Where all the directors of a company resign from their offices, or vacate their offices under section 167, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in general meeting [Section 168(3)].

Resignation to be valid must be addressed to the company. Letter of resignation addressed to a third party shall have no effect - *Registrar of Companies* v. *Orissa Paper Products Ltd.* [1988] 63 Comp. Cas. 460 (Ori.). In *Saumil Dilip Mehta* v. *State of Maharashtra* [2002] 39 SCL 102 (Bom.), it was held that a director can resign just by sending in writing a letter informing either chairman or secretary of company, his intention to resign from post of director of said company. He can tender his

resignation unilaterally and without filling in Form No. 32 and without sending a notice to Registrar of Companies.

Once a resignation letter is submitted to the board, the date on which the intention to relinquish post is communicated to board would be the date from which the director ceases to be a director of the company - *Mother Care (India) Ltd.* v. *Prof. Ramaswamy P. Aiyar* [2004] 51 SCL 243 (Kar.).

Where a director has contracted to serve the company for a fixed period, he may resign subject to payment of damages, if any, suffered by the company as a consequence of premature termination of his service agreement.

Once a director has given a notice of resignation, he cannot withdraw it except with the consent of the company properly considered by the directors. But, where articles contain a provision that a director may resign only if the Board consents, the resignation shall not be effective until the Board's consent is given and the resignation may be withdrawn in the meantime - *Glossop* v. *Glossop* [1907] 2 Ch. 370.

A managing or whole time director cannot resign merely by giving a notice. In his case, a formal acceptance of the resignation by the company is essential. This is because of the fact that such a director, besides being an ordinary director, is also in the whole or substantially the whole time employment of the company. He has to be relieved of all the duties and responsibilities attaching to his office. The notice by a director holding office both of a whole time and ordinary director, for resignation shall apply to both the offices - *Mosely* v. *Koffyfontein Mines Ltd.* [1911] 1 Ch. 73.

Notice of resignation of director to the Registrar

As per Rule 15 of the Companies (Appointment and Qualification of Directors) Rules, 2014, the company must within 30 days from the date of receipt of notice of resignation from a director intimate the Registrar in Form DIR 12 and post the information on its website.

Further, Rule 16 requires the director to file, within 30 days of the date of resignation, with the Registrar a copy of his resignation along with reasons thereof in Form DIR 11.

Vide its Notification dated 19 January, 2015, MCA has issued the Companies (Appointment and Qualification of Directors) Amendment Rules, 2015 whereby in case a company has already filed Form DIR-12 with the Registrar under rule 15, a foreign director of such company resigning from his office may authorise in writing a practicing chartered accountant or cost accountant in practice or company secretary in practice or any other resident director of the company to sign Form DIR-11 and file the same on his behalf intimating the reasons for the resignation.

Clarification relating to filing of e-forms DIR-11 & DIR-12 under the Companies Act, 2013 - [General Circular No.03/2015; F.No.MCA21/272/2014]

The Ministry of Corporate Affairs has clarified that where due to **deactivation of Digital signature certificate (DSC) following en masse resignation of all the directors of a company** before appointment of new directors in their places, the Registrar of Companies within their respective jurisdictions are authorized, on request from the stakeholders, and after due examination, to allow any one of the

resigned director who was an authorized signatory Director for the purpose of filing DIR-12 only along with additional fees, as applicable and subject to compliance of other provisions of Companies Act, 2013.

Case Law: *Pinku Kumar Das* v. *Securities and Exchange Board of India* [2018] 91 taxmann.com 421 (SAT - Mumbai)

Facts of the Case: Appellant was director of company 'N' which had collected money through redeemable preference shares (RPS). SEBI by impugned order directed appellant, company and other directors to refund money collected. Appellant contended that he had resigned from directorship on 21-9-2011 so his liability was limited from date of appointment, *i.e.*, 20-12-2010 to 21-9-2011.

Decision: Held that since appellant did not pursue his resignation with ROC, appellant had not resigned from directorship on 21-9-2011 and it was only on 1-4-2013 that he had resigned from directorship. Therefore, liability of appellant under impugned order was to be restricted to period from 20-12-2010 to 1-4-2013 with interest, jointly and severally with company and other directors of company.

14.20 Validity of the acts of a director where his appointment is invalid [Section 176]

Section 176 provides that the acts done by a director shall be valid even if his appointment is discovered to be invalid because of any defect or disqualification or where his appointment had terminated by virtue of any provision contained in the Companies Act or in the articles.

Exceptions

However, the aforesaid position shall not prevail in the following cases:

(*i*) Where appointment is illegal or no appointment at all.

(*ii*) Where the director continues in his office knowingly that his term has expired.

(*iii*) Where the director knew from the beginning that his appointment was defective.

(*iv*) Acts done after his appointment has been noticed by the company to be invalid or to have terminated.

(*v*) Acts *ultra vires* the company.

(*vi*) Where the third party was aware of the irregularity, such party shall not be entitled to enforce against the company.

(*vii*) Where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid [Section 196(5)].

14.21 Powers of the Board of Directors

Section 179 of the Companies Act, 2013 provides for *General Powers* of the Board of Directors. It provides:

Subject to the provisions of the Act, the Board of Directors of a company shall be entitled to exercise all such powers, and to do all such acts and things, as the company is authorised to exercise and do.

In exercising the aforesaid powers or doing any of the aforesaid acts or things, the Board will be subject to the provisions contained in that behalf in the Companies Act or any other Act, or in the Memorandum or Articles of the company, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting.

Again, the Board cannot exercise those powers, acts or things which are directed or required, whether under the Companies Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting.

However, no regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

Thus, the Board may exercise all powers of the company and can do all such acts and things that the company can do except those which are specifically provided to be exercised or done by the company in a general meeting. But the exercise of such powers of the Board shall be in conformity with the provisions of the Companies Act or any other Act and Memorandum, Articles, and resolutions of the company passed in general meeting.

It is therefore clear that the powers of a company in respect of all matters are to be exercised by the Board of directors except where these are reserved for exercise by company in general meeting. In *Nibro Ltd.* v. *National Insurance Co. Ltd.* [1991] 70 Comp. Cas. 388 (Delhi), the Delhi High Court observed as follows:

> "It is well settled that under section 291 [Now section 179] except where express provision is made that the powers of a company in respect of a particular matter are to be exercised by the company in general meeting; in all other cases the Board of directors is entitled to exercise all its powers."

Do shareholders have the right to intervene? - Shareholders, by amending the articles may restrict the powers of the Board. But such amendment cannot be made retrospectively and a meeting of shareholders cannot therefore invalidate any act validly done by the Board. In *Jagdish Prasad* v. *Pt. Paras Ram* [1942] 12 Comp. Cas. 21 (All.), it was observed that it is a first and elementary principle of company law that, when powers are vested in a Board of directors by the Articles of association of a company, they cannot be interfered with by the shareholders as such. If the shareholders are dissatisfied with what the directors do, their remedy is to remove them in the manner provided by the Articles or the Act. But so long as a Board of directors exists and particular powers are vested in it by the Articles, the Board is entitled to exercise those powers without interference by the shareholders and it is irrelevant whether the shareholders approve of what the directors have done or not.

Further, majority shareholders cannot impugn the decision of the Board to institute judicial proceedings [*Herbertsons Ltd.* v. *Kishore Rajaram Chabbaria* [1999] 97 Comp. Cas. 429 (CLB-New Delhi)].

Exceptions - In the following cases, however, the general meeting of shareholders is competent to intervene and act in respect of a matter delegated to the Board of directors:

1. *Directors acting* mala fide - Where the directors act for their own personal interests in complete disregard to the interests of the company (*Marshall's Valve Gear Co.* v. *Manning Wardle & Co. Ltd.* [1909] 1 Ch. 267), or where the personal interest of the directors clashes with their duties towards the company, or when they try to avoid taking steps for the redressal of the wrong done to the company, the majority shareholders may act to redress the wrong.
2. *Directors themselves wrong doers* - Where the directors who are the only persons to conduct litigation in the name of the company, are themselves the wrong doers and have acted *mala fide*, the shareholders can take steps to redress the wrong - *Satya Charan Lal* v. *R.P. Bajoria* [1950] SLR 394.
3. *Incompetency of the Board* - When the Board has become incompetent to act, *e.g.*, where all the directors constituting the Board are interested in a dealing or where none of the directors was validly appointed, the majority of shareholders may exercise powers in a general meeting of the company. - *B.N. Vishwanathan* v. *Tiffins B.A. and P Ltd.* AIR 1953 Mad. 510.
4. *Deadlock in management* - When there is a deadlock in the management so that directors cannot exercise some of their powers, the majority shareholders may exercise the powers in a general meeting of the company. In *Barron* v. *Potter* [1914] 1 Ch. 895, the Articles of a company gave the Board of directors power to appoint additional directors. But owing to differences between the directors, no meeting could be held for the purpose. The Articles also did not confer any power on the shareholders to increase the number of directors. *Held*, the company retained the power to appoint additional directors in a general meeting.

Powers of the individual directors - Section 179 provides for general powers of the Board of directors. In other words, it is the collective wisdom of the directors which has been conferred the privilege of managing the affairs of the company. However, unless the Act or the articles otherwise provide, the decisions of the Board are required to be the majority decisions only. Individual directors do not have any general powers. They shall have only such powers as are vested in them by the Memorandum or Articles or otherwise by the Board of directors. Thus, unless a power to institute suit is specifically conferred on a particular director, he has no authority to institute a suit on behalf of the company - *Nibro Ltd.* v. *National Insurance Co. Ltd.* [1991] 70 Comp. Cas. 388 (Delhi).

Unless the power to institute a suit is specifically conferred on a particular director, he would have no authority to institute a suit on behalf of the company. Individual directors are vested with only such powers as are available to them either under the memorandum or articles of the company, or otherwise by the Board of directors. A managing director also does not have any power to manage the affairs of the

company over and above those available to the board; the managing director can exercise only such powers as have been delegated to him. A company cannot orally authorise another person to sign a plaint on its behalf. A company can act only as provided under its articles of association - *Floating Services Ltd.* v. *MV 'San Fransceco Dipalola'* [2004] 52 SCL 762 (Guj.).

Any director acting individually has no power to act on behalf of the company in respect of any matter except to the extent to which any power or powers of the Board have been delegated to him by the Board within the limit permitted by the Companies Act or any other law. The position of the Chairman of the Board of directors is not substantially different from an individual director - *Shubh Shanti Services Ltd.* v. *Manjula S. Agarwalla* [2005] 60 SCL 280 (SC).

Accordingly, a director who was authorized to institute a suit on behalf of the company by the Board, cannot in turn, authorize Sales Manager of the company to institute the suit. Board is the authority to delegate any act to be done for and on behalf of the company, subject to the restrictions in section 291 [Now section 179] of the Act, and not any individual director - *Eimco Elecon (I) Ltd.* v. *Mahanadi Coal Fields Ltd.* [2011] 110 SCL 622 (Orissa).

The mode or manner of exercise of Board's powers - Section 179(3) of the Companies Act, 2013 provides that the Board of directors of a company shall exercise the following powers on behalf of the company by means of resolutions passed at meetings of the Board:

(*a*) to make calls on shareholders in respect of money unpaid on their shares;

(*b*) to authorise buy-back of securities under section 68;

(*c*) to issue securities, including debentures, whether in or outside India;

*(*d*) to borrow monies[11];

*(*e*) to invest the funds of the company[12];

*(*f*) to grant loans or give guarantee or provide security in respect of loans;

(*g*) to approve financial statement and the Board's report;

(*h*) to diversify the business of the company;

(*i*) to approve amalgamation, merger or reconstruction;

(*j*) to take over a company or acquire a controlling or substantial stake in another company;

(*k*) any other matter which may be prescribed:

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11. The acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of this section [Second Proviso to section 179(3)].

12. This power shall however be subject to the provisions of sections 180 and 186

*These powers in case of a section 8 company may be exercised by the Board by passing the resolution through circulation instead of at a Board meeting—*Vide MCA Notification dated 5-6-2015.*

However, the Board may, by a resolution passed at a meeting, delegate to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office, the powers specified in clauses (*d*) to (*f*) on such conditions as it may specify.

Further, sub-section (4) of section 179 provides that the company in general meeting may impose any restrictions and conditions on the exercise by the Board of any of the powers specified above.

Besides the powers specified in section 179 there are certain other powers also which *can be exercised only at the meeting of the Board. These include:*

1. The power of filling casual vacancies in the Board (Section 161).
2. Sanctioning of a contract in which a director is interested (Section 188).
3. The power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the approval by the shareholders.
4. The power to make political contributions (Section 182).
5. The power to appoint a person as managing director or manager who is holding either office in another company (Section 203).
6. The power to give loan to or invest in any shares of any other body corporate[13] (Section 186).
7. The power to enter into any contract or arrangement with a related party (Section 188).
8. The power to appoint or remove key managerial personnel[14]
9. To appoint internal Auditors and secretarial auditor[14]

14.21-1 Restrictions on powers of directors:

Section 180 of the Companies Act, 2013 provides that the Board of directors of a company cannot exercise the following powers without the consent of the shareholders by way of special resolution* :

(*a*) Sell, lease or otherwise dispose of the whole, substantially the whole[15], of the undertaking[16] of the company, or where the company owns more than one undertaking, of the whole or substantially the whole, of any such undertaking.

13. Section 186 requires that not only the resolution be passed at a meeting of the Board but it must be an unanimous resolution.
14. The Companies (Meetings of Board and its Powers) Rules, 2014, as amended vide Notification No. GSR 206(E) [F. No. A-1/32/2013-CL-V-PART], dated 18.3.2015
15. The expression "substantially the whole of the undertaking" in any financial year shall mean twenty per cent or more of the value of the undertaking as per the audited balance sheet of the preceding financial year - *Explanation* to section 180(1)(*a*)(*ii*).
16. "undertaking" shall mean an undertaking in which the investment of the company exceeds twenty per cent of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent of the total income of the company during the previous financial year - *Explanation* to section 180(1)(*a*)(*i*).

*Private companies have been exempted from the requirement of special resolution—*Vide MCA Notification dated 5-6-2015.*

The special resolution passed by the company consenting to the transaction of sale or lease, as above, may stipulate such conditions as may be specified in such resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

The aforesaid restriction shall not be applicable to the sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.

Again, the title of a buyer or other person who buys or takes on lease any property, investment or undertaking in good faith shall not be affected.

Company Law Board [Now Tribunal] in *Aasia Properties Development Ltd.* v. *Juhu Beach Resorts Ltd.* [2007] 74 SCL 153 (CLB - New Delhi) held that the provisions of section 293 [Now section 180] are attracted only in cases of sale, lease or otherwise disposal of an undertaking. Thus, in a hotel industry where it is common to enter into a management contract with reputed international hotel chains, which use its expertise in manning and managing hotel for an agreed consideration as management fees, no sale or lease can be said to be involved so as to attract the provisions of section 293(1)(*a*) [Now section 180 (1)(a)].

In *Thakur J. Bakshani* v. *Shriutivinda Agro Farms (P.) Ltd., Hyderabad* [2018] 91 taxmann.com 13 (Madras), the Madras High Court held that the sale of immovable properties as well as plant and machineries either individually or collectively would fall within section 293(1)(a) (*now section 180*) and for effecting such a sale, consent/approval of shareholders of company is required. Sale without the consent of shareholders was void.

(*b*) Invest, otherwise than in trust securities, the amount of compensation received by it as a result of any merger or amalgamation.

(*c*) Borrow monies exceeding the aggregate of the paid-up capital of the company, its free reserves and securities premium. **'Borrowing' does not include temporary loans** *(i.e., loans payable on demand or within six months such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character but excluding loans for capital expenditure)* obtained from the company's bankers in the ordinary course of business.

The special resolution passed by the company in general meeting must specify the total amount up to which monies may be borrowed by the Board of Directors.

Borrowing by the company in excess of the limit, as aforesaid, shall not be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded [Sub-section (5)].

(*a*) Remit or give time for the repayment of any debt due by a director.

(*b*) Contribute to a charitable or other fund.

However, as per section 181, the Board of Directors of a company may contribute to *bona fide* charitable and other funds any amount the aggregate of which, in any

financial year, does not exceed five per cent of its average net profits for the three immediately preceding financial years. Any contribution beyond this ceiling will require the prior approval of shareholders. But, the resolution required to be passed is ordinary resolution only and not the special resolution.

With respect to clause (c) above, you should note that the Companies Act does not expressly empower companies to borrow money. Therefore, most of the companies expressly provide for such borrowing powers in the Memorandum. In such cases, where Memorandum authorises the company to borrow, the Articles provide as to how and by whom these powers shall be exercised. It may also fix up the maximum amount which can be borrowed by the company. It may, however, be noted that a trading company has an inherent implied power to borrow even if the objects clause in the memorandum of association is silent on borrowal. But, in many instances it may be difficult to specify a company as clearly a trading company. As such, as a safety measure, it is usual for the companies to take the power to borrow through the memorandum of association.

14.21A COMMITTEES OF THE BOARD

As discussed, the day to day management of a company is with the Board of Directors. The Board of Directors is empowered to do all such acts and things as the company is authorized to exercise and do. In discharge of its function, the Board of Directors may constitute various committees consisting of the board members. A committee therefore is a sub-set of the Board of Directors. Committees are formed for some specialized work and the committee members are expected to have expertise in the specified field. The role and structure of each board committee is defined by the Board of Directors. It may be noted that the Board of Directors is responsible for the acts of the committee. The Act mandates constitution of various committees for improved governance and efficiency of the Board of Directors.

Audit Committee

Section 177 requires every listed company and such other companies as may be prescribed, to constitute an audit committee. Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014 requires the following classes of companies to constitute an Audit Committee of the Board—

i. all public companies with a paid up capital of ten crore rupees or more;

ii. all public companies having turnover of one hundred crore rupees or more;

iii. all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority. The majority of members of Audit Committee including its Chairperson shall be persons with ability to read and understand the financial statement.

As per the listing agreement, two third of the members of the Audit Committee shall be independent directors and the committee is required to be chaired by an independent director. The Company Secretary shall act as the secretary to the Audit Committee. The audit committee must meet at least four times a year and not more than one hundred and twenty shall elapse between two meetings.

The primary focus of the Audit Committee is on the oversight of financial reporting and disclosures. It *inter alia* is responsible for:

i. making recommendation for appointment, remuneration and terms of appointment of auditors of the company;

ii. reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;

iii. examining the financial statements and the auditors' report thereon;

iv. approving and modification of transactions of the company with related parties;

v. scrutiny of inter-corporate loans and investments;

vi. valuing of undertaking or assets of the company, whenever necessary;

vii. evaluating internal financial controls and risk management systems; and

viii. monitoring the end use of funds raised through public offers and related matters.

The listing agreement further lays down the role of the audit committee in respect of listed companies.

The composition of Audit Committee needs to be disclosed in the Board's Report. If the Board of Directors has not accepted any recommendation of the Audit Committee, the same along-with reasons thereof, is also required to be disclosed in the Board's report.

Risk Management Committee

The listing agreement requires that a Risk Management Committee shall be constituted by the top 100 listed companies based upon the market capitalization. The Board of Directors is responsible for framing, implementing and monitoring risk management in the company, which is delegated to the Risk Management Committee. The role and responsibilities of the Risk Management Committee are defined by the Board of Directors.

The Risk Management Committee shall consist of members of the Board of Directors. Other executives of the company may also be made members of the committee; however majority shall consist of members of the Board of Directors. The Risk Management Committee is chaired by a member of the Board of Directors.

Nomination and Remuneration Committee

Section 178 requires every listed public company and such other class of companies as may be prescribed, to constitute the Nomination and Remuneration Committee of the Board of Directors. Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014 requires the following classes of companies to constitute a Nomination and Remuneration Committee of the Board —

(*i*) all public companies with a paid up capital of ten crore rupees or more;

(*ii*) all public companies having turnover of one hundred crore rupees or more;

(*iii*) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

The Nomination and Remuneration Committee shall consist of a minimum of three non-executive directors with independent directors forming a majority. The Chairperson of the company may be appointed as a member of the Nomination and Remuneration Committee but shall not chair the Committee. As per the listing agreement, all the members of the Nomination and Remuneration Committee shall be non-executive directors and the chairperson shall be an independent director.

The Nomination & Remuneration Committee *inter alia* is responsible for:

(*i*) identifying persons who are qualified to become directors and who may be appointed in senior management positions;

(*ii*) specifying manner for effective evaluation of performance of Board, its committees and individual directors.

(*iii*) Formulating the criteria for determining qualifications, positive attributes and independence of a director; and

(*iv*) recommending to the Board, a policy relating to the directors, key managerial personnel and other employees.

The listing agreement further lays down the role of the Nomination and Remuneration Committee in respect of listed companies.

Stakeholder Relationship Committee

As per section 178(5), a company which consists of more than one thousand shareholders, debenture-holders, deposit-holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee. The Stakeholders Relationship Committee is chaired by a non-executive director and may have other members as may be decided by the Board.

The Stakeholders Relationship Committee is primarily responsible for looking into the mechanism of redressal of grievances of shareholders, debenture holders and other security holders including complaints related to transfer of shares, non-receipt of annual report and non-receipt of declared dividends.

Corporate Social Responsibility Committee (CSR Committee)

Sec. 135(1) requires every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year to constitute a Corporate Social Responsibility (CSR) Committee of the Board.

The CSR committee shall consist of three or more directors, out of which at least one director shall be an independent director. The composition of the CSR committee shall be disclosed in the Board's Report.

The CSR committee is responsible for:

i. formulating and recommending to the Board, a CSR Policy indicating the activities to be undertaken by the company;

ii. recommending the amount of expenditure to be incurred on the CSR activities;

iii. monitoring the Corporate Social Responsibility Policy of the company from time to time.

It may be noted that the activities to be undertaken have been specified in Schedule VII of the Act and the company is required to spend, in every financial year, at least two per cent of the average net profit of the company made during the three immediately preceding financial years, on CSR activities.

14.22 Political contributions by Directors [Section 182]

14.22-1 Meaning of Political Contribution

The word 'contribution' means payment without consideration. Apart from the clear meaning of the word 'contribution' according to section 182(2), the expression 'political contribution' includes: (*a*) a donation or subscription or payment caused to be given by a company on its behalf or on its account to a person who, to its knowledge, is carrying on any activity which can reasonably be regarded as likely to affect public support for a political party, at the time of donation, subscription or payment; and

(*b*) the amount of expenditure incurred, directly or indirectly, by a company on advertisement in any publication (being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like) by or on behalf of a political party or for its advantage.

Thus, 'contribution would include donation, subscription or any other payment'. The same may or may not be given by the company itself. Even if someone gives it on behalf of the company or on its account, the same would be treated as political contribution. Further, the amount need not be contributed directly to a political party but may even be given to any person who is canvassing support for a political party. Even such a contribution would be deemed to be contribution for a political purpose. Even direct or indirect expenditure by a company on advertisement in any publication, in certain circumstances, may be deemed to be political contribution either to a political party or for a political purpose. The publication may be a souvenir, a brochure, a tract, a pamphlet or the like. What needs to be seen is whether or not the advertisement is to gain advantage for a political party or that it is by or on behalf of a political party.

Are all companies entitled to make political contributions? - Section 182 allows companies to make contributions to political parties or for political purposes to any person, directly or indirectly, out of their profits. However, the following companies are not allowed to make political contributions:

(*i*) Government companies; and

(*ii*) Companies which have been in existence for less than three financial years.

Any other company may contribute any amount to any political party or for any political purpose subject, however, to the following conditions:

(*i*) Before any such contribution is made by the company, a resolution authorising the making of the contribution shall be passed at a meeting of the Board of directors.

(*ii*) The company shall disclose in its profit and loss account the amount or amounts of such contributions during the financial year to which that account relates, giving particulars of the total amount contributed.

(*iii*) The contribution shall not be made except by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account. However, a company may make contribution, through any instrument issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

Penalty - If a company makes any contribution in contravention of the provisions of section 182—

(*a*) the company shall be punishable with fine up to five times the amount so contributed; and

(*b*) every officer of the company who is in default shall be punishable with imprisonment which may extend to six months and with fine which may extend to five times the amount so contributed.

14.23 Related party transactions [Section 188]

(1) Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed[17], no company shall enter into any contract or arrangement with a related party with respect to—

(*a*) sale, purchase or supply of any goods or materials;

(*b*) selling or otherwise disposing of, or buying, property of any kind;

(*c*) leasing of property of any kind;

(*d*) availing or rendering of any services;

(*e*) appointment of any agent for purchase or sale of goods, materials, services or property;

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17. Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 has prescribed the following conditions with respect to any contract or arrangement with a related party:-

(1) The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-

(*a*) the name of the related party and nature of relationship;

(*b*) the nature, duration of the contract and particulars of the contract or arrangement;

(*c*) the material terms of the contract or arrangement including the value, if any;

(*d*) any advance paid or received for the contract or arrangement, if any;

(*e*) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;

(*f*) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and

(*g*) any other information relevant or important for the Board to take a decision on the proposed transaction.

(2) Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

(*f*) such related party's appointment to any office or place of profit[18] in the company, its subsidiary company or associate company; and

(*g*) underwriting the subscription of any securities or derivatives thereof, of the company.

However, no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution* and no such member who is a related party shall vote on such resolution[19]. It may be noted that the restriction relating to voting shall not apply to a company in which 90% or more members, in number are relatives of promoters or are related parties. Again in case of a private company, such member may vote— *Vide MCA Notification dated 5-6-2015.*

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* Companies (Amendment) Act, 2015 requires only an ordinary resolution to be passed.

18. The expression "office or place of profit" means any office or place—

(*i*) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(*ii*) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise. [*Explanation (a)*]

19. As per Rule 15(3) of Companies (Meetings of Board and its Powers) Rules, 2014 (as amended by the Companies (Meetings of Board and its Powers) Amendment Rules, 2017), a company shall not enter into any contract or arrangement with a related party except with the prior approval of the company by a special resolution* and subject to the following conditions, namely:-

(*a*) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned below -

(*i*) sale, purchase or supply of any goods or materials, directly or through appointment of agent, amounting to ten per cent or more of the turnover of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (a) and clause (e) respectively of sub-section (1) of section 188;

(*ii*) selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent, amounting to ten per cent or more of net worth of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (b) and clause (e) respectively of sub-section (1) of section 188;

(*iii*) leasing of property of any kind amounting to ten per cent or more of the net worth of the company or ten per cent or more of turnover of the company or rupees one hundred crore, whichever is lower, as mentioned in clause (c) of sub-section (1) of section 188;

(*iv*) availing or rendering of any services, directly or through appointment of agent, exceeding ten per cent of the turnover of the company or rupees fifty crore, whichever is lower, as mentioned in clause (d) and clause (e) respectively of sub-section (1) of section 188:

Explanation.—It is hereby clarified that the limits specified in sub-clauses (i) to (iv) shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

(Contd on p. 485)

However, transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length[20] basis shall not be affected by the aforesaid provisions[21].

(2) Every contract or arrangement entered into under sub-section (1) shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.

(3) Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting under sub-section (1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be **voidable at the option of the Board** or as the case may be, of the shareholders and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.

(4) The company may proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this

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(Contd. from p. 484)

(*b*) is for appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and half lakh rupees as mentioned in clause (f) of sub-section (1) of section 188; or

(*c*) is for remuneration for underwriting the subscription of any securities or derivatives thereof, of the company exceeding one per cent of the net worth as mentioned in clause (g) of sub-section (1) of section 188.

Explanation - (1) The Turnover or Net Worth referred in the above sub-rules shall be computed on the basis of the Audited Financial Statement of the preceding Financial Year.

(2) In case of a wholly owned subsidiary, the special resolution* passed by the holding company shall be sufficient for the purpose of entering into the transactions between the wholly owned subsidiary and the holding company. However, the requirement of passing the resolution, as aforesaid, shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval. – *Vide the Companies (Amendment) Act, 2015*

(3) The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars : -

(*a*) name of the related party ;

(*b*) name of the directors or key managerial personnel who is related, if any;

(*c*) nature of relationship;

(*d*) nature, material terms, monetary value and particulars of the contract or arrangement;

(*e*) any other information relevant or important for the members to take a decision on the proposed resolutions."

20. The expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest [*Explanation (b)*].

21. In case of wholly owned subsidiary, the resolution passed by the holding company shall be sufficient for the purpose of entering into the transactions between wholly owned subsidiary and holding company [**Explanation (2)**].

section for recovery of any loss sustained by it as a result of such contract or arrangement.

(5) Any director or any other employee of a company, who had entered into or authorized the contract or arrangement in violation of the provisions of this section shall,—

(*i*) in case of **listed company**, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and

(*ii*) in case of **any other company**, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

Meaning of related party - "Related party", as per section 2(76), with reference to a company, means—

(*i*) a director (other than an independent director) or his relative; [Section 2(77) read along with Rule 4 of Companies (Specification of Definitions Details) Rules, 2014, says '**relative**' with reference to any person, **means** anyone who is related to another, if— (*i*) they are members of a Hindu Undivided Family; (*ii*) they are husband and wife; or (*iii*) if he or she is (*a*) Father including step-father; (*b*) Mother including the step-mother; (*c*) Son including the step-son; (*d*) Son's wife; (*e*) daughter; (*f*) daughter's husband; (*g*) brother including step brother and (*h*) sister including step sister;

(*ii*) a key managerial personnel or his relative;

(*iii*) a firm, in which a director, manager or his relative is a partner;

(*iv*) a private company in which a director or manager or his relative is a member or director;

(*v*) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

(*vi*) any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(*vii*) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (*vi*) and (*vii*) shall apply to the advice, directions or instructions given in a professional capacity;

(*viii*) any body corporate which is-

(A) a holding, subsidiary or an associate company of such company;

(B) a subsidiary of a holding company to which it is also a subsidiary; or

(C) an investing company or the venturer of the company;

Explanation.—For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the

company would result in the company becoming an associate company of the body corporate (*i.e.*, at least 20% voting power).

(*ix*) such other person as may be prescribed.

14.24 Interested Director [Section 184]

A director who is interested in a transaction of the company must disclose his interest to the Board. Section 184 in this regard provides that every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals. The disclosure shall include the shareholding and shall be made in such manner as may be prescribed.

Further, sub-section (2) requires every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

(*a*) with a body corporate in which such director or such director in association with any other director, holds **more than two per cent** shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or

(*b*) with a firm or other entity in which, such director is a partner, owner or member, as the case may be,

shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting.**

Where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

Non-disclosure of the interest by a director or his participation in the meeting renders the contract or arrangement voidable and not void [Sub-section (3)].

However, the director shall be punishable with imprisonment for a term which may extend to one year or with fine which may extend to one lakh rupees, or with both [Sub-section (4)].

It may be noted that the Companies Act, 2013 does not prevent a company to enter into a contract or arrangement in which a director is interested. Section 184 only requires the disclosure of director's interest at a meeting of the Board.

Exception: — The aforesaid disclosure requirement does not apply to any contract or arrangement entered into or to be entered into between two companies or body corporates where any of the directors of the one company or the body corporate

**However, director of a private company may participate in the meeting after disclosure of his interest—*Vide MCA Notification dated 5-6-2015.*

or two or more of them together holds or hold not more than two per cent of the paid-up share capital in the other company or the body corporate.

14.24-1 Disclosure of Interest

Please see discussion under 'Duties of Directors'.

14.25 Duties of Directors

Duties of Directors may be divided under two heads :

1. Statutory Duties, and
2. General Duties.

14.25-1 Statutory duties

Statutory duties are the duties and obligations imposed by the Companies Act. Important among them are :

(*a*) *To file return of allotments* - Section 39(4) of the Companies Act, 2013 requires a company to file with the Registrar, within a period of 30 days, a return of the allotments stating the specified particulars. Failure to file such return shall make the company and its officer who is in default liable to a penalty, for each default, of Rs. 1,000 per day till the default continues or on lakh rupees, whichever is less.

Where company filed Form 2 for allotment of shares with defective list of allottees and subsequently filed proper Form, since delay was not wilful, in view of ROC's observations, offence was to be compounded on payment of compounding fees - *Mrs. Kiran Mazumdar Shaw, In re* [2017] 77 taxmann.com 95 (NCLT - Bang.)

(*b*) Duties under Section 166 - Section 166 provides that:

(*1*) Subject to the provisions of this Act, a director of a company shall act in accordance with the articles of the company.

(*2*) He shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

Case Law: *Mrs. Sandhya Varma* v. *Union of India* [2017] 78 taxmann.com 344 (Madras)

Facts: In this case, a complaint was filed by bank against accused company, its directors and bank officials under section 13(1) of the Prevention of Corruption Act alleging that the company entered into criminal conspiracy with bank officials and cheated complainant by submitting glossy, unsigned, fudged and inflated balance sheet to avail over draft facilities of Rs. 250 lakhs which resulted in a wrongful loss to bank. Petitioner-director filed application for discharge - Trial Court dismissed said application.

Decision : Since petitioner had knowledge of submitting inflated value in book debts and had managed to get required amount of loan by persuading bank

authorities, it was held that the petitioner had actively participated in day-to-day activities of accused-company along with her husband. Besides, there were *prima facie* materials available to proceed case against petitioner, and hence there was no illegality, infirmity or perversity in order passed by Additional Chief Metropolitan Magistrate in dismissing discharge petition filed by petitioner.

(*3*) He shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

(*4*) A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

Where a person was a director in a running business but started her independent business in competition with her own company, the Delhi High Court held her act to be *prima facie* not *bona fide* as it was done for monetary purposes and same was in violation of her fiduciary duties as a director under section 166 - *Rajeev Saumitra* v. *Neetu Singh* [2016] 66 taxmann.com 18 (Delhi).

(*5*) He shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

(*6*) A director of a company shall not assign his office and any assignment so made shall be void.

(*c*) *To disclose interest (Section 184)* - A director who is interested in a transaction of the company must disclose his interest to the Board. The disclosure must be made at the first meeting of the Board held after he has become interested.

If a director fails to disclose his interest, as aforesaid, he shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees, or with both.

Where general notice of disclosure was given by directors but same could not be taken on note in Board Meeting as no board meeting was conducted, there was non-compliance of section 184 (Section 299 of the Companies Act, 1956). - *Personal Performance Consultants India (P.) Ltd., In re* [2016] 75 taxmann.com 299 (NCLT - Bang.)

Where the whole body of directors is aware of the facts, a formal disclosure is not necessary - *Venkatachalapati* v. *Guntur Mills* AIR 1929 Mad. 353.

(*d*) *To disclose receipt from transfer of property (Section 191)* - Any money received by the directors from the transferee in connection with the transfer of the company's property or undertaking must be disclosed to the members of the company and approved by the company in general meeting. Other-

wise, the amount shall be held by the directors in trust for the company. This money may be in the nature of compensation for loss of office or as consideration for retirement from office but in essence may be on account of transfer of control of the company.

However, the amount received from the company by a managing director or whole-time director or manager as compensation for loss of office or as consideration for retirement from office shall not be covered by the aforesaid requirement.

If a director of the company contravenes the provisions of this section, such director shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(*e*) *To disclose receipt of compensation from transferee of shares (Section 191)* - If the loss of office results from the transfer (under certain conditions) of all or any of the shares of the company, its directors would not receive any compensation from the transferee unless the same has been approved by the company in general meeting before the transfer takes place. If the approval is not sought or the proposal is not approved, any money received by the directors shall be held in trust for the shareholders who have sold their shares.

If a director of the company contravenes the provisions of this section, such director shall be liable to a penalty of one lakh rupees*.

(*f*) *Duty to attend Board meetings* - A number of powers of the company are exercised by the Board of directors in their meetings held from time to time. Although a director may not be able to attend all the meetings but if he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board, his office shall automatically fall vacant [Section 167(1)(*b*)].

(*g*) To convene Annual General Meeting (AGM) and also extraordinary general meetings [Sections 96 & 100].

(*h*) To prepare and place at the AGM along with the financial statements including consolidated financial statement, if any, and auditors' report, a report by the Board of Directors covering the specified particulars (Sections 134).

(*i*) To authenticate annual financial statement including consolidated financial statement, if any (Section 134).

(*j*) To appoint first auditor of the company (Section 139).

(*k*) To appoint cost auditor of the company (Section 148).

It may be noted that the above is not an exhaustive listing of statutory duties of the Board.

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* *Vide* Companies (Second Amendment) Ordinance, 2019.

14.25-2 General duties

General duties of directors are as follows :

1. *Duty of good faith* - The directors must act in the best interest of the company. Interest of the company implies the interest of present and future members of the company on the footing that the company would be continued as a going concern.

   Thus a director should not make any secret profits. He should also not exploit to his own use the corporate opportunity. In *Cook* v. *Veeks* [1916] AC 554, it was observed that "men who assume complete control of a company's business must remember that they are not at liberty to sacrifice the interest which they are bound to protect and while ostensibly acting for the company, direct in their own favour business which should properly belong to the company they represent.

   In this case there was an offer of a contract to the company. Directors who were the holders of the share of 3/4th of the votes resolved that the company had no interest in the contract and later entered into the contract by themselves. Held, the benefit of the contract belonged in equity to the company.

   As regards the director selling his property to the company there would be breach of faith and he would have to account for the profit to the company if the property was acquired by him under circumstances which made it in equity the property of the company. But if the property in equity as well as in law belonged to him, there is no breach of faith - *Burland* v. *Earle* [1902] AC 83. In this case, the plaintiff was a director in one company and a shareholder and creditor in another company. The second company was being wound-up and the plaintiff purchased the assets of the second company at a public auction in four lots. One such lot he sold to the former company (in which he was a director) at almost three times the price he had paid for it. The lower Court decided that he should account for the profit on resale to the company. But the Privy Council overruled the decision.

   Again, if the property is acquired by a director by reason of the fact that he is a director and in the course of the exercise of the office of director, then the profit on resale of such property would belong to the company - *Regal (Hastings) Ltd.* v. *Gulliver* [1942] 1 All ER 378 (HC).

2. *Duty of care* - A director must display care in performance in work assigned to him. He is, however, not expected to display an extraordinary care but that much care only which a man of ordinary prudence would take in his own case. Justice Romer in *Re City Equitable Fire Insurance Company's* case observed :

   > "His (director's) duties will depend upon the nature of the company's business, the manner in which the work of the company is distributed between the directors and other officials of the company. In discharging these duties a director must exercise some degree of skill and diligence. But he does not owe to his company the duty to take all possible care or to act with best care. Indeed, he need not exhibit in the performance of his duties a greater degree of skill than

> may reasonably be expected from a person of his knowledge and experience. *It is, therefore, perhaps another way of stating the* same proposition that directors are not liable for mere errors of judgment."

Similar view was expressed in *Lagunas Nitrate Co.* v. *Lagunas Nitrate Syndicate* [1899] 2 Ch. 392, in the following words:

> "If directors act within their powers, if they act with such care as is to be reasonably expected of them having regard to their knowledge and experience and if they act honestly for the benefit of the company they discharge both their equitable as well as legal duty to the company."

Section 463 further states that where a director may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust but if he has acted honestly and reasonably and having regard to all the circumstances of the case, he ought fairly to be excused, the court may relieve him either wholly or partly from his liability on such terms as it may think fit.

3. *Duty not to delegate* - Director being an agent is bound by the maxim *'delegatus non potest delegare'* which means a delegatee cannot further delegate. Thus, a director must perform his functions personally. A director may, however, delegate in the following cases:
   (*a*) Where permitted by the Companies Act or Articles of the company.
   (*b*) Having regard to the exigencies of business certain functions may be delegated to other officials of the company.

14.26 Liabilities of Directors

The liabilities of directors may be considered under the following heads:

1. Liability to the company.
2. Liability to third parties.
3. Liabilities for breach of statutory duties.
4. Liability for acts of co-directors.
5. Criminal liability.

14.26-1 Liability to the company

The liability of a director to the company may arise from :

(*a*) Breach of fiduciary duty,
(*b*) *Ultra vires* acts,
(*c*) Negligence, and
(*d*) *Mala fide* Acts.

Breach of fiduciary duty - Where a director acts dishonestly to the interest of the company, he will be held liable for breach of fiduciary duty. Most of the powers of directors are 'powers in trust' and therefore, should be exercised in the interest of the company and not in the interest of the directors or any section of members. Thus, where the directors, in order to forestall a take-over bid, transferred the

unissued shares of the company to trustees to be held for the benefit of the employees, and an interest-free loan from the company was advanced to the trustees to enable them to pay for the shares, it was held to be a wrongful exercise of the fiduciary powers of the directors - *Hogg* v. *Cramphorm Ltd.* [1967] Ch. 254.

Ultra vires *acts* - Directors are supposed to act within the parameters of the provisions of the Companies Act, Memorandum and Articles of association, since these lay down the limits to the activities of the company and consequently to the powers of the Board of directors. Further, the powers of the directors may be limited in terms of specific restrictions contained in the Articles of association. The directors shall be held personally liable for acts beyond the aforesaid limits, being *ultra vires* the company or the directors. Thus, where the directors pay dividends or interest out of capital, they will be liable to indemnify the company for any loss or damage suffered due to such act.

Negligence - As long as the directors act within their powers with reasonable skill and care as expected of them as prudent businessmen, they discharge their duties to the company. But, where they fail to exercise reasonable care, skill and diligence, they shall be deemed to have acted negligently in discharge of their duties and consequently shall be liable for any loss or damage resulting therefrom. However, error of judgment will not be deemed as negligence. But, the Court may grant relief to directors against such liability under section 463 of the Act.

Mala fide *acts* - Directors are the trustees for the moneys and property of the company handled by them, as well as for exercise of the powers vested in them. If they dishonestly or in a *mala fide* manner, exercise their powers and perform their duties, they will be liable for breach of trust and may be required to make good the loss or damage suffered by the company by reason of such *mala fide* acts. They are also accountable to the company for any secret profits they might have made in course of performance of duties on behalf of the company.

Directors can also be held liable for their acts of 'misfeasance', *i.e.*, misconduct or wilful misuse of powers. However, misconduct which is not wilful shall not amount to 'misfeasance'. Moreover, the directors are entitled to relief against liability for breach of trust or misfeasance under section 463.

Where a director misapplies or misappropriates money or properties of the company or has been guilty of breach of trust or misfeasance, the Court may order him to repay the money or restore the property or to pay compensation - *P.K. Nedungadi* v. *Malayalee Bank Ltd.* AIR 1971 SC 829.

14.26-2 Liability to third parties

The discussion on liabilities of directors towards third parties may be grouped as under:

1. Liability under the provisions of the Companies Act, 2013.
2. Liability for breach of warranty of authority.

Liability under the Companies Act - The directors shall be personally liable to the third parties, *inter alia*, under the following provisions of the Companies Act, 2013:

(*i*) *Prospectus* - Failure to state any particulars as per the requirements of section 26 of the Act or mis-statement of facts in a prospectus renders a

director personally liable for damages to the third party. Section 35 provides that a director shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damages he may have sustained by reason of any untrue or misleading statement included therein. He may, however, *escape liability* where he proves that the prospectus was issued without his consent or he withdrew his consent before the issue of the prospectus.

(*ii*) *With regard to allotment* - Directors may also incur personal liability for allotment before minimum subscription is received (Section 39). If the amount stated in the prospectus as the minimum amount has not been subscribed and the sum payable on application is not received within a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the Securities and Exchange Board, the amount received as application money shall be returned within such time and manner as may be prescribed. In case of default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

(*iii*) *Fraudulent conduct of business* - Directors may also be made personally liable for the debts or liabilities of a company by an order of the Tribunal under section 339. Such an order shall be made by the Tribunal where the directors have been found guilty of fraudulent *conduct of business*. Section 339(1), in this regard, provides that if in the course of the winding-up of a company, it appears that any business of the company has been carried on, with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the Tribunal, on the application of the Official Liquidator, or the company liquidator or any creditor or contributory of the company, may if it thinks it proper so to do, declare that any persons who were knowingly parties to the carrying on business in the manner aforesaid shall be personally responsible without any limitation of liability, for all or any of the debts or other liabilities of the company as the Tribunal may direct.

Further, sub-section (3) of section 339 provides that every person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be liable for action under section 447[22].

Liability for breach of warranty - Directors are supposed to function within the scope of their authority. Thus, where they transact any business in respect of matters, *ultra vires* the company or *ultra vires* the articles, they may be proceeded against personally for any loss sustained by any third party.

14.26-3 Liability for breach of statutory duties

The Companies Act, 2013 imposes numerous statutory duties on the directors under various sections of the Act. Default in compliance of these duties attract penal

22. Under section 447 the person who is found guilty 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. And where the fraud in question involves public interest, the term of imprisonment shall not be less than three years.

consequences. The various statutory penalties which directors may incur by reason of non-compliance with the requirements of the Companies Act are referred to at appropriate places.

14.26-4 Liability for acts of co-directors

A director is the agent of the company except for matters to be dealt with by the company in general meeting and not of the other members of the Board. Accordingly, nothing done by the Board can impose liability on a director who did not participate in the Board's action or did not know about it. To incur liability he must either be a party to the wrongful act or later acquiesce (consent) to it. Thus, the absence of a director from meeting of the Board does not make him liable for the fraudulent act of a co-director on the ground that he ought to have discovered the fraud - *Dovey* v. *Cory* [1901] AC 477 except where he had the knowledge or he was a party to confirm that action.

Where a director is made liable for the acts of a co-director, he is entitled to contribution from the other directors or co-directors who were a party to the wrongful act - *Ramskill* v. *Edwards* [1885] 31 Ch. D 100. However, where the director seeking contribution alone benefited from the wrongful act, he is not entitled to contribution.

14.26-5 Criminal liability

Apart from civil liability under the Act or under the common law, directors of a company may also incur criminal liability under common law, as well as under the Companies Act, and other statutes.

14.27 Loans to Directors

Section 185, as amended by the Companies (Amendment) Act, 2017 provides that no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by,—

(*a*) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(*b*) any firm in which any such director or relative is a partner.

However, a company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, **subject to the condition** that—

(*a*) **a special resolution is passed** by the company in general meeting:

Further, the explanatory statement to the notice for the relevant general meeting must disclose the full particulars of the loans given, or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security and any other relevant fact; and

(*b*) the loans are utilised by the borrowing company for its principal business activities.

"Person in whom director is interested" means—

(*a*) any private company of which any such director is a director or member;

(*b*) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(*c*) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

The following transactions are however, not covered by the aforesaid restrictions—

(*a*) the giving of any loan to a managing or whole-time director—

(*i*) as a part of the conditions of service extended by the company to all its employees; or

(*ii*) pursuant to any scheme approved by the members by a special resolution; or

(*b*) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or

(*c*) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or

(*d*) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

The loans made under clauses (*c*) and (*d*) should be utilised by the subsidiary company for its principal business activities.

Penalty

If any loan is advanced or a guarantee or security is given or provided or utilised in contravention of the provisions of this section,—

(*i*) the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees;

(*ii*) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees; and

(*iii*) the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.

Can a deposit be treated as a loan? - Whether a deposit shall be treated as a loan or not will depend upon the nature of the transaction and the facts gathered from the terms and conditions attached to the transaction. The essential requirement of a loan is the advance of money upon the understanding that it shall be returned, and it may or may not carry interest - *Dr. Fredie Ardeshir Mehta* v. *Union of India* [1991] 70 Comp. Cas. 210 (Bom.).

Again allotment of a flat against payment in instalments is not a loan - *Dr. Fredie Ardeshir Mehta* v. *Union of India* (*supra*).

14.28 Remuneration of Directors (Managerial Remuneration)

It is important to understand what constitutes a managerial position that entitles a person to receive managerial remuneration. Though the term managerial position has not been defined in the Act, a reference to section 197 unequivocally suggests that directors, including managing director and whole time director of the company and manager constitute managerial personnel. An executive in a company, howsoever, lofty position he may be holding in the company will not come under the concept of managerial personnel and accordingly any remuneration or compensation package received by him will not be counted as 'managerial remuneration' contemplated in the Act. Even a person carrying administrative designation of manager like general manager or any functional manager will not be included as a managerial personnel.

14.28-1 Meaning of managerial remuneration

Managerial remuneration may take the form of monthly payments, say, salary, or a specified percentage of net profits or a commission and/or by way of a fee for each meeting of the Board (called sitting fee).

Section 2(78) defines "remuneration" to mean any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961. Explanation B to Schedule V further provides that "Remuneration" shall also include reimbursement of any direct taxes to the managerial person.

However, Section 197(3)* provides that where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel. But, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

14.28-2 Directors' entitlement to remuneration

There is no specific provision in the Companies Act suggesting that directors must be paid remuneration for their services. However, sub-sections (5) and (6) of section

*Government companies have been exempted from the provisions of section 197—*Vide MCA Notification dated 5-6-2015.*

197 lay down the manner of payment of remuneration to a director and the limits thereto. Also, section 197* deals with overall maximum managerial remuneration. Again, Schedule V deals with payment of remuneration to managerial personnel obviating requirement of the approval of the Central Government. However, none of these provisions can be cited as the authority to remunerate the directors. Thus, for the services rendered, the director is not automatically entitled to remuneration - *Hutton* v. *West Cork Railway Co.* 23 Ch. D. 654. Directors must show some contractual authority for their entitlement to remuneration - *Anglo Australian Printing & Publishing Union, In re* [1892] 2 Ch. 158.

Drawing remuneration to which he is not entitled is an act of misfeasance on the part of the director - *Young* v. *Naval, etc. Society of South Africa* [1905] 2 KB 687.

14.28-3 Manner of payment of managerial remuneration

Sub-section (5) and sub-section (6) of section 197* lay down the manner by which the remuneration may be paid to the managerial personnel. According to sub-section (6), a director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by other.

14.28-4 Sitting Fees

Sub-section (5) of section 197 provides that a director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board.

But, the amount of such fees shall not exceed the amount as may be prescribed. Further, different fees for different classes of companies and fees in respect of independent director may be such as may be prescribed.

Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provide that a company may pay a sitting fee to a director for attending meetings of the Board or committees thereof, such sum as may be decided by the Board of directors thereof which ***shall not exceed one lakh rupees per meeting*** of the Board or committee thereof.

Sitting fees paid to Independent Directors and Women Directors shall not be less than the sitting fee payable to other directors.

14.28-5 Overall limits to managerial remuneration

Section 197(1) provides that the total managerial remuneration payable by a **public company** to its directors, including managing director and whole-time director and its manager in respect of any financial year **must not exceed eleven per cent of the net profits** of that company for that financial year computed in the manner laid down in section 198 of the Companies Act except that remuneration of the directors will not be deducted from gross profits of the company.

The company in general meeting may authorise the payment of remuneration exceeding eleven per cent of the net profits of the company, subject to the provisions of Schedule V.

In computing the aforesaid ceiling of eleven per cent, section 197(2) says that the fees payable to directors for attending Board or its Committees or other meetings shall not be included.

14.28-6 Determination of managerial remuneration

Section 197(4) provides that the remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of section 197, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting.

The remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

However, any remuneration for services rendered by any such director in other capacity shall not be so included if—

(*a*) the services rendered are of a professional nature; and

(*b*) in the opinion of the Nomination and Remuneration Committee[23], if the company has such a Committee as per section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

14.28-7 Individual ceiling on managerial remuneration

According to second proviso to sub-section (1) of section 197 provides that *except with the approval of the company in general meeting by a special resolution*—

(*i*) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent of the net profits of the company and if there is more than one such director, remuneration shall not exceed ten per cent of the net profits to all such directors and manager taken together;

(*ii*) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed:

(*a*) one per cent of the net profits of the company, if the company has a managing or whole time director or manager;

(*b*) three per cent of the net profits in any other case.

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23. As per Rule 6 of the Companies (Meetings of Board and its Powers) Rules, 2014, the following companies shall constitute a Nomination and Remuneration Committee of the Board-

(*i*) Every listed company;

(*ii*) all public companies with a paid up capital of ten crore rupees or more;

(*iii*) all public companies having turnover of one hundred crore rupees or more;

(*iv*) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation.- The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

However, where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting.

14.28-8 Remuneration payable to an Independent director

Sitting fees paid to Independent Directors shall not be less than the sitting fee payable to other directors, namely, as decided by the Board of directors but ***not exceeding one lakh rupees per meeting*** of the Board or committee thereof[24].

14.28-9 Refund of excess remuneration

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limits prescribed under section 197 or without the prior sanction of the Central Government, where it is required, he shall refund such sums to the company and until such sum is refunded, hold it in trust for the company [Section 197(9)].

Sub-section (10) of section 197 further provides that the company shall not waive the recovery of any sum refundable to it under sub-section (9) unless permitted by the Central Government.

14.28-10 Additional remuneration from subsidiary

Sub-section (14) of section 197 provides that any director (other than a managing or whole-time director of the company), **who is in receipt of any commission**[25] from the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

14.28-11 Private companies

The provisions relating to managerial remuneration, as aforesaid, shall not apply to a private company [Section 197(1)].

14.28-12 Managerial remuneration vis-a-vis Schedule V

Schedule V allows a public company, to appoint a managing or whole-time director or a manager and fix their remuneration so long as the same is in accordance with the conditions laid down in Schedule V without seeking the prior approval of the Central Government[26].

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24. Rule 4 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.
25. You may note that the exemption is not available to a director who receives salary as remuneration.
26. **Clarification on Managerial Remuneration** - MCA vide its General Circular No. 7/2017 [File No. 1/5/2013-CL-V] dated 10.4.2015 has clarified that the managerial person may continue to receive remuneration for his/her remaining term in accordance with terms and conditions approved by companies as per provisions of Schedule XIII of the Companies Act, 1956 even if part of his tenure falls after April 1, 2014.

The **salient features of Schedule V** are as follows:

Section I: Remuneration payable by companies having profits - Subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons not exceeding the limits specified in that section. [*Already discussed under 'Individual ceiling on managerial remuneration'*]

Section II: Remuneration payable by companies having no profits or inadequate profits - Where in any financial year during the currency of tenure of a managerial person, a company has no profits or its profits are inadequate, it may, pay remuneration to the managerial person not exceeding the higher of the limits under (A) and (B) given below*:—

(A)

Where the effective capital of a company is –	Limit of **yearly remuneration** payable shall not exceed[27] (Rupees) –
(*i*) Negative or less than 5 crores	60 lakhs
(*ii*) 5 crores and above but less than 100 crores	84 lakhs
(*iii*) 100 crores and above but less than 250 crores	120 lakhs
(*iv*) 250 crores and above	120 lakhs *plus* 0.01% of the effective capital in excess of Rs. 250 crores

(B) In case of a managerial person who is functioning in a professional capacity, if :

(*i*) such managerial person is not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures[28], and

(*ii*) not having any direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment, and

(*iii*) possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

Any employee of a company holding shares of the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan or by way of qualification shall be deemed to be a person not having any interest in the capital of the company.

However, to pay remuneration to a managerial person as per the aforesaid ceiling limits, it has been made mandatory that:

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* W.e.f. 12-9-2016.

27. *Explanation.*—It is hereby clarified that for a period less than one year, the limits shall be prorated.

28. For the purposes of Section II of this part, "Statutory Structure" means any entity which is entitled to hold shares in any company formed under any statute - Explanation.

(*i*) payment of remuneration is approved by a resolution passed by the Board and also by the Nomination and Remuneration Committee, in case of a listed company and companies required to have such committee; and

(*ii*) the company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, and in case of default, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting.

(*iii*) An ordinary or special resolution, as the case may be, has been passed at the general meeting of the company for payment of remuneration as per item (A) or a special resolution has been passed as per item (B) at a general meeting of the company for a period not exceeding three years;

(*iv*) a statement along with a notice calling the general meeting referred to in clause (*iii*) is given to the shareholders containing the prescribed information.

Schedule V allows companies to pay remuneration to their managerial personnel ***in excess of above limits,*** by observing the required procedure as stated above *and* passing a special resolution at the general meeting, the notice of which must be accompanied by a statement containing the specified particulars.

Section III : Remuneration payable by companies having no profit or inadequate profit in certain special circumstances:

In the following circumstances, a company may, pay remuneration to a managerial person in excess of the amounts provided in Section II above:—

(*a*) where the remuneration in excess of the limits specified in section I or II is paid by any other company and that other company is either a foreign company or has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

(*b*) where the company—

(*i*) is a newly incorporated company, for a period of seven years from the date of its incorporation, or

(*ii*) is a **sick company**, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction or National Company Law Tribunal, for a period of five years from the date of sanction of scheme of revival, or

(*iii*) is a company in relation to which a resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 for a period of 5 years from the date of such approval;

it may pay any remuneration to its managerial persons.

(*c*) where remuneration of a managerial person exceeds the limits in section II but the remuneration has been fixed by the Board for Industrial and Financial Reconstruction or the National Company Law Tribunal:

Provided that the limits under this section shall be applicable subject to meeting all the conditions specified under Section II and the following additional conditions:—

(*i*) except as provided in para (*a*) of this section, the managerial person is not receiving remuneration from any other company;

(*ii*) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub-section (4) of section 196.

(*iii*) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

(*d*) a company in a Special Economic Zone as notified by Department of Commerce from time to time which has not raised any money by public issue of shares or debentures in India, and has not made any default in India in repayment of any of its debts (including public deposits) or debentures or interest payable thereon for a continuous period of thirty days in any financial year, may pay remuneration up to Rs. 2,40,00,000 per annum.

14.28-13 Perquisites not included in managerial remuneration

As per section IV of Schedule V the following perquisites are not included in managerial remuneration in the computation of the ceiling on remuneration specified in section II and section III:—

(*a*) contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961;

(*b*) gratuity payable at a rate not exceeding half a month's salary for each completed year of service; and

(*c*) encashment of leave at the end of the tenure.

In addition to the perquisites specified above, an expatriate managerial person (including a non-resident Indian) shall be eligible to the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in section II or section III—

(*a*) *Children's education allowance*: In case of children studying in or outside India, an allowance limited to a maximum of Rs. 12,000 per month per child

or actual expenses incurred, whichever is less. Such allowance is admissible up to a maximum of two children.

(*b*) *Holiday passage for children studying outside India or family staying abroad:* Return holiday passage once in a year by economy class or once in two years by first class to children and to the members of the family from the place of their study or stay abroad to India if they are not residing in India, with the managerial person.

(*c*) *Leave travel concession:* Return passage for self and family in accordance with the rules specified by the company where it is proposed that the leave be spent in home country instead of anywhere in India.

14.28-14 Remuneration payable to a managerial person in two companies

Subject to the provisions of sections I to IV, a managerial person may draw remuneration from one or both companies, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

14.28-15 Meaning of effective capital

The expression "effective capital", for the purposes of Schedule V means the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account; reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, over drafts, interest due on loans unless funded, bank guarantee, etc., and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investment by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

14.28-15a TIME WHEN EFFECTIVE CAPITAL SHALL BE CALCULATED - *Explanation II* to section IV of Schedule V provides that where the appointment of the managerial person is made in the year in which company has been incorporated the effective capital shall be calculated as on the date of such appointment. In any other case, the effective capital shall be calculated as on the last date of the financial year preceding the financial year in which the appointment of the managerial person is made.

14.29 Managing Director and other Key Managerial Personnel

14.29-1 Meaning of Managing director

Section 2(54) defines 'managing director' to mean a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called.

The definition makes it clear that the managing director's powers of managing the affairs of the company must be substantial. The power to do administrative acts of routine nature such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to sign any certificate of share or to direct registration of transfer of any share shall not be deemed to be included within substantial powers of management.

The managing director exercises his powers subject to the superintendence, control and direction of the Board of directors.

The managing director is thus a director who carries on the day to day business of the company. He is the executive head of the company and, subject to the control of the Board of directors of the company, controls the company's affairs.

The managing director has necessarily to be a director. He, like any other director, has no powers of management except when acting as one of the members of the Board.

A director entrusted with managerial functions will be a managing director even though he may be called as 'technical director' or 'technical advisor' (*Fourth Annual Report - year ended 31st March, 1960*).

14.29-2 Managing director - Whether an employee

In *Employees State Insurance Corpn.* v. *Apex Engineering (P.) Ltd.* [1998] 1 CLJ 10, the Supreme Court held that a managing director has a dual identity. A managing director performs duties over and above the duties of an ordinary director and therefore can as well be treated as an employee.... The Court also distinguished the position of a managing director in a company from the position of a salaried partner in a firm. Even though in a firm a partner may draw salary but his identity as a partner only remains undisturbed.

14.29-3 Meaning of Key Managerial Personnel

According to section 2(*51*)* "key managerial personnel", in relation to a company, means—

(*i*) the Chief Executive Officer or the managing director or the manager;

(*ii*) the company secretary;

(*iii*) the whole-time director;

(*iv*) the Chief Financial Officer;

(*v*) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and

(*vi*) such other officer as may be prescribed.

14.29-4 Appointment of managing director

In terms of section 2(54), a managing director may be appointed in any of the four ways, namely:

(*a*) by virtue of an agreement with the company,

(*b*) by virtue of a resolution passed by the company in general meeting,

*As amended *vide* Companies (Amendment) Act, 2017.

(*c*) by virtue of a resolution passed by the Board of directors, and

(*d*) by virtue of Articles of Association.

As per section 203 read along with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every listed company[29] and every other public company having a paid-up share capital of ten crore rupees or more shall have the following whole-time key managerial personnel,—

(*i*) managing director, or Chief Executive Officer or manager and in their absence, a whole-time director;

(*ii*) company secretary; and

(*iii*) Chief Financial Officer.

However, an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless,—

(*a*) the articles of such a company provide otherwise; or

(*b*) the company does not carry multiple businesses.

Again, the aforesaid restriction with respect to Managing director-cum-chairman or CEO-cum-chairman shall not apply to such class of companies engaged in multiple businesses and which has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government.

Also, please note that **no company shall appoint or employ at the same time a managing director and a manager** [Section 196(1)].

Every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration [Sub-section (2) of section 203].

In case of appointment of a **managing director, whole-time director or manager** the terms and conditions of such appointment and remuneration payable shall be approved by the Board of Directors at a meeting which shall be subject to **approval by a resolution at the next general meeting** of the company **and by the Central Government** [Section 196(4)*]

A return in the prescribed form shall be filed within sixty days of such appointment with the Registrar.

Where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid [Sub-section (5)*].

14.29-5 Approval of the Central Government

As per Part I of Schedule V to the Companies Act, 2013, no approval of the Central Government shall be required for appointment of managing director, manager or

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29. "listed company" means a company which has any of its securities listed on any recognised stock exchange [section 2(52)]

* You may note that private companies have been exempted from the requirements of sub-sections (4) and (5) of section 196. Accordingly, approval of the general body and that of Central Government shall not be required—*Vide MCA Notification dated 5-6-2015.*

whole-time director if the conditions stated therein are satisfied. In all other cases, the appointment made by the company must be approved by the Central Government. Approval of the Central Government would not be required if the following conditions are satisfied :

(*a*) He had not been sentenced to imprisonment for any period or to fine exceeding Rupees one thousand for conviction of an offence under any of the specified nineteen Acts[30] mentioned in Schedule V.

(*b*) He had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

No further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval under (a) or (b) above.

(*c*) He has completed the age of twenty-one years and has not attained the age of seventy years.

However, a managerial person who has attained the age of 70 years may be appointed without the approval of the Central Government provided his appointment is approved by special resolution passed by the company in a general meeting.

Where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

(*d*) Where he is a managerial person in more than one company, provided that the total remuneration drawn from the companies does not exceed the higher maximum limit admissible from any one of the companies of which he is a managerial person.

(*e*) He is resident in India.[31]

30. The sixteen Acts are: (*i*) the Indian Stamp Act; (*ii*) the Central Excise Act; (*iii*) the Industries (Development and Regulation) Act, 1951; (*iv*) the Prevention of Food Adulteration Act, 1954; (*v*) the Essential Commodities Act, 1955; (*vi*) the Companies Act, 2013; (*vii*) the Securities Contracts (Regulation) Act, 1956 (42 of 1956); (*viii*) the Wealth-tax Act, 1957; (*ix*) the Income-tax Act, 1961; (*x*) the Customs Act, 1962; (*xi*) the Competition Act, 2002; (*xii*) the Foreign Exchange Management Act, 1999; (*xiii*) the Sick Industrial Companies (Special Provisions) Act, 1985; (*xiv*) the Securities and Exchange Board of India Act, 1992; (*xv*) the Foreign Trade (Development and Regulation) Act, 1922; (*xvi*) the Prevention of Money-Laundering Act, 2002. (*xvii*) Insolvency and Bankruptcy Code; (xviii) The Goods and Sevices Tax Act, 2017; (*xix*) The Fugitive Economic Offenders Act, 2018.

31. For the purpose of Schedule V, 'resident in India' includes a person who has been staying in India for a continuous period of not less than twelve months immediately preceding the date of his appointment as a managerial person and who has come to stay in India,—

(*i*) for taking up employment in India; or

(*ii*) for carrying on a business or vacation in India.

14.29-6 Number of companies of which one person may be appointed Managing Director/Key Managerial Personnel

Sub-section (3) of section 203* states that a whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time. However, a key managerial personnel shall not be disentitled from being a director of any company with the permission of the Board.

Further, whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

A company may appoint or employ a person as its **managing director**, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved **by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting** and of which meeting, and of the resolution to be moved there at, specific notice has been given to all the directors then in India. Thus, a person may be appointed as managing director of two companies by passing a unanimous resolution of the Board (Obviously of the second company).

14.29-7 Filling of vacancy in the office of whole-time key managerial personnel

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy [Sub-section (4)]

14.29-8 Tenure of appointment

According to section 196(2), no company shall appoint or re-appoint any person as its managing director, whole-time director or manager for a term exceeding five years at a time. Further, no re-appointment shall be made earlier than one year before the expiry of his term**.

14.29-9 Remuneration[32]

A managing director may be remunerated either by way of a monthly payment or as a specified percentage of the net profits of the company or partly by one way and partly by the other. However, such remuneration should not exceed five per cent of the net profits without the sanction of the Central Government. Where there are more than one managing director/whole-time director(s)/manager the total remuneration payable to all of them must not exceed ten per cent of the net profits without sanction of the Central Government [Section 197].

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*Does not apply to a Government company—*MCA Notification dated 5-6-2015.*

**The restrictions of section 196(2) do not apply to a Government company—*Vide Notification issued by MCA dated 5-6-2015.*

32. For details, please see under 'Managerial Remuneration'.

14.29-10 Disqualifications

Section 196 prohibits the appointment of certain persons as **managing director/whole-time director/manager**. Sub-section (3) provides that no company shall appoint or continue the employment of any person as managing director, whole-time director or manager who —

(*a*) is below the age of twenty-one years or has attained the age of seventy years. However, appointment of a person who has attained the age of seventy years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person.

Where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

Continuation of a Managing Director/Whole-time Director/Manager post attaining the age of 70 years? - The Bombay High Court in the case of *Sridhar Sundarajan* v. *Ultramarine & Pigments Ltd.* [2016] 66 taxmann.com 167 (Bombay) held that Special resolution under section 196(3)(a) is to be passed to continue any person aged 70 years as MD even if his appointment was made before coming into force of Companies Act, 2013, i.e., before 1-4-2014 when he was below 70 years. It was observed that if appointment to post of Managing Director is made after coming into force of Amendment Act, 2013, namely, 1-4-2014, a person who is above age of 70 years cannot be appointed on account of disqualification, subject to fulfilment of proviso to section 196(3)(a) i.e., passing of special resolution by company. Again, where, if he was already appointed prior to 1-4-2014 when he was below age of 70 years, the Bombay High Court held that on account of operation of statute, disqualification, whenever incurred after Amendment Act, would operate automatically, subject to proviso to section 196(3)(a). Thus, special resolution under section 196(3)(a) is to be passed to continue any person aged 70 years as MD even if his appointment was made before coming into force of Companies Act, 2013, i.e., before 1-4-2014, when he was below 70 years. The Court observed that the legislative intent in introducing section 196(3)(a) is quite clear. Obviously, the intention was to change the earlier position by providing that the person who has been appointed as Managing Director before he was 70 years old is prohibited from continuing as Managing Director once he has attained the age of 70.

This marks the reversal of the decision of the single judge of the Bombay High Court delivered in this case in 2015[33]

Section 196(3) of Companies Act, 2013 applies to both - private and public - companies alike.

(*b*) is an undischarged insolvent or has at any time been adjudged as an insolvent;

33. [2015] 59 taxmann.com 249.

(*c*) has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

(*d*) has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

Since a managing director has necessarily to be a director, a person who is disqualified to be appointed as a director under section 164 (already discussed) cannot be appointed as managing director/whole time director.

Further, a person who does not satisfy the conditions of Part I of Schedule V cannot be appointed as a managing director of a company without the approval of the Central Government.

14.30 Manager

14.30-1 Meaning

Section 2(53) defines 'manager' as : Manager means an individual who, subject to the superintendence, control and directions of the Board of directors, has the management of the whole or substantially the whole of the affairs of the company, and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not.

Thus, an individual must be in charge of the whole or substantially the whole of the affairs of the company, in order to be called a manager in accordance with the Companies Act. A person who is one of the departmental manager or a branch manager is not deemed to be a manager in this sense.

Please note that only an individual can be appointed a manager of a company. Also, note that no company shall appoint or employ at the same time a managing director and a manager.

14.30-2 Disqualifications of a manager

Same as that of a managing director.

14.30-3 Number of companies a person can be appointed manager

Provisions applicable to managing director mutatis mutandis *are applicable to manager also.*

14.30-4 Remuneration of manager (Section 197)

See under 'Managing Director'.

14.31 Prohibition of simultaneous appointment of different categories of managerial personnel [Section 196]

Section 196(1) prohibits the simultaneous appointment of a managing director and manager in a company. There is no legal prohibition against having whole time director and manager simultaneously or managing director and whole-time director simultaneously. Again, there is no prohibition on a company having more than one managing director.

14.32 Distinction between managing director and manager

On a perusal of the definitions of the terms "managing director" and "manager" under sub-sections (54) and (53) of section 2 respectively, along with other relevant sections of the Companies Act, the following points of distinction may be noted :

1. A 'managing director' is entrusted with substantial powers of management. A 'manager', on the other hand, has the management of the whole or substantially the whole of the affairs of a company.
2. A company may have more than one managing director but it cannot have more than one manager.
3. A managing director must be director whereas a manager may or may not be a director.
4. A managing director, on his ceasing to be a director, shall automatically cease to be the managing director as well. A managing-director, however, can continue as a manager even though he ceases to be a director.

14.33 Whole time director

In many sections of the Companies Act, the term 'Whole time director' has been used side by side with that of the 'managing director'. Confusion is, therefore, likely to arise in respect of their respective position and role.

While the term 'managing director' has been specifically defined under section 2(54), no such definition of a whole time director is available. *Sub-section (94) of section 2*, however, states that the expression 'whole time director' includes a director in the whole time employment of the company.

Regarding appointment/re-appointment and remuneration of a whole time director, same provisions as are applicable to a managing director, are applicable.

14.34 Procedure for appointment of managing director/whole time director/manager

Following procedure is to be followed :

1. Where a person who is not a director of the company is proposed to be appointed as managing/whole-time director of the company, it is necessary that he be first appointed as the director of the company as per the procedure laid down under section 160 (discussed earlier under 'appointment of a director other than a retiring director'). He should also file his written consent with the company to act as a director as per section 152.
2. If the appointment of the managing director/whole-time director/manager is in accordance with the conditions specified in Schedule V, the appointment would not require approval of the Central Government.
3. If the appointment does not fulfil the conditions of Schedule V, an application for approval of the Central Government will have to be made to the Central Government.

4. Where the proposed incumbent is already holding the post of managing director or manager in any other company, section 203 requires the approval of the Board of directors by passing a resolution at its meeting with the consent of all the directors present at the meeting. Specific notice of the meeting and the resolution to be moved thereat has to be given to all the directors then in India.

   Besides, where he is a managerial person in more than one company, ensure that he draws remuneration from one or more companies subject to the ceiling provided in Schedule V.

1.The appointment and the terms and conditions of the proposed appointment are to be considered and approved by the Board. Where the appointment is made in the Board meeting, proper disclosure has to be made if any director is interested in the appointment (*vide* section 184 of the Act). In case approval of general meeting is required, the Board has also to decide about the place, date and time of the general meeting and will finalise the draft notice containing the necessary resolution and explanatory statement and authorise the company secretary to issue notice for the meeting.

2.Unless the Articles provide otherwise or company is carrying multiple businesses, ensure that the managing director is not appointed the chairman of the company [*vide* First proviso to section 203(1)].

3. Ensure that the company is keeping at its registered office,—

(*a*) a copy of the contract, where a contract of service with a managing or whole-time director is in writing; or

(*b*) where such a contract is not in writing, a written memorandum setting out its terms.

4. On the appointed day the general meeting shall be held for passing necessary resolution (ordinary or special, depending upon the stipulation in the articles of association).

5. Three copies of the notice of the meeting and one copy of the proceedings of the meeting have also to be sent to the stock exchange, in case of listed companies (Standard Listing Agreement).

6. Where the resolution passed is a special resolution, a copy thereof shall be filed with the Registrar of Companies together with the filing fee within thirty days. Also a copy of the resolution of the Board or agreement executed by the company, relating to the appointment/re-appointment/renewal of an appointment or variation of the terms of appointment of the managing director should be filed with the Registrar of Companies [Section 117].

7. The remuneration payable to the appointee should be within the specified limits of Part II of Schedule V. Otherwise, approval of the Central Government shall have to be obtained.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (FINAL), C.S. (INTER)/(FINAL), ICWA (INTER)]

1. (*a*) Define 'Director'. What is his legal position in a company?

(*b*) How are the directors of a company appointed?

2. What do you understand by the term "Director Identification Number" (DIN)? Describe the procedure to obtain the same. **Hints :** Refer to Para 1.2.

3. Total strength of the Board of directors of your company is ten. How many directors are liable to retire by rotation at the next annual general meeting?

4. X, who is not a shareholder in a company, sent a notice to the company of his candidature for the office of a director in the place of a retiring director at the ensuing annual general meeting of the company. The same company received another notice from Y, a member, holding only one share signifying his intention to propose the candidature of Z for the office of director in the place of a retiring director. As a secretary of the company, how will you deal with these notices ? Can any member present at the meeting propose the aforementioned proposals for consideration at the meeting ?

5. (*a*) What are the disqualifications of a director?

(*b*) A and B are directors of a private company. The majority of shares are controlled by A and his family. At a meeting of the company, resolution is passed removing B as a director of the company. Is B entitled to compensation for loss of office?

6. State in relation to a public company:

(*a*) When additional directors can be appointed and for what period?

(*b*) When an alternate director can be appointed and for what period ?

(*c*) How the office of a director is filled in case of a casual vacancy and for what period?

(*d*) Can directors be appointed by proportional representation?

7. Your company has total ten directors as under :

Non-retiring directors	-	2
Directors liable to retire by rotation	-	4
Additional directors	-	4

State the number of directors liable to retire by rotation at the Annual General Meeting and the total number of directors who shall vacate the office at the AGM.

8. What is the maximum number of directors who can be appointed in a public company on non-rotational basis, *i.e.*, not subject to retirement in an Annual General Meeting? How is the appointment of such directors regulated in a private company ?

9. "The Board of directors of a company shall be entitled to exercise such powers and do all such acts and things, as the company is authorised to exercise and do in general meetings". Critically discuss the statement with special reference to the provisions of the Companies Act, 2013 regarding the powers and the restrictions thereon, to be exercised by the Board.

10. Enumerate the powers of the Board of Directors which can be exercised only at the Board Meetings.

11. What are the restrictions on the powers of the Board of Directors of a company? Can members in general meeting change the decision taken by the Board?

12. (*a*) What do you understand by an office or place of profit held by a director under the company?

(*b*) What are the restrictions of the Companies Act, 2013 in respect of a director holding an office or place of profit under the company?

13. Can a director enter into any contract with his company? Is he under any legal obligation with regard to contracts entered into by the company in which he is interested? What is the effect of failure by the director to observe the legal obligation?

14. (*a*) Enumerate the types of contracts which a company cannot enter into with a related party unless it follows a certain procedure.

(*b*) Under what circumstances do such contracts require the prior approval of the members by way of special resolution.

15. State the procedure for approving the contracts in which directors are interested.

16. Write a short note on 'Related party transactions'.

17. Write short note on 'managing director'.

18. Mr. P, the managing director of M/s XYZ Ltd., is proposed to be appointed as managing director of M/s ABC Ltd. State the procedure for such an appointment.

19. 'X', the managing director of ABC Ltd. resigns from his position merely by giving a notice. How would you deal with it under the provisions of the Companies Act, 2013?

20. Comment on the following:

"No one above the age of seventy years can be appointed as managing director of a public company"

21. Distinguish between 'managing director' and 'manager'. What are their disqualifications?

22. Mr. Multi Millionaire was convicted by Court for an offence of smuggling and was sentenced to imprisonment for four months in 2003. He wants to float a company as one of the promoter directors with an investment of Rupees one crore from his bank. All the other promoters have welcomed him with open arms because of the large funds he could bring in the company. What would be your advice to Mr. Multi Millionaire?

23. (*a*) When is the office of a director of a company deemed to be vacated?

(*b*) When does the resignation of a director become effective ?

24. Point out the difference between 'alternate director' and 'additional director'

25. (*a*) Discuss the right of members of a company to remove a director before the expiry of his tenure. What safeguards are available to a director who is faced with such an action.

(*b*) Can the members remove a managing director before the expiry of his tenure ?

26. State the legal position in the following circumstances:

Mr. X who was appointed as a director at the last Annual General Meeting resigned. The Board filled up the casual vacancy by appointing Mr. Y. But within a number of days of his becoming director Mr. Y died. The Board wishes to fill up the casual vacancy by appointing Mr. Z in place of Mr. Y in the next Board meeting.

27. "Directors of a company cannot borrow as much as they want". Comment

28. Discuss the legal position in the following cases :

(*i*) A director fails to disclose his interest in a contract in which he is interested which was approved at the Board meeting.

(*ii*) ABC Ltd. proposes to appoint X, a relative of one of the directors of the company, as general manager on a monthly remuneration of Rs. 30,000.

29. What is the procedure for removing a director—

(*i*) by the shareholders ?

(*ii*) by the Tribunal ?

30. Alpha Ltd. had advanced a loan of Rs. 1,00,000 to one of its directors in contravention of the provisions of section 185 of the Companies Act, 2013. State the consequences of such contravention.

31. ABC Ltd. is the holding company of XYZ Pharmaceuticals Ltd. M, a director of XYZ Pharmaceuticals Ltd., was appointed by the Board of directors of ABC Ltd. at its meeting held on 31st March, 1997, as sales manager on a salary of Rs. 14,000 per month.

32. P and Q have been appointed as directors of Zoom Electricals Ltd. on the same day. P is aged 58 years and Q is aged 63 years. At the next annual general meeting, one director is liable for retirement by rotation under section 152 of the Companies Act, 2013. P and Q holding offices of directors for longest period, the legal advisor had advised Q to retire as he is senior to P in age. Decide

Hints : Seniority in age is no criterion. Retirement may be, in this case, either by mutual consent or by draw of lots.

33. Advise the managing directors of XYZ Ltd., in each of the following cases :

(*i*) He wants his brother's son to be appointed as assistant secretary in the company at a monthly salary of Rs. 50,000.

(*ii*) He wants to borrow Rs. 1,50,000 from the company.

(*iii*) He wants to resign from the position of managing director of the company.

(*iv*) His appointment has been made at a Board meeting where majority of the directors present were interested.

34. What are the provisions relating to payment of sitting fees to the directors for attending Board meetings?

35. To what extent can the directors of a company be considered its trustees, agents or managing partners of the company?

36. State the circumstances under which a director retiring at an Annual General Meeting shall be deemed to have been reappointed even though no such appointment was made.

37. "A company in a general meeting cannot override the powers vested in the directors by the Articles of association". Discuss this statement with reference to the provisions of the Companies Act in this regard.

38. How far the acts of a director will be valid, if his appointment is not valid?

39. What are the duties of a director?

40. State briefly the liabilities of a director to the company and to outsiders.

41. Explain, in brief, the limitations under the Companies Act, 2013 regarding payment of remuneration to the managerial personnel.

42. Explain the provisions of the Companies Act, regarding the payment of minimum remuneration to managing director and whole time director in the event of loss or inadequacy of profits in a financial year of the company.

43. Is it obligatory on the part of the companies to have a managing director or manager? When does the appointment of managing or whole time director require the approval of the Central Government? What are the consequences, if such approval is not obtained?

44. What are the rights and liabilities of the Directors for their *ultra vires* acts ? Is it in order for the company to indemnify the Directors against all liabilities that may be incurred by them ?

45. Can a Managing Director of a company be a Manager of another company also ? Answer in brief.

PRACTICAL PROBLEMS

1. The Board of Directors of M/s ABC Motors Ltd. made the following appointments at its meeting held on 1st January, 2014:

(*i*) Mr. X, a Director of its subsidiary company, namely, M/s ABC Forgings Ltd., was appointed as Purchase Manager on a consolidated salary of Rs. 1,00,000 per month with effect from 1st January, 2014.

(*ii*) Mr. Y was appointed as the Sales Manager on a consolidated salary of Rs. 1,50,000 per month with effect from 1st January, 2014. Answer the following explaining the relevant provisions of the Companies Act:

(*a*) Does the appointment of Mr. X require the approval of the members in a general meeting of any company? Will your answer be different if M/s ABC Motors Ltd. is the subsidiary of M/s ABC Forgings Ltd.?

(*b*) Mr. P, a relative of Mr. Y was appointed as a Director of M/s ABC Motors Ltd. on 1st August, 2014. Does it affect the continuation of Mr. Y as the Sales Manager?

Hints : (*a*) No, the appointment of Mr. X is not hit by section 188 and therefore shall not require the approval of general meeting by way of special resolution. Section 188(1) forbids the specified persons to be appointed to an office or place of profit : (*a*) under the company, or (*b*) under any of its subsidiaries. Since Mr. X is not a director of ABC Motors Ltd., his appointment is not affected by the section. Section 188(1) does not prohibit a director of a subsidiary company from holding an office or place of profit in its holding company. Moreover, the rules framed under section 188 provide that appointment to any office or place of profit in the company, its subsidiary company or associate company at a monthly remuneration exceeding two and half lakh rupees shall require approval by way of special resolution.

Again, it will not require the aforesaid approval if M/s ABC Motors Ltd. is the subsidiary of M/s ABC Forgings Ltd., the salary being less than the prescribed amount.

(*c*) Section 188(1) does not apply since at the time of appointment of 'Y' as the sales manager, his relative 'P' was not the director of the company.

2. The Board of Directors of a public company in the private sector having made an average net profit of Rs. 1 crore during the last three financial years propose to donate during the current year a sum of Rs. 4,00,000 to a political party.

Advice the Board of Directors about the powers in respect of the above explaining the relevant provisions of the Companies Act.

Hints : Board of Directors is empowered to contribute to a political party up to seven and a half of its average net profits during the three immediately preceding financial years. Accordingly, donation to a political party, in the given case being less than Rs. 7.5 lakhs (7.5% of Rs. 1 crore), it shall be in order under section 182.

3. State briefly the legal requirements to be complied with by a public company to give effect to the following proposals:

(*i*) Payment of Rs. 50,000 as minimum remuneration to the ordinary directors in a financial year when the company has suffered a loss. The directors have been receiving remuneration by way of commission on net profits within the prescribed limits.

(*ii*) Payment of minimum remuneration to a whole-time director in a financial year when the company has suffered a loss. The appointment has been made in accordance with the conditions specified in Schedule V to the Companies Act and he is being remunerated by way of commission on net profits.

(*iii*) Appointment of a person as Managing Director without remuneration in accordance with the conditions specified in Schedule V to the Companies Act, when he is already holding position of a Managing Director in a Private Company.

Hints :

(*i*) Remuneration by way of commission can be paid to an ordinary director [Sec. 197(6)].

The concept of minimum remuneration, however, has no relevance with reference to ordinary directors.

(*ii*) As per Schedule V, depending upon the effective capital of the company, a whole-time director can be paid @ Rs. 2.5 lakh p.m. to Rs. 5,00,000 p.m. plus 0.01% of the effective capital in excess of Rs. 250 crores.

(*iii*) According to section 203 read along with Sch. V, the following shall be necessary :

(*a*) Passing of a resolution to the Board of Directors;

(*b*) The remuneration drawn by him from any one or both the companies is within the ceiling of Part II of Schedule V.

4. 'X' was appointed as Managing Director for life by the Articles of Association of a private company incorporated on 1st June, 1970. The articles also empowered 'X' to appoint a successor. 'X' appointed, by will, 'G' to succeed him after his death. Answer the following :

(*i*) Can 'G' succeed 'X' as Managing Director after the death of 'X' ?

(*ii*) Is it possible for the company in general meeting to remove 'X' from his office of directorship during his lifetime ?

Hints :

(*i*) 'G' can succeed 'X'. Appointing a successor under a power conferred under the Articles is not considered as 'assignment of office' which is prohibited under section 166 [*Oriental Metal Pressing* v. *Bhasker Kashinath Thakoor* [1961] 31 Comp. Cas. 143 (SC)].

(*ii*) Yes. Any director can be removed under section 169.

5. XYZ Machineries Ltd. having a paid up share capital of Rs. 80 lakhs proposes to enter into contract with the following parties for the supply of certain components for a period of five years with effect from 1st January, 2014:

(*i*) ABC Forgings Private Limited where 'X', a director of XYZ Machineries Limited, is interested as a director and member.

(*ii*) DEF Casting Limited, where 'Y', a director of XYZ Machineries Limited, is interested as a member holding 1% of the paid up share capital.

State briefly the legal requirements to be complied with under the Companies Act to give effect to the above proposals.

Hints :

(*i*) Under section 188, it will require a resolution of the Board of Directors to be passed at its meeting.

Also under section 184, 'X' must disclose his interest to the Board and not participate in the said meeting/deliberations.

(*ii*) Section 188 as well as section 184 do not cover cases of directors of public limited companies if the shareholding of the director along with his relatives is less than 2%. Thus, the aforesaid approval and disclosure shall not be necessary.

6. State whether the restrictions under section 188 of the Companies Act, 2013 would apply if a relative of the director of a private company is appointed as managing director of the company.

Hints : Section 188 applies to both public as well as private companies.

7. M, a director of a public company has been removed by the company, before the expiry of his period of office, by passing under section 169, an ordinary resolution in a general meeting. The director seeks your advice for claiming compensation from the company, for loss of his office. Advise.

Hints : Director 'M' shall not be entitled to any compensation for loss of office since he is not a managing director or a director in the whole-time employment or a director holding the office of a manager [section 202].

8. The directors of a public company desire to authorise the managing director to invest from time to time surplus funds in the purchase of shares of other companies. State with reasons whether the delegation to the managing director is valid.

Hints : Section 179(3)(*e*) of the Companies Act, 2013 empowers the Board of directors to delegate to any Committee of Directors, the managing director, the manager or any other principal officer of the company the power to invest the funds of the company. But inter-corporate investments by public companies in the shares is concurrently governed by section 186 of the Companies Act. Section 186 contains the relevant provisions and sub-section (5) provides that no investment shall be made by the Board of Directors of an investing company unless it is sanctioned by a resolution passed at the meeting of the Board with the consent of all the directors present at the meeting. Thus, section 186 overrides the provisions of section 179 insofar as investments in shares are concerned. Section 186 does not contain any provision for delegation of the power and hence notwithstanding the general provisions under section 179, the proposed delegation to managing director, if made, shall not be valid.

9. Mohan, a director of XYZ Ltd., died in an air crash. It has been decided to appoint Murari in his place. Will the company be required to call extraordinary general meeting to approve the latter's appointment as a director? When appointed, how long Murari would remain in office?

Hints : The vacancy being a casual vacancy can be filled by the Board of directors at its meeting under section 161. Thus, there is no need to call an EGM for the purpose.

Murari's tenure will be the period for which Mohan, if he had not died would have continued.

10. Mr. X is a director of a private Co. Mr. A, who is the husband of Mr. X's grand-daughter, is appointed as a General Manager of the Co. on a remuneration of Rs. 1,40,000 per month, without the approval of the general body of the company. Is the appointment valid?

Hints : Yes; The relationship is not covered under 'related party' as per section 188 and the Rules made thereunder.

11. M/s XYZ Ltd., with a paid up capital of Rs. 5 crores has nine Directors on its Board and as per its articles, the quorum for a Board meeting is 3 (Three). A meeting of the Board was called to consider a contract relating to purchase of raw materials from another company ABC (P.) Ltd., in which A & B, the Directors of XYZ Ltd. are also major shareholders. In the Board meeting of XYZ Ltd. 3 Directors including 'A' and 'B' attended. The matter was discussed and the three Directors voted for the contract. ABC (P.) Ltd. wants to enforce the contract. Will it succeed? Discuss.

Hints : The problem relates to interested directors. In this case, A & B are interested directors and accordingly must disclose their interest as per section 184. *Further*, interested director is forbidden to take part in the discussion or vote on any contract or arrangement entered into by or on behalf of the company where he is directly or indirectly interested in it.

Still further, interested director is not to be counted for quorum and the quorum for a Board's meeting, as per the articles is fixed at minimum of 3 directors [Section 174]. Any resolutions

passed without quorum would be void and incapable of even subsequent ratification (*Fire Stone Tyre & Rubber Co.* v. *Synthetic and Chemicals* [1970] 2 Comp. L.J. 200).

Thus, in the instant case, the ABC (P.) Ltd. cannot enforce the contract.

12. "DEF Limited" proposes to enter into a contract with "ABC Private Limited". 'D' is a Director in "DEF Limited". D's relatives are holding all the shares in "ABC Private Limited", but none of them is a Director of "DEF Limited". None of the Directors of "ABC Private Limited" holds any share in "DEF Limited". Explain the legal position relating to disclosure of interest by 'D' in the proposed contract to be entered into by "DEF Limited" with "ABC Private Limited".

Hints: Section 184(2) provides that a director shall not be required to disclose his interest in any contract or arrangement that is entered into or is proposed to be entered into between two companies where any of the directors of the one company or two or more of them together holds or hold not more than 2 per cent of the paid up share capital in the other company.

In the instant case, D's relations are holding all the shares in ABC Pvt. Ltd. but none of them is a director in DEF Ltd. The directors of ABC Pvt. Ltd. do not hold any shares in DEF Ltd.

Accordingly, there is no legal requirement relating to disclosure of interest by D in the proposed contract between the two companies.

13. X Co. Ltd. wants to make a contract with a partnership. Four out of the five directors of the company are partners of such partnership. How can the contract be executed?

Hints: The given problem relates to a situation where a director is interested in a contract. As per section 184(2), an interested director must not vote on any contract or arrangement in which he is interested. Moreover, interested director is not counted towards quorum. In the present case, since 4 out of 5 directors are interested directors, no valid meeting of the Board can take place regarding the contract in question. However, it should be noted that there is no ban on a company to enter into a contract in which a director or directors are interested. Section 184 of the Companies Act only requires the interest to the disclosed. Thus, in the present case, the Board of directors having been rendered incompetent, the contract can be executed by the general body of shareholders by passing an ordinary resolution to that effect.

14. Your company has received a notice from a shareholder holding shares, paid-up value of which is Rs. 60,000 which is equal to 5% of the voting power of the company, proposing himself for appointment as a Director of the company in place of a retiring director. How would you, as the company secretary, deal with the matter ?

Hints : Section 160. *See para 14.7-5.*

15. Mr. X who was appointed as a Director at the last annual general meeting resigned. The Board filled up the casual vacancy by appointing Mr. Y. But within a few days of his becoming Director, Y died. The Board wishes to fill up the casual vacancy by appointing Mr. Z in place of Mr. Y in the next Board meeting.

State the legal position.

Hints : Section 161(4) provides that in the case of a public company, if the office of any director *appointed by the company in general meeting* is vacated before the expiry of his term of office in the normal course, the resulting casual vacancy may, subject to any regulations in the Articles of the company, be filled by the Board of directors at a meeting of the Board.

It would thus be noted that the Board of directors is empowered to fill a casual vacancy only in respect of a director appointed by the company in general meeting. If a casual vacancy arises in the office of a director appointed in the casual vacancy under section 161(4), there is no casual vacancy within the meaning of section 161. However, the Deptt. of Company Affairs (now Ministry of Corporate Affairs) has opined that the same may be filled by the Board of directors as a casual vacancy. Consequently Board can appoint Mr. Z in place of Mr Y.

16. X, who was appointed as an additional director of a public limited company for the first time, filed his consent with the company by way of a letter. He also signed his consent in the prescribed Form and gave it to the company for filing with the Registrar of Companies. Due to inadvertence the aforesaid consent was not filed within the prescribed period of 30 days. What will be the state of X as director ?

Hints : Section 152 requires that a person shall not act as a director of the company unless he has within 30 days of his appointment signed and *filed with the Registrar* his consent in writing to act as such director. However, failure to file the consent with the Registrar, in the opinion of the Department of Company Affairs (now Ministry of Corporate Affairs) shall not result in the vacation of the office as director. The only consequence shall be that penalty under section 450 would become attracted. Such consent may be filed after the expiry of 30 days on payment of additional fee as contemplated under section 403.

17. State with reference to the provisions of the Companies Act, 2013 whether the following companies can make donations to political parties and if so the conditions to be complied with in this regard :

(*i*) ABCD Ltd., a Government company registered in 1991, wants to donate a sum of Rs. 10 lakhs.

(*ii*) EFG Ltd., a public company registered in 2013, wishes to contribute a sum of Rs. 5 lakhs.

(*iii*) RST Ltd., a company incorporated in the year 2010, decides to contribute a sum of Rs. 3 lakhs.

Hints : Section 182 of the Companies Act, 2013 contain law relating to political donations by companies. *See para 14.23.*

Accordingly,

(*i*) No political donation can be made by ABCD Ltd., being a Government company.

(*ii*) Company EFG Ltd. having been in existence for less than three years cannot contribute.

(*iii*) RST Ltd. having been in existence for more than three years is allowed to make political contribution of Rs. 3 lakhs provided the aggregate of the amount contributed in the financial year including the proposed amount is within 7.5 per cent of the average net profits for the last-three immediately preceding financial years.

18. The company secretary of a company, having a paid up share capital of more than Rs. 5 crores, resigned and left the company. The company has not appointed his successor. Meanwhile, it has started incurring losses. Its sales have declined and financial position became weak. Can it be a valid reason for not appointing a whole-time secretary? How long can the company delay the appointment ? What penalty can be imposed ? Will the liability extend to all the directors or only to the managing director ?

Hints : According to section 203 read along with Rules 8 and 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, a company having a paid-up share capital of Rs. 5 crore or more must appoint a whole-time secretary possessing the prescribed qualifications. In case the secretary resigns and leaves the company, the resulting vacancy shall be filled up by the Board at a meeting of the Board within a period of six months from the date of such vacancy [Section 203(4)]. Therefore, the company should take all the necessary steps for the appointment of the new secretary within the stipulated period of six months.

Here the company has not appointed a new secretary on the ground that it has started incurring losses, its sales have declined and financial position has become weak. The argument may not find favour with the authorities. The company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees and every director and key managerial personnel of the company who is in default shall be

punishable with fine which may extend to fifty thousand rupees and where the contravention is a continuing one, with a further fine which may extend to one thousand rupees for every day after the first during which the contravention continues [Section 203(5)].

19. X, an employee of ABC Ltd., was appointed as an alternate director. In the meantime, the original director returned and wanted to attend the Board meeting. Advise.

Hints : In terms of section 161 of the Act, an alternate Director can act on behalf of the original Director during the latter's absence for a period of not less than three months from India. But, in any case he has to vacate office when the original director returns to India.

20. ABC Ltd. intends to appoint D as an alternate director in place of X who has gone abroad for one year. But there is no provision in the articles of association authorising the Board to appoint alternate director. State the legal position.

Hints :

Under section 161, if articles do not authorise, shareholders may authorise the Board of Directors by passing an ordinary resolution. *See para 14.7-6c*

15 Company Secretary and Practising Company Secretary

15.1 Definition of company secretary/secretary

Section 2(24) of the Companies Act, 2013 defines a '**company secretary'** or **'secretary'** as follows :

> "Company Secretary or secretary means a company secretary as defined in clause (*c*) of sub-section (*1*) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act."*

The Company Secretaries Act, 1980 defines a company secretary as "a person who is a member of the Institute of Company Secretaries of India" [Section 2(1)(*c*)].

15.2 Appointment of whole-time company secretary

15.2-1 Compulsory appointment of a whole-time company secretary

Section 203 read along with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 (as amended) provide that every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial person which includes a company secretary.

However, in June, 2014, MCA with respect to unlisted public companies brought down the prescribed amount from ten crores to five crores insofar as appointment of whole-time company secretary is concerned. Through the insertion of Rule 8A, even the private companies with a paid up capital of rupees five crores or more are mandated to have a whole-time company secretary.

Rule 8A inserted by Notification No G.S.R. 390(E), dated 9th June, 2014 reads as follows:

> "A company other than a company covered under rule 8 which has a paid up share capital of five crore rupees or more shall have a whole-time company secretary."

To put matters in clear perspective, it may be said that the following classes of companies must appoint a company secretary, namely—

*A section 8 company may appoint a secretary who is not a member of ICSI—*Vide Notification issued by MCA dated 5-6-2015.*

(*i*) Listed company;

(*ii*) Unlisted public company having a paid-up share capital of rupees five crore or more;

(*iii*) Private company having a paid-up share capital of rupees five crore or more.

15.2-2 Manner of appointment of whole-time company secretary

The whole-time company secretary of a company like any other whole-time key managerial personnel shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration [Section 203(2)].

15.2-3 Whole-time company secretary not hold office in more than one company

A whole-time company secretary like any other key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time [Section 203(3)].

However, may be appointed a director of any company with the permission of the Board.

A whole-time company secretary holding office in more than one company at the same time of the date of commencement of this Act, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of company secretary.

15.2-4 Vacation of office of the whole-time company secretary

If the office of the whole-time company secretary is vacated, the resulting vacancy shall be filled up by the Board at a meeting of the Board within a period of six months from the date of such vacancy [Section 203(4)].

15.2-5 Penalty

If any company makes any default in complying with the provisions of this section, such company shall be liable to a penalty of five lakh rupees and every director and key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand rupees and where the default is a continuing one, with a further penalty of one thousand rupees for each day after the first during which such default continues but not exceeding five lakh rupees [*Sub-section (5) inserted by Companies (Amendment) Act, 2019*]

15.3 Procedure for appointment

The promoters of a large sized company generally appoint the first secretary who helps them in fulfilling the various formalities. He is known as *pro tem* secretary.

The *pro tem* secretary appointed by the promoters may or may not be appointed as regular secretary by the Board. Even when the name of the first secretary is mentioned in the Articles, it does not bind the company to appoint that very person as its secretary, because Articles bind the company to its members only and it does

not constitute an agreement between the company and the outsiders. Therefore, if the *pro tem* secretary is not appointed as the first secretary by the Board after incorporation of the company, he cannot sue the company. However, he should be given a proper notice, otherwise, he can sue the company for damages.

The *pro tem* secretary must, immediately after the incorporation, secure his position by getting a resolution passed at the first Board meeting. This resolution appointing a person as the secretary of the company should contain the terms and conditions of his appointment including the remuneration.

The secretary is to be appointed by a formal resolution of the Board. If any director is interested in the appointment of the secretary, he must disclose such interest as per section 184 and should not participate in the discussion or voting. Besides the provisions of section 188 with respect to related party transactions must be duly satisfied.

Company secretary is a 'key managerial personnel' as per section 2(51) of the Companies Act, 2013 and therefore, requirements of section 203 must be duly complied with.

Ensure that the whole-time company secretary is not holding office in any other company as a key managerial personnel including that of a company secretary except in its subsidiary (*Vide sub-section (3) of section 203).* He may, however, be a director in any other company provided the Board of directors approve the same.

In accordance with section 170(1) of the Act, the appointment of a person as secretary must be recorded in the 'Register of Directors and key managerial personnel and their shareholding'. Besides, the details of the securities held by him in the company or its holding, subsidiary, subsidiary of company's holding company or associate companies shall also be entered in that register.

The specimen Form of resolution for appointment of secretary is as follows :

Resolved That Shri . . . who possesses the requisite qualifications under the Companies Secretaries Act, 1980, be, and is hereby, appointed secretary of the company on the terms and conditions set out in the draft agreement, a copy of which is initialled by the chairman for the purpose of identification and placed before the meeting for approval, with effect from. . . .

Resolved Further That the aforesaid agreement with Shri . . . . regarding his appointment as secretary is hereby approved and the agreement will receive the seal of the company in the presence of Shri . . . . and Shri. . . ., directors of the company, who will sign the same on behalf of the company.

15.4 Position of company secretary

According to section 2(*59*) of the Companies Act, 2013, the term "officer" includes any director, manager or key managerial personnel (which includes a company secretary). This clearly shows that just like directors or a manager in a company, a secretary is also recognised as an officer of the company. Though, in the eyes of law, the secretary is a mere officer of the company, in actual practice, he commands considerable influence with the directors. He plays an important role and enjoys a unique position in the management of the company.

The position of the secretary changed considerably over a period of time. In *Barnett Hoares & Co.* v. *South London Tramways Co. Ltd.* [1887] 18 QBD 815 :

> "a secretary was termed as a mere servant; his position is that he is to do what he is told, and no person can assume that he has any authority to represent anything at all."

Therefore, the secretary had no original authority and had to work under the full control of the Board of directors. He had no authority to negotiate contracts or make representations. In *Panorama Developments (Guildford) Ltd.* v. *Fidelis Furnishing Fabrics Ltd.* [1971] 2 QB 711 (CA) it was observed by *Lord Denning* that—

> "a company secretary is a much more important person now-a-days than he was in 1887. He is an officer of the company with extensive duties and responsibilities. He is no longer a mere clerk. He regularly makes representations on behalf of the company, and enters into contracts on its behalf. Mr. Justice Salmon also observed in this case that the secretary has ostensible authority to sign contracts on behalf of the company."

Now, the company secretary has been bracketed with the key managerial personnel including directors, managing directors and manager in regard to compliance with the provisions of the Companies Act. He is also responsible for complying with the requirements of not only the provisions of the Companies Act but all other applicable laws such as FEMA, Securities Contracts (Regulation) Act, SEBI Act, Competition Act, etc.

It is true that the secretary has to carry out the instructions of the Board but for routine day-to-day affairs, the secretary is responsible and he has the authority to carry out the work. As an agent of the company, the secretary has to carry out the policy decisions of the Board. The secretary should not appoint a sub-agent to do the company's work, without proper authority. If he delegates his powers in an unauthorised manner, the secretary shall be personally liable for the consequences.

The secretary acts as a link between the company and the outside world. The ostensible authority of the company secretary to bind the company by his acts arises from the company's relationship with the outside world. If the company represents to outsiders that the secretary has the necessary authority to enter into contracts on behalf of the company, then the company shall be liable to third parties who have acted on such representations.

The third parties can hold the company liable for such contracts provided it can be proved that (*i*) a representation was made to outsiders that the company secretary had the authority to enter into such a contract; (*ii*) the representation was made by a person having actual authority to do so; (*iii*) the outsider was actually induced to make the contract and he relied upon it; (*iv*) the contract was within the powers of the company; and (*v*) such powers were validly delegated to the secretary.

However, as an agent of the company, managerial powers can be delegated to the secretary by the company and/or the Board of directors. There is nothing in the Act to prevent the Board to delegate to him wider powers. But without such delegation, the secretary has no authority to exercise managerial powers. He cannot bind the company unless he has been expressly authorised with such powers.

Without express authority, a secretary cannot exercise the following powers:

(*a*) He cannot make any representation or enter into any contract on behalf of the company - *Barnett Hoares* v. *The South London Tramways Co. Ltd.* [1887] 18 QBD 815, 817.

(*b*) He cannot borrow money in the name of the company - *Re, Cleadon Trust Ltd.* [1939] Ch. 286.

(*c*) He cannot call a meeting of the company - *Re, Haycroft Gold Reduction and Mining Co. Ltd.* [1900] 2 Ch. 230.

(*d*) He cannot register transfer of shares without the Board's authority - *Chida Mines Ltd.* v. *Anderson* [1905] 22 TLR 27.

(*e*) He cannot acknowledge a debt in any suit against the company - *Lakshmi Rattan Cotton Mills Ltd.* v. *Aluminium Corpn. of India Ltd.* AIR 1971 SC 1482.

In conclusion, it can be said that a company secretary has no authority to make any representations or to enter into contracts on behalf of the company without express authority from the company or the Board. He shall be personally liable to third parties for representations for which he has no proper authority.

15.5 Duties of secretary

15.5-1 General duties[1]

The duties of the secretary vary with the size and nature of the company and the terms of the arrangement made with him. In the ordinary course he is to be present in all meetings of the company, and all meetings of the directors, and make proper minutes of proceedings. He issues, under the direction of the Board, all necessary notices to members and others; he conducts all correspondence with shareholders in regard to further issue of shares and calls, making of transfers and forfeitures; he is in charge of the books of the company, or such of them as relate to the internal business of the company, *e.g.*, the Register of Members, share ledger, the transfer book, the Register of debentureholders; he certifies transfers; and he performs other administrative functions. He is also responsible for filing all necessary returns with the Registrar of Companies.

15.5-2 Statutory duties

Rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that a Company Secretary shall also discharge, the following duties, namely:—

(1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

(2) to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;

(3) to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;

(4) to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;

1. Palmer's Company Law, 24th Edition, Paras 68-70

(5) to assist the Board in the conduct of the affairs of the company;

(6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and

(7) to discharge such other duties as have been specified under the Act or rules; and

(8) such other duties as may be assigned by the Board from time to time.

15.6 Liabilities of company secretary

The discussion on liabilities of a company secretary may be grouped under two broad heads : (*a*) Statutory liabilities, and (*b*) Contractual liabilities.

15.6-1 Statutory liabilities

The Companies Act has recognised the secretary as a key managerial personnel of the company, and as such, various liabilities have been imposed upon him. As per section 2(60) of the Act, a secretary has been included in the list of "Officers in default" and is made liable to heavy penalties for any default or non-compliance of the provisions of the Act. The company secretary is responsible for conducting the affairs of the company in accordance with the provisions of the Companies Act. He is also responsible to comply with the requirements of other laws of the country. Thus, the company secretary may be held liable for various acts of omission or commission in the management of the company.

The company secretary may be held liable for the following matters under Companies Act :

(*i*) *Default in filing returns as to allotment* - If a default is made in filing returns as to allotment of shares within the prescribed time, he shall be punishable with fine which may extend to one thousand rupees for every day during which the default continues or one lakh rupees, whichever is less [Section 39(5)].

(*ii*) *Default in the preparation of share/debenture certificates* - As per section 56(4) the company shall deliver the certificates of all securities allotted, transferred or transmitted—

(*a*) within a period of two months from the date of incorporation, in the case of subscribers to the memorandum;

(*b*) within a period of two months from the date of allotment, in the case of any allotment of any of its shares;

(*c*) within a period of one month from the date of receipt by the company of the instrument of transfer under sub-section (1) or, as the case may be, of the intimation of transmission under sub-section (2), in the case of a transfer or transmission of securities;

(*d*) within a period of six months from the date of allotment in the case of any allotment of debenture:

Where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities.

In case of default, the company secretary, as an officer in default, shall be punishable with fine which shall not be less than ten thousand rupees but which may extend to one lakh rupees [Section 56(6)].

(*iii*) *Default regarding Register of members/debentureholders, etc* - Failure will make company secretary, if he is in default, punishable with fine which shall not be less than fifty thousand rupees but which may extend to three lakh rupees and where the failure is a continuing one, with a further fine which may extend to one thousand rupees for every day, after the first during which the failure continues [Section 88].

(*iv*) *Default in the filing of particulars regarding charges* - If a default is made in filing with the Registrar the particulars of any charge created by the company, every officer of the company who is in default which includes a company secretary shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, or with both [Section 86].

(*v*) *Default regarding the publication of name of company* - If a default is made in getting the name and address of the registered office of the company painted or affixed or printed outside every office or place of business or printed on all its business letters, bill heads, etc., company secretary, if he is in default, shall be liable to a penalty of one thousand rupees for every day during which the default continues but not exceeding one lakh rupees [Section 12].

(*vi*) *Default in filing of annual returns* - If a company secretary fails to file the annual return in or a company secretary in practice certifies the annual return otherwise than in conformity with the requirements of this section or the rules made thereunder, he shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees [Section 92].

(*vii*) *Default in holding annual general meeting* - Default in holding the annual general meeting in accordance with the provisions of sections 96 to 98, shall make him liable to a fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continues. [Section 99].

(*viii*) *Default in circulation of members' resolutions* - If a default is made in circulating members' resolution of which they have given notice to the company, he shall be punishable with fine which may extend to Rs. 25,000 [Section 111].

(*ix*) *Default in registering certain resolutions and agreements* - This default shall be punishable with fine which shall not be less than fifty thousand rupees* but which may extend to five lakh rupees. [Section 117].

(*x*) *Default in recording the minutes of the meetings* - If a default is made in recording the minutes of all proceedings of every general meeting and meetings of the Board, a fine of Rs. 5000 may be levied upon an officer in default which includes company secretary [Section 118].

(*xi*) *Default in maintaining minute books or allowing inspection or furnishing copies of minutes to members* - If a default is made in furnishing a copy of the minutes within seven working days after the date of request by any member or if inspection is not allowed, he shall be liable for a fine of Rs. 5,000 for each such refusal or default, as the case may be. [Section 119].

(*xii*) *Failure to give notice of Board's meeting* - A meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. Failure to give notice will make every officer of the company whose duty is to give notice under this section (company secretary is such an officer) and who fails to do so shall be liable to a penalty of twenty-five thousand rupees [Section 173].

(*xiii*) *Failure to maintain the register of directors and key managerial personnel and their shareholding* - Company secretary in default shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees. [Section 172].

(*xiv*) *Failure to maintain register of inter-corporate loans and investments* - For this default company secretary, if he is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees [Section 186].

In addition to the above-mentioned liabilities under the Companies Act, a company secretary is responsible for deducting income-tax from the salaries of the staff and from dividends or interest and depositing the same in Government treasury under Income-tax Act.

Under the Indian Stamp Act, a secretary is responsible to ensure that documents like share certificates, share warrants, debenture certificates, transfer forms, etc., are properly stamped as per the provisions of Indian Stamp Act.

In case the company is a manufacturing concern, the secretary shall also be responsible for complying with the requirements of the various labour laws such as Employees' State Insurance Act, Factories Act, Minimum Wages Act, Payment of Wages Act, Industrial Disputes Act, etc. The company secretary is also, as a principal officer, responsible to fulfil the duties cast upon him under the Foreign Exchange Management Act (FEMA).

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* *Vide* Amendment Act, 2017.

15.6-2 Contractual liabilities

A company secretary enters into a service contract with the company and accordingly he has several contractual liabilities which arise out of his service agreement. These may be as follows :

(*i*) The secretary derives his powers from the Board, therefore, he should carry out the orders given to him.

(*ii*) He should work for the company and should never allow his personal interest to clash with the interest of the company.

(*iii*) He shall be liable to account for the secret profit made by him by virtue of his position as a secretary.

(*iv*) He shall be personally liable if he acts beyond his authority.

(*v*) He shall be liable for any loss or damage caused to the company by wilful misconduct or negligence in the discharge of his duties.

(*vi*) He shall be liable to indemnify the company for any loss suffered by the company as a result of disclosure of some secret information relating to the company.

(*vii*) He shall be liable for any fraud or wrong committed in the course of his employment.

However, if the secretary performs his duties diligently and honestly, he shall not be liable. The secretary shall also not be liable for any fraud by his assistants unless he is a party to such fraud.

15.7 Functions of company secretary [Section 205]

As per sub-section (1) of section 205, the functions of the company secretary shall include,—

(*a*) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company[2];

(*b*) to ensure that the company complies with the applicable secretarial standards[3];

(*c*) to discharge such other duties as may be prescribed.

15.8 Secretarial audit [Section 204]

Sub-section (1) of section 204 provides that every listed company and a company belonging to other class of companies as may be prescribed shall annex with its

2. It's for the first time that the company secretary has been made responsible to report to the Board compliance of other applicable laws by the company. This addition is very significant and calls for a larger responsibility on the part of the company secretaries both in employment and in whole-time practice.
3. For the purpose of this section, the expression "secretarial standards" means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government - Explanation to section 205(1).

Board's report made in terms of sub-section (3) of section 134, a secretarial audit report, given by a company secretary in practice, in such form as may be prescribed.

Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 has prescribed the following class of companies for the purposes of sub-section (1):

(*a*) every public company having a paid-up share capital of fifty crore rupees or more; or

(*b*) every public company having a turnover of two hundred fifty crore rupees or more.

Sub-rule (2) of Rule 9 says that the format of the Secretarial Audit Report shall be in Form No.MR.3.

Sub-section (2) of section 204 charges the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

Further, the Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in his report under sub-section (1) [Section 204(3)].

Penalty: If a company or any officer of the company or the company secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the company secretary in practice, who is in default, shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees [Section 204(4)].

15.9 Rights of company secretary

Rights are given to the secretary by the Companies Act, Board of directors and the general body of shareholders. He also derives some rights out of his service agreement with the company. A secretary has the following rights :

(*i*) He has the right to control and supervise the working of his department.

(*ii*) As a principal officer of the company, he has the right to sign a document or proceeding requiring authentication by the company.

(*iii*) He has a right to be indemnified by the company for any loss suffered by him while discharging his duties.

(*iv*) As an employee of the company, he has the right to receive remuneration. In the event of winding-up of the company, he has a right to be treated as a preferential creditor for his salary subject to a maximum amount that may be notified.

But a company secretary has no right to borrow money in the name of the company or to make allotment of shares or register transfer of shares without the express authority or consent of the Board of directors. He has no authority to convene a meeting of the company unless directed by the Board or to remove a name from the Register of members, or to take policy decisions.

15.10 Role of company secretary

The company secretary plays an important role in company administration. From the position of a clerk, he has risen to the level of an officer of the company. The scope of his role depends on the size and nature of the company. He is liable not only to the company, but also to its shareholders, creditors, employees, consumers, society and the Government.

Generally speaking, the company secretary plays a three-fold role as a statutory officer, as a coordinator and as an administrative officer.

15.10-1 As statutory officer

As one of the principal officers of the company, the company secretary is responsible for strict compliance with the various provisions of the Companies Act.

Some of which are given hereunder :

1. Under section 21 he is authorised to sign any document for authentication.
2. Under section 92(1) he is authorised to sign and deliver to the Registrar the Annual Return of the company made up to the date of the close of the financial year.
3. Under sections 134 and 137(1) he is authorised to authenticate the financial statement, including consolidated financial statement, if any, of the company and deliver the same to the Registrar of Companies within 30 days of the Annual General Meeting.
4. An obligation has been imposed on company secretary for filing of various returns under the Companies Act, 2013 with the Registrar of Companies, *viz.*, return of allotment, return of creation and satisfaction of charges, annual return, change of registered office, etc.
5. He is duty bound to issue share certificates and debentures under section 56.
6. He is duty bound to maintain various statutory registers, *viz.*—
   (*i*) Minutes of General Meeting and Board Meetings
   (*ii*) Register of Members, debentureholders and Index
   (*iii*) Register of changes among directors
   (*iv*) Register of charges
   (*v*) Register of directors and key managerial personnel and their shareholdings
   (*vi*) Register of loans and investments, etc.
7. He is duty bound to send notices for convening the meetings of shareholders and debentureholders, etc.

As a statutory officer, the company secretary is also responsible to comply with the provisions of other Acts, such as Competition Act, Securities (Contracts and Regulation) Act, Income-tax Act, FEMA, Indian Stamp Act, Sales Tax Act, various labour laws like Factories Act, Minimum Wages Act, Payment of Wages Act, Industrial Disputes Act, etc.

15.10-2 Secretary as a coordinator

The secretary holds a high administrative position in the company. The Board of directors of a company is responsible for managing the affairs of the company and they lay down the broad policies to be followed by the company. It is the duty of the secretary to ensure that the policies and decisions of the Board are effectively implemented. In this connection, it should be noted that a secretary cannot be regarded as equal to a manager performing managerial functions. He has to co-ordinate the work of executives at different levels. The secretary is an important link between the Board and other executives. He can be said to be the 'mouthpiece of the Board'. The company secretary plays the role of a coordinator not only within the company, but also with the outsiders such as shareholders, society and different Government departments. The secretary's role as a coordinator has two aspects - internal and external. His role as an internal coordinator consists of his activities between the Board, managing director and the chairman on the one hand and other line and staff executives, trade unions and auditors of the company, on the other. His role as an external coordinator relates to the relationship of the company with shareholders, Government and society.

Internal role as a coordinator

(*a*) *Relating to the Board, chairman and managing director* - The secretary is responsible for convening the meetings of the Board and shareholders. He has to keep the Board informed about the activities of the company and the progress made in different areas. He has to inform them about the various legal obligations imposed on them and keep them informed with the latest changes and developments taking place in the corporate world. He is to guide the Board of directors. He helps the Board in taking various decisions. That is why it is said that "while the directors are the brain of the company, the secretary is its ears, eyes and hands".

The secretary is responsible for communicating the decisions of the Board to different executives and the outsiders. The secretary is not vested with managerial powers; he has to work under the managing or whole-time director. He has to act as a connecting link between the officials and in the process to maintain utmost secrecy. The secretary is to see that work of the company is carried on according to the provisions of the law and that various returns, reports, etc., are sent in time. The secretary is responsible for collecting the information from different operating units and communicate the same to the top management. In this way the secretary helps the management in taking right policy decisions.

(*b*) *Relating to the employees* - The company secretary plays an important role as a coordinator of the personnel policy of the company. Though for employing persons, there may be a separate personnel department, but even then the secretary has to advise the top management on manpower planning and formulation of recruitment policy and seeing that the good labour relations are maintained. Whenever an agreement is made with the trade union, the secretary should make a proper note of the same so that there may not be any misunderstanding or dispute later on. The secretary must see to it that the provisions of different labour welfare laws are strictly complied

with. The secretary has an important role to play in maintaining staff discipline. Before taking any disciplinary action, he must ensure that the legal formalities and procedures are followed. The secretary must make every possible effort to maintain cordial relations with the employees; it is then only the objectives of the company could be achieved. The creative activities of employees should be encouraged and wherever possible grants and subsidy from the company should be given.

(*c*) *Relating to the auditors* - Every company is required to get its accounts audited by a qualified auditor and submit the annual audited accounts before the general body of shareholders at the annual general meeting. Apart from statutory audit, auditor's certificates are also required under various other laws. The secretary has, therefore, to coordinate with the auditors. The company secretary has to ensure that the appointment of auditors is made in accordance with the requirements of the Companies Act. The secretary has to see that all books and documents, resolutions, etc., required by auditors for audit work are made available to them in time.

External role as coordinator

(*a*) *Relating to the shareholders* - For maintaining cordial relations with the shareholders, the company secretary has to maintain proper link or liaison between the Board and the shareholders. Under the Companies Act, shareholders have the right to receive share certificates, notices of meetings, dividend warrants, etc., in time, to inspect books and registers of the company and have extracts of registers on payment of prescribed fees. The secretary must ensure that the rights of shareholders are honoured in time and the extracts of registers asked for by shareholders are supplied to them within the statutory periods.

The secretary should ensure that all letters and complaints from shareholders are promptly dealt with and their queries are answered without violating the statutory provisions. He should be polite and courteous while dealing with shareholders.

(*b*) *Relating to the Government* - The company secretary has a very important role *vis-a-vis* the Government. The secretary has to ensure that the provisions of the Companies Act and other laws of the country are complied with strictly. He must see to it that the company is implementing the policies of the Government in their true spirit. He should advise the Board about the changing policies of the Government. While sending information and reports to the Government, the secretary should make sure that they are factually correct and are in accordance with the law.

(*c*) *Relating to the society* - It has been well recognised that a company has some responsibility towards the society. We find that leading companies are making important contributions in providing more employment opportunities, imparting technical education, establishing schools, colleges and hospitals. The secretary should advise the Board regarding the areas where the company can make useful contribution. Companies supplying goods and services should be more careful in discharging their social responsibility by supplying goods and services at reasonable rates by maintaining acceptable

quality. Further, he has to see that the requirements for keeping pollution within legally and socially acceptable limit are complied with.

15.10-3 As an administrative officer

As a general administrative officer, he is responsible for efficient administration of the company. The secretary has to ensure that the policies of the company are duly carried out. He has to supervise, control and coordinate the functioning of different departments such as finance, personnel, organisation. The best possible results can be achieved by having a sound organisational structure. The company secretary is in such a position that he can have an overall view of different aspects of company administration and can develop a strong and efficient organisational structure.

The company secretary has to play an important role in financial administration. He may have to analyse the financial statements and recommend suitable steps; though in large-sized companies, the financial part is looked after by a financial expert. The secretary is to assist the Board in laying down the policies and dealing with the Government and financial institutions. The secretary has also an important role to play in the personnel administration of the company. He can render valuable advice to the Board regarding the recruitment, training, remuneration, promotion, retirement, discharge, discipline of the staff.

The company secretary has to ensure the safety and proper maintenance of the assets and properties of the company. He has to ensure that they are not misused. He has to see that the property and other records are properly insured against loss by fire and other risk. The company secretary has also to ensure that the records are maintained properly. With the fast changes taking place, a company secretary is expected to play a still more important role in the administration of the company.

15.11 Dismissal of a company secretary

A secretary may be removed from his office by a resolution of the Board of Directors. A secretary being an employee of the company, the general rules of employment of the company will also be applicable to him. He can be removed by giving the due notice in writing or compensation in lieu thereof. Even where the appointment of a secretary is for a fixed period, the company can dismiss him before the said period by giving due notice.

A secretary can, however, be dismissed without giving him a notice in the following cases : (*a*) for wilful disobedience; (*b*) for misconduct or moral turpitude; (*c*) for negligence; (*d*) for incompetence or permanent disability.

In the event of compulsory winding up of the company, the order of the court shall serve as a notice of discharge to officers and employees of the company, *i.e.*, the secretary will also be automatically dismissed.

When the appointment of a secretary is terminated, necessary particulars in the prescribed Form and in the prescribed manner should be filed with the Registrar of Companies within thirty days of termination. Necessary changes should also be made in the Registers of Directors, Managing Director, Secretary, etc.

15.12 Company secretary in practice

Section 2(25) defines 'Secretary in practice' to mean a secretary who is deemed to be in practice within the meaning of sub-section (2) of section 2 of the Company Secretaries Act, 1980.

Section 2(2) of the Company Secretaries Act, 1980 provides that a member of the Institute shall be "deemed to be in practice" when, individually or in partnership with one or more members of the Institute in practice or in partnership with members of such other recognised professions as may be prescribed, he, in consideration of remuneration received or to be received, engages himself, *inter alia*,—

(*a*) in the practice of the profession of Company Secretaries to, or in relation to, any company; or

(*b*) offers to perform or performs services in relation to the promotion, forming, incorporation, amalgamation, reconstruction, reorganization or winding up of companies; or

(*c*) offers to perform or performs such services as may be performed by—

(*i*) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company,

(*ii*) a share transfer agent,

(*iii*) an issue house,

(*iv*) a share and stock broker,

(*v*) a secretarial auditor or consultant.

15.12-1 Who can use the designation of Secretary

Section 7 of the Company Secretaries Act, 1980 provides that only the members of the Institute of Company Secretaries of India are entitled to use the designation of company secretary. It provides that every member of the Institute in practice shall, and any other member may, use the designation of a company secretary.

Further, this section does not prohibit any such member adding any other description or letter to his name, if entitled thereto, to indicate membership of such other institute whether in India or elsewhere as may be recognised in this behalf by the Council, or any other qualification that he may possess. It also does not prohibit a firm, all the partners of which are members of the Institute and in practice, from being known by its firm name as Company Secretaries.

15.12-2 Who can practise

According to section 6 of the Company Secretaries Act, 1980, only a member of the Institute, whether in India or elsewhere, shall be entitled to practise provided he has obtained from the Council a certificate of practice.

A member desirous of practising should make an application in the prescribed form along with the prescribed fee. Fee is payable on or before 1st April each year.

Regulation 10(2) of Company Secretaries Regulations, 1982 provides that the Council shall on acceptance of the application for issue of certificate, issue a

certificate in the appropriate form. The certificate so issued shall be valid till it is cancelled. In the case of renewal of certificate of practice, the Secretary of the Institute of Company Secretaries shall issue a letter extending the validity period of the certificate of practice in the appropriate form [Reg. 10(3)].

15.12-3 Who cannot practise

The following are prohibited from practising as Company Secretaries :

1. A company, whether incorporated in India or abroad [Section 26 of the Company Secretaries Act, 1980].
2. Any person other than a member of the Institute of Company Secretaries of India [Section 27 of the Company Secretaries Act, 1980].

In case a member ceases to be in practice he must intimate that fact to the Council in writing not later than 30 days from the date he ceases to be in practice [Reg. 10(4)]. He should also surrender forthwith the certificate of practice to the Secretary of the Institute [Reg. 10(5)].

15.12-4 Can a firm practise

Yes, a firm of Company Secretaries can engage in the practice of the profession. However, the following provisions shall be noted in this regard—

1. *Trade or Firm name to require Council's approval* - Regulation 169 makes the following provisions in this regard :

(*i*) No company secretary in practice who is not a partner of a firm or such company secretaries shall practise under any name or style other than his own except with the prior approval of the Council.

(*ii*) No firm of company secretaries in practice shall practise under any name or style except with the previous approval of the Council.

(*iii*) The Council may, at its discretion, refuse to approve the particular trade, firm or other name, if—

(*a*) the same or similar or nearly similar name is already used by a company secretary in practice or a firm of such company secretaries; or

(*b*) that name, in the opinion of the Council, is undesirable.

A firm's name may be considered undesirable if it does not bear the name of its partners, present or past, except where the firm name has been acquired by payment of goodwill or otherwise.

(*iv*) Where the same trade or firm name has been *inadvertently* registered in the Register of Offices and Firms maintained by the Council in the case of two or more members or firms, the Council may direct the member(s) or firm(s), as the case may be, other than the one whose name was registered first in the Register, to alter their names in such manner as the Council may direct in this behalf.

On alteration being effected, the member must inform the Council within three months of the issue of Council's direction.

2. *Constitution or reconstitution of firm to require Council's approval* - Regulation 170 makes the following provisions in this regard :
   (*i*) No firm of company secretaries shall be constituted or reconstituted except with the prior approval of the Council.
   (*ii*) The Council shall not refuse to accord approval to the constitution or reconstitution of a firm unless it is of the opinion that the terms of the partnership agreement permit, directly or indirectly, the doing of anything by the firm or any partner thereof which amounts to professional misconduct or that the terms and conditions of the proposed partnership are not fair and reasonable or that, having regard to the circumstances of the case, the constitution or reconstitution of the proposed partnership would not be in the interests of the general public.

Firm having more than one office - Section 37(1) of the Company Secretaries Act, 1980 permits a company secretary in practice or a firm of such company secretaries to have more than one office in India.

The following provisions are required to be complied with by such a company secretary or a firm of company secretaries :

1. There should be a member of the Institute in separate charge of each such office. However, the Council may make exemptions in this regard.
2. A list of such offices and the persons in charge thereof should be reported to the Council as also of changes in relation thereto.
3. Particulars of his office or that of the firm must be submitted to the Council within 3 months from the date of the commencement of practice or formation of the firm, as the case may be, whichever is later. The particulars are to be submitted in the prescribed form.

   Any subsequent change in the particulars submitted must be sent so as to reach the Council within 30 days after the change was effected (Reg. 165).
4. Every member in practice must have a place of business in India in his own charge or in charge of another member (Reg. 167).

15.12-5 Areas of practice

Section 2(*c*) of the Company Secretaries Act, 1980 has prescribed the following areas of practice for a Company Secretary in practice :

(*a*) to engage in the practice of the profession of Company Secretaries to, or in relation to, any company; or

(*b*) to offer to perform or perform services in relation to the promotion, forming, incorporation, amalgamation, reconstruction, reorganisation or winding up of companies; or

(*c*) to offer to perform or perform such services as may be performed by - (*i*) an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including form, applications and return) by or on behalf of the company; (*ii*) a share transfer agent; (*iii*) an issue house; (*iv*) a share and stock broker; (*v*) a secretarial auditor or

consultant; (*vi*) an adviser to a company or management, including any legal or procedural matter falling under the Industries (Development & Regulation) Act, 1951; the Companies Act, 2013; the Securities Contracts (Regulation) Act, 1956; any of the rules or bye-laws made by a recognised Stock Exchange; the Foreign Exchange Management Act, 1999; or under any other law for the time being in force; (*vii*) to issue certificates on behalf of, or for the purposes of, a company; or

(*d*) to hold himself out to the public as a company secretary in practice; or

(*e*) to render professional services or assistance with respect to matters of principle or detail relating to the practice of the profession of company secretaries; or

(*f*) to render such other services as, in the opinion of the Council, are or may be rendered by a company secretary in practice.

Besides, certain important statutes (including the Companies Act, Securities Contracts Regulation Act) and authorities (including IDBI, IFCI, ICICI, IRBI, Indian Banks Association, State Financial Institutions, Banks) have recognised the practising company secretaries for issue of certificates for certain purposes.

15.12-6 Certificate of practice

Regulation 10(2) provides that the Council shall on acceptance of the application for issue of certificate, issue a certificate in the appropriate form which shall remain valid until it is cancelled.

In case of renewal, the Secretary of the Institute shall issue a letter extending the validity period of the certificate of practice for that year in the appropriate form.

In case a member ceases to be in practice he shall intimate the fact to the Council in writing not later than 30 days from the date he ceases to be in practice [Reg. 10(4)].

Regulation 10(5) provides that a member who ceases to be in practice or whose certificate of practice has been cancelled shall surrender forthwith the certificate then held by him to the Secretary of the Institute.

15.12-7 Cancellation of certificate of practice

Regulation 11 of the Company Secretaries Regulations, 1982 stipulates the circumstances under which a certificate of practice issued shall be cancelled. It provides as follows :

1. A certificate of practice shall be cancelled when—
   (*a*) the name of the holder of the certificate is removed from Register of Members; or
   (*b*) the Council is satisfied that such certificate was issued on the basis of incorrect, misleading or false information provided by the applicant or by mistake or inadvertence on the part of the Council ; or
   (*c*) the member has ceased to be in practice; or
   (*d*) the member has not paid the annual certificate fee on or before 30th June of that year.

However, before cancelling his certificate under clause (*b*) reasonable opportunity to explain his case shall be given to the member.

2. The cancellation of a certificate shall be effective :
   (*a*) *in a case falling under clause (*a*) of sub-regulation (1),* from the date on which and during the period for which the name of the holder of the certificate was removed from the Register of Members; and
   (*b*) *in any other case,* from such date and from such period, as the Council may determine.
3. When a certificate is cancelled, the date from which and the period for which the certificate stands cancelled shall be communicated in writing by registered post to the member concerned at the address entered in the Register of Members and may also be published in the Journal of the Institute of Company Secretaries of India, *viz.,* 'Chartered Secretary'.

15.12-8 Restoration of Certificate of Practice

Regulation 14 provides for the restoration of certificate of practice. According to the said regulation a member whose certificate of practice has been cancelled may apply for its restoration if he is otherwise eligible for such restoration, by paying the arrears of the annual certificate fees for the previous years, if any, and the annual certificate fee for the year in which his certificate of practice is required to be restored.

The Council may on receipt of such application along with dues, if any, restore the certificate of practice from the date of its cancellation or from such other date as it deems fit. The person concerned shall be communicated in writing of the restoration of the certificate of practice and it may also be published in the Journal of the Institute of Company Secretaries of India, *viz.,* 'Chartered Secretary'.

15.12-9 Company secretary not to engage in any other business or occupation

A company secretary in practice cannot engage in any business or profession other than the profession of company secretary unless it is permitted by a general or specific resolution of the Council [Reg. 168].

However, he may act as a secretary, trustee, executor, administrator, arbitrator, receiver, appraiser, valuer, internal auditor, management auditor (but not financial auditor), management consultant, or as a representative on financial matters including taxation and may take up an appointment that may be made by the Central or any State Government, Courts of Law, Labour Tribunals, or any other statutory authority.

In the context of Limited Liability Partnership Act, 2008, the Council of ICSI has passed a resolution under Regulation 168 of the Company Secretaries Regulations, 1982. The same is annexed as Annexure 15.3 of this Chapter.

15.12-10 Can a company secretary have more than one office

Where a company secretary in practice has more than one office, he must send a

list of such offices and the persons in charge thereof to the Council. Any change therein must also be intimated to the Council within one month (Reg. 163).

Regulation 165 provides that every company secretary in practice and every firm of such company secretaries must submit to the Council in the appropriate form the particulars of his office or that of the firm within three months from the commencement of practice or formation of the firm, as the case may be.

Regulation 167 makes it obligatory on every member in practice to have a place of business in India in his own charge or in charge of another member. Particulars of such place of business shall be supplied by the member to the Council. Any change of such place of business must be intimated within 30 days.

15.13 Professional misconduct

The Company Secretaries (Amendment) Act, 2006, amongst other matters, has significantly altered the concept of misconduct and the related procedures and endowed it with substantial independence, a degree of autonomy and expeditious disposal. Prior to the aforesaid amendment, the Council of the Institute was vested with the power of receiving complaints/information and get them enquired into, if considered necessary, by the Disciplinary Committee of the Institute. The convict, on receipt of the report from the Disciplinary Committee had the right to pronounce members guilty/not guilty in respect of cases enquired into by the Disciplinary Committee and award punishment in cases found guilty of professional misconduct under the then First Schedule to the Company Secretaries Act and refer the cases found guilty under the then Second Schedule as also cases of other misconduct to the appropriate High Court.

The aforesaid position has undergone conceptual and modification, inasmuch as the Act as amended in 2006 now :

(*a*) has created four statutory authorities, namely (*i*) Disciplinary Directorate, headed by an officer of the Institute; (*ii*) Board of Discipline; and (*iii*) The Disciplinary Committee—all the above to be constituted by the Council of the Institute in the manner laid down in sections 21, 21A and 21B of the amended Act. The fourth is the Appellate Authority to be constituted by the Central Government in the manner specified in section 22A of the amended Act. Now, the entire disciplinary activity is confined within these four authorities and the Council of the Institute has been relieved from any further role in this regard.

(*b*) A new definition of Professional or Other Misconduct has been given in section 22 of the Company Secretaries Act. Previously section 22 contained the definition of Professional Misconduct. Amended section 22 defines Professional or other misconduct as under :

For the purposes of this Act, the expression 'professional or other misconduct' shall be deemed to include any act or omission provided in any of the schedules but nothing in this section shall be construed to limit or abridge in any way the power conferred or duty cast on the Director (Discipline) under sub-section (1) of section 21 to inquire into the conduct of any member of the Institute under any other circumstances.

(*c*) The First and Second Schedules of the Act have been revised (given as Annexure 15.2). Board of Discipline is the authority in matters of offences only under the First Schedule to decide the case brought before it by the Director (Discipline). However, appeal if any, shall lie with the Appellate Authority. The Board of Discipline shall follow summary disposal procedure for all the cases brought before it.

The Disciplinary Committee is the deciding authority for cases involving offences under Second Schedule or offences stretching to both the Schedules. The Director (Discipline) shall place all the cases involving Second Schedule or involving both the Schedules to the Disciplinary Committee. Appeal, if any, shall lie with the Appellate Authority.

(*d*) No more matters need to go to the High Court.

(*e*) All the four authorities mentioned above shall have the power of a civil court, in respect of summoning and enforcing the attendance of any person and examining him on oath, the discovery and production of any document and receiving evidence on affidavit.

(*f*) Proceedings started before the 2006 amendments in respect of disciplinary matters, shall be continued under the previous procedure.

(*g*) Company Secretaries (Procedure of Investigations of Professional and Other Misconduct and Conduct of Cases) Rules, 2007 have been issued by the Central Government [*Vide* Notification No. GSR 111(E), dated 27-2-2007.]

15.14 Quality Review Board

The Company Secretaries Act, as amended in 2006, has empowered the Central Government in section 29 to constitute a Quality Review Board consisting of a Chairperson and four other members. The Board shall perform the following functions :

(*i*) Recommendation to the Council of the Institute in regard to quality of services provided by members,

(*ii*) Reviewing the quality of services provided by the members, and

(*iii*) Guidance to the members of the Institute to improve the quality of services and adherence with various statutory and other regulatory requirements.

It may be noted that the Council is entitled to inquire into the conduct of a person who was a member of the Institute at the time of the alleged offence but has ceased to be so at the time of inquiry.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (FINAL), C.S. (INTER)/FINAL, ICWA (INTER)]

1. Explain the term 'Secretary' under the Companies Act, 1956. Is it necessary for every company to have a secretary ?

2. What do you mean by 'company secretary' under the Company Secretaries Act, 1980 ?

3. Discuss the legal position of a company secretary and state his main functions.
4. "The status of secretary in the Indian corporate scene has undergone significant change during the last three decades." Discuss in the light of legal pronouncements and statutory amendments.
5. State the qualifications which a company secretary must possess.
6. The company secretary of a company having a paid-up share capital of more than Rupees five crore, resigned and left the company. The company has not appointed his successor. Meanwhile it has started incurring losses. Its sales have declined and financial position became weak. Can it be a valid reason for not appointing a whole time secretary? How long can the company delay the appointment ? What penalty can be imposed ? Will the liability extend to all the directors or only to the managing director ?
7. The term 'officer' as defined in the Companies Act, 2013, includes secretary, as it includes 'director' or 'manager'. State the ostensible authority of a company secretary to bind the company by his act and also give at least three examples where he has no such authority.
8. "The part of the secretary is what the company and the individual make of it." Explain and discuss the statutory duties of a company secretary.
9. Discuss the statutory and contractual liability of a company secretary.
10. Explain the role of a company secretary in the functioning of a company.
11. Explain the term 'secretary' and elucidate his role as a co-ordinator.
12. Discuss the role of a 'company secretary' as a statutory officer and as a corporate manager.
13. Describe the role and position of a company secretary in the context of changing business environment in India ?
14. (*i*) Define the term 'company secretary'.

    (*ii*) What are the areas of practice for a company secretary in practice.

    (*iii*) Under what circumstances may a certificate of practice be cancelled ? State the procedure for its restoration ?

    (*iv*) Mr. 'A' is a qualified cost accountant and also a company secretary. He is appointed in a company as a cost controller. He intends to practice as company secretary on a part time basis outside the company's business hours without causing inconvenience to his employer company. Can he do so ?
15. (*a*) Define 'company secretary in practice' and his/her areas of practice under the Company Secretaries Act, 1980.

    (*b*) State the circumstances under which the certificate of practice issued to a member is liable to be cancelled. What is the procedure for restoration of this certificate ?
16. What do you mean by 'Secretary in practice' under the Companies Act, 2013 ?
17. Outline and discuss the provisions of the Company Secretaries Regulations, 1982 in regard to a 'practising company secretary'.
18. (*a*) What is 'professional misconduct' under the Company Secretaries Act, 1980 ?

    (*b*) Under what circumstances a certificate of practice issued could be cancelled? What is the procedure for restoration of certificate of practice ?

    (*c*) S, a company secretary in whole-time practice, accepts an assignment of signing of annual return. Earlier, annual returns were signed by P, another company secretary in practice. S did not make any communication with P in writing. Is this in order ? Discuss.

19. (*a*) Who can use the designation of 'Company Secretary' ?

(*b*) Explain the provisions of the Company Secretaries Act, 1980 and the Company Secretaries Regulations, 1982 relating to the issue, renewal, cancellation and restoration of a certificate of practice.

20. X, a practising chartered accountant who is also a qualified company secretary, desires to take up the work of practising company secretary, in addition to the audit of the accounts of the companies. Discuss the legal position.

Hints : *See Para 15.12-9*

21. Discuss the legal position with regard to the following :

(*i*) A company secretary, practising in Delhi, desires to open a branch office in Bombay, where he would be visiting for 3 days in a week.

(*ii*) S, a company secretary in whole time practice, enters into an agreement with B, a practising Chartered Accountant, providing that each person shall pay commission to the other on the business procured for the other from their clients.

(*iii*) M, a whole time secretary of XYZ Pvt. Ltd. having a paid up capital of Rs. 10 crores, desires to take up private practice as a company secretary after company's business hours.

(*iv*) X, a practising chartered accountant who is also qualified as company secretary desires to take the work of practising company secretary, in addition to the audit of accounts of the companies for which he is already holding a certificate of practice.

THE FIRST SCHEDULE TO THE COMPANY SECRETARIES ACT, 1980 AS AMENDED IN 2006

[*See* sections 21(4) and 22]

PART I

Professional misconduct in relation to company secretaries in practice

A Company Secretary in practice shall be deemed to be guilty of professional misconduct, if he—

(*1*) allows any person to practice in his name as a Company Secretary unless such person is also a Company Secretary in practice and is in partnership with or employed by him;

(*2*) pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute or a partner or a retired partner or the legal representative of a deceased partner, or a member of any other professional body or with such other persons having such qualifications as may be prescribed, for the purpose of rendering such professional services from time to time in or outside India.

Explanation. — In this item, "partner" includes a person residing outside India with whom a Company Secretary in practice has entered into partnership which is not in contravention of item (*4*) of this Part;

(*3*) accepts or agrees to accept any part of the profits of the professional work of a person who is not a member of the Institute:

Provided that nothing herein contained shall be construed as prohibiting a member from entering into profit sharing or other similar arrangements, including receiving any share commission or brokerage in the fees, with a member of such professional body or other person having qualifications, as is referred to in item (*2*) of this Part;

(*4*) enters into partnership, in or outside India, with any person other than a Company Secretary in practice or such other person who is a member of any other professional body having such qualifications as may be prescribed, including a resident who but for his residence abroad would be entitled to be registered as a member under clause (*e*) of sub-section (1) of section 4 or whose qualifications are recognised by the Central Government or the Council for the purpose of permitting such partnerships;

(*5*) secures, either through the services of a person who is not an employee of such Company Secretary or who is not his partner or by means which are not open to a Company Secretary, any professional business:

Provided that nothing herein contained shall be construed as prohibiting any arrangement permitted in terms of items (*2*), (*3*) and (*4*) of this Part;

(*6*) solicits clients or professional work, either directly or indirectly, by circular, advertisement, personal communication or interview or by any other means:

Provided that nothing herein contained shall be construed as preventing or prohibiting—

(*i*) any Company Secretary from applying or requesting for or inviting or securing professional work from another Company Secretary in practice; or

(*ii*) a member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence;

(*7*) advertises his professional attainments or services, or uses any designation or expressions other than Company Secretary on professional documents, visiting cards, letterheads or sign boards, unless it be a degree of a University established by law in India or recognised by the Central Government or a title indicating membership of the Institute of Company Secretaries of India or of any other institution that has been recognised by the Central Government or may be recognised by the Council:

Provided that a member in practice may advertise through a write up setting out the services provided by him or his firm and particulars of his firm subject to such guidelines as may be issued by the Council;

(*8*) accepts a position as a Company Secretary in practice previously held by another Company Secretary in practice without first communicating with him in writing;

(*9*) charges or offers to charge, accepts or offers to accept, in respect of any professional employment, fees which are based on a percentage of profits or which are contingent upon the findings, or results of such employment, except as permitted under any regulation made under this Act;

(*10*) engages in any business or occupation other than the profession of Company Secretary unless permitted by the Council so to engage:

Provided that nothing contained herein shall disentitle a Company Secretary from being a director of a company except as provided in the Companies Act, 1956 (1 of 1956);

(*11*) allows a person not being a member of the Institute in practice, or a member not being his partner to sign on his behalf or on behalf of his firm, anything which he is required to certify as a Company Secretary, or any other statements relating thereto.

PART II

Professional misconduct in relation to members of the Institute in service

A member of the Institute (other than a member in practice) shall be deemed to be guilty of professional misconduct, if he, being an employee of any company, firm or person—

(*1*) pays or allows or agrees to pay, directly or indirectly, to any person any share in the emoluments of the employment undertaken by him;

(*2*) accepts or agrees to accept any part of fees, profits or gains from a lawyer, a Company Secretary or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

PART III

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

(*1*) not being a Fellow of the Institute, acts as a Fellow of the Institute;

(*2*) does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority;

(*3*) while inviting professional work from another Company Secretary or while responding to tenders or enquiries or while advertising through a write up, or anything as provided for in items (*6*) and (*7*) of Part I of this Schedule, gives information knowing it to be false.

PART IV

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if—

(*1*) he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months;

(*2*) in the opinion of the Council, he brings disrepute to the profession or the institute as a result of his action whether or not related to his professional work.

THE SECOND SCHEDULE TO THE COMPANY SECRETARIES ACT, 1980 AS AMENDED IN 2006

[*See* sections 21(3), 21B(3) and 22]

PART I

Professional misconduct in relation to company secretaries in practice

A Company Secretary in practice shall be deemed to be guilty of professional misconduct, if he—

(*1*) discloses information acquired in the course of his professional engagement to any person other than his client so engaging him, without the consent of his client, or otherwise than as required by any law for the time being in force;

(*2*) certifies or submits in his name, or in the name of his firm, a report of an examination of the matters relating to company secretarial practice and related statements unless the examination of such statements has been made by him or by a partner or an employee in his firm or by another Company Secretary in practice;

(*3*) permits his name or the name of his firm to be used in connection with any report or statement contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast;

(*4*) expresses his opinion on any report or statement given to any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest;

(*5*) fails to disclose a material fact known to him in his report or statement but the disclosure of which is necessary in making such report or statement, where he is concerned with such report or statement in a professional capacity;

(*6*) fails to report a material mis-statement known to him and with which he is concerned in a professional capacity;

(*7*) does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

(*8*) fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;

(*9*) fails to invite attention to any material departure from the generally accepted procedure relating to the secretarial practice;

(*10*) fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

PART II

Professional misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he—

(*1*) contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council*;

(*2*) being an employee of any company, firm or person, discloses confidential information acquired in the course of his employment, except as and when required by any law for the time being in force or except as permitted by the employer;

(*3*) includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false;

(*4*) defalcates or embezzles moneys received in his professional capacity.

PART III

Other misconduct in relation to members of the Institute generally

A member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.'.

RESOLUTION UNDER REGULATION 168 OF THE COMPANY SECRETARIES REGULATIONS, 1982

Resolved under Regulation 168 of the Company Secretaries Regulations, 1982, the council gives general permission to the members in practice to:

(*a*) become passive partner of a Limited Liability Partnership (LLP) the objects of which include carrying out non-attestation services which fall within the scope of profession of company secretaries irrespective of whether or not the practising member holds substantial interest in that LLP.

(*b*) become passive partner of LLP which is engaged in any other business or occupation provided that the practising member does not hold substantial interest in that LLP.

For the purposes of the above resolution:

(*i*) "Attestation Services" include services which require signing any certificate, document, report or any other statements relating thereto on behalf of a Company Secretary in Practice or a firm of such Company Secretaries in his or its professional capacity or which require signing anything that is required to be signed by a Company Secretary in practice.

(*ii*) "Non-attestation Services" means services which are not attestation services.

(*iii*) A "passive partner" means a partner of LLP who fulfils the following conditions:

(*a*) he must not be a designated partner;

(*b*) subject to the LLP agreement, he may make agreed contribution to the capital of LLP and receive share in the profits of the LLP; and

(*c*) he must not take part in the management of the LLP nor act as an agent of the LLP or of any partner of the LLP;

However, none of the following activities shall constitute taking part in the management of the LLP:

(1) Enforcing his rights under the LLP agreement (unless those rights are carrying out management function).

(2) Calling, requesting, attending or participating in a meeting of the partners of the LLP.

(3) Approving or disapproving an amendment to the partnership agreement.

(4) Reviewing and approving the accounts of the LLP.

(5) Voting on, or otherwise signifying approval or disapproval of any transaction or proposed transaction of the LLP including—

(*a*) the dissolution and winding up of the LLP;

(*b*) the purchase, sale, exchange, lease, pledge, mortgage, hypothecation, creation of a security interest, or other dealing in any asset by or of the LLP;

(*c*) a change in the nature of the activities of the LLP;

(*d*) the admission or removal of a partner of the LLP;

(*e*) transactions in which one or more partners have an actual or potential conflict of interest with one or more partners of the LLP;

(*f*) any amendment to the LLP agreement;

(*iv*) a member shall be deemed to have a "substantial interest" in an LLP if he is entitled at any time to not less than 25% of the profits of such LLP."

16 Company Meetings-I - General

16.1 Meaning of 'meeting'

A meeting may be generally defined as a gathering or assembly, getting together of a number of persons for transacting any lawful business, for entertainment or the like. There must be at least two persons to constitute a meeting. However, in certain exceptional cases, even one person may constitute a valid meeting.[1]

Company meetings must be convened and held in perfect compliance with the applicable provisions of the Companies Act, 2013 and the Rules framed thereunder.

16.2 Kinds of meetings

Company meetings may be classified as :

1. Shareholders' meetings :
   (*a*) Statutory meeting,
   (*b*) Annual general meeting (AGM),
   (*c*) Extraordinary general meeting (EGM), and
   (*d*) Class meetings.
2. Board meetings;
3. Meetings of the Committees of the Board;
4. Meetings of Debenture-holders;
5. Meetings of Creditors :
   (*a*) for purposes other than winding-up, and
   (*b*) for winding-up;
6. Meetings of contributories in winding-up.

1. These exceptional circumstances are discussed later.

16.3 Requisites of a valid meeting

Every meeting, in order to be valid, must be duly convened, properly constituted and conducted.

16.4 Meeting to be properly convened

This means that :

(*i*) the meeting must have been convened by the proper authority. The proper authority to convene the meeting is the Board of directors, shareholders or Tribunal; and

(*ii*) proper and adequate notice must have been given to all those entitled to attend.

16.4-1 Proper authority

The proper authorities to call the meetings are :

(*a*) ***Board of Directors*** **-** The Articles of Association of a company normally empower the Board of directors to convene general meetings. However, Board of directors have this power at common law even if it is not expressly conferred on them. Notice of a meeting given by the Secretary without the sanction of the Board of directors is invalid.

(*b*) ***Shareholders*** **-** The members of a company have, in certain circumstances, the right to insist on the calling of an extraordinary meeting [*For details, please see discussion under Para 17.3*]

(*c*) ***Tribunal*** *[Sections 97 and 98]* - If for any reason there occurs a default in holding an AGM, then the Tribunal may, on a petition of *any member,* direct the calling of AGM (Section 97). In case of an extraordinary general meeting (EGM), *Tribunal* has been conferred with the similar powers. However, an EGM may be called or directed to be called not only on a petition of any member but also on a petition of any director or even *suo motu.* But, power to call an EGM can be exercised only where it has become impracticable to call, hold or conduct such meeting [Section 98].

A meeting called, held or conducted, as aforesaid, shall be deemed to be a meeting of the company duly called and conducted.

16.4-2 Proper and adequate notice

A notice of a company meeting in order to be valid must comply with :

(*i*) general rules in relation to notice, and

(*ii*) rules as laid down in the Articles and the Companies Act.

16.4-2a GENERAL RULES - The following general rules should be observed while issuing notices of meetings :

(*a*) The notice may take any reasonable form which sufficiently conveys to the person, entitled to receive it, information enabling the person to attend the meeting and to take part in its deliberations.

(*b*) The notice must specify the date, time and place of the meeting.

(*c*) The notice must state the nature of the business to be transacted, that is, a complete agenda of the meeting should be forwarded with or as part of the notice.

(*d*) The notice must be served in the manner prescribed in the Articles read with the Companies Act.

SS-2, in this regard, contains the following provisions:

1. Notice shall be sent by hand or by ordinary post or by speed post or by registered post or by courier or by facsimile or by e-mail or by any other electronic means[2].
2. In case the Notice and accompanying documents are given by e-mail, these shall be sent at the Members' e-mail addresses, registered with the company or provided by the depository, in the manner prescribed under the Act.

   In case of the Directors, Auditors, Secretarial Auditors and others, if any, the Notice and accompanying documents shall be sent at the e-mail addresses provided by them to the company, if being sent by electronic means.
3. Notice shall be sent to Members by registered post or speed post or courier or e-mail and not by ordinary post in the following cases:

   (*a*) if the company provides the facility of e-voting;

   (*b*) if the item of business is being transacted through postal ballot;
4. If a Member requests for delivery of Notice through a particular mode, other than one of those listed above, he shall pay such fees as may be determined by the company in its Annual General Meeting and the Notice shall be sent to him in such mode.
5. In case Meeting is called by the requisitionists themselves where the Board had not proceeded to call the Meeting, the Notice shall be sent to Members by registered post or speed post or email.
6. In case of companies having a website, the Notice shall be hosted on the website also.

16.4-2b SERVICE BY POST - WHEN DEEMED EFFECTIVE [SECTION 20] - Service of notice of a meeting will be deemed to have been effected only when it is posted in a letter containing the same. The letter should carry the address noted in the register of members and the same should be substantially accurate though not literally the same. *Liverpool Marine Insurance Co.* v. *Haughton* [1874] 23 WR 93. A notice sent to all the members of the company on the register at the date of sending out is good, even though the register is subsequently rectified with retrospective effect to a day prior to that date - *Sussex Brik Co. Re* [1994] 1 Ch. 598.

Notice of a meeting sent by post shall be deemed to have been served on expiry of 48 hours from the time of posting thereof [Section 20 read along with Rule 35 of the Companies (Incorporation) Rules, 2014]. However, the presumption arises only

2. 'Electronic means' means any communication sent by a company through its authorised and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the Member.

where the letter has been properly addressed. There is no presumption as to its delivery where the letter itself has not been properly addressed - *Inter Sales* v. *Reliance Industries Ltd.* [1997] 35 CLA 370 (Cal.).

The presumption of service of notice shall, however, be rebuttable as there may be cases where the parties may collude with the postal authorities for procuring postal seals - *R. Khemka* v. *Deccan Enterprises (P.) Ltd.* [1998] 16 SCL 1 (AP). The Court, however, observed that the burden shall be on the party alleging that he did not receive the notice to rebut the presumption by adducing satisfactory evidence.

It is not stated at which post office or box the letter has to be posted, presumably, it has to be posted at or near the place of the registered office of the company. The provisions in the section will not be satisfied if the posting is made deliberately at any far off place, with a view to delay delivery.

(*a*) The length of the notice must again be according to the provisions of the Articles read with the Companies Act.

(*b*) The notice must be served to all members at their registered addresses in India.

(*c*) The notice must be clear, explicit and unconditional.

(*d*) Generally speaking, issue of notice is obligatory. But where meetings are fixed to be held on a specified day of each week or month, notice may take the form of reminders only or may be totally avoided - *Barron* v. *Potter* [1914] 1 Ch. 895 (Ch.D).

16.4-2c RULES UNDER THE COMPANIES ACT - The notice in order to be valid should be of proper length; should be given to all persons entitled to receive it; and should contain the date, time and place of the meeting and the nature of the business to be transacted thereat.

Sections 20, 96 and 101 and 102 contain provisions with regard to the aforesaid matters.

Length of notice - For general meeting of any kind (Annual or Extraordinary) at least 21 clear days' notice must be given to members. Notice, as per section 20(2), may be sent by post or by registered post or by speed post or by courier[3] or by delivering at his office or address, or by such electronic or other mode as may be prescribed. However, a member may request for delivery of any document through a particular mode, for which he shall pay such fees as may be determined by the company in its annual general meeting.

A general meeting may be called after giving shorter notice than that specified in this sub-section if consent, in writing or by electronic mode, is accorded thereto—

(*i*) in the case of an annual general meeting, by not less than ninety-five per cent of the members entitled to vote thereat; and

(*ii*) in the case of any other general meeting, by members of the company—

(*a*) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than ninety-five per

3. For the purposes of this section, the term "courier" means a person or agency which delivers the document and provides proof of its delivery - *Explanation* to section 20.

cent of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(*b*) having, if the company has no share capital, not less than ninety-five per cent of the total voting power exercisable at that meeting:

But, where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, those members shall be taken into account for the purposes of this sub-section in respect of the former resolution or resolutions and not in respect of the latter.

Such a consent may be received before the meeting is held or after the resolutions are passed - *Re Self-Help Private Industrial Estate Pvt. Ltd.* [1972]; *Re Parikh Engineering and Body Building Co. Ltd.* [1975].

The number of days in each case shall be clear days. *'Clear days'* means the days must be calculated excluding the day on which the notice is issued, 48 hours (*i.e.,* two days) for postal transit [Sec. 20 read along with Rule 35 of the Companies (Incorporation) Rules, 2014] and the day on which the meeting is to be held.

The effect of this provision is that if notice of a general meeting is sent by post, it must be posted at such time as to give 21 clear days' notice as required by section 101, *plus* 48 hours in addition. Each of the twenty-one days must be a full calendar day, so that notice can be said to be not less than 21 days' notice - *Bharat Kumar Dilwali* v. *Bharat Carbon Ribbon Mfg. Co. Ltd.* [1973] 43 Comp. Cas. 197 (DB Delhi).[4] Therefore, notice of a general meeting must be sent at least 25 days before the date of the meeting (where the service of notice is by post). If, for instance, a general meeting is to be held at 3 p.m. on 6th April, service of the notice of the meeting will be deemed to have been duly effected if it had been despatched by post at any time before 3 p.m. on 13th March. This will satisfy the requirement of 21 clear (full) days' notice *plus* 48 hours for transmission by post.

The presumption of deemed delivery cannot be raised when at the time of posting, the post office was, within the knowledge of the company, on strike - *Bredman* v. *Trinity Estate Plc* [1989] BCLC 757 (Ch. D).

Publication of a notice in a newspaper - whether obligatory?

It is not obligatory to advertise notice in the newspapers. However, as a matter of abundant precaution, the company may advertise in the newspapers to avoid objection from such of the shareholders as reside outside India and who accidentally may not receive the notices served through post. Publication of a notice in newspaper is not a substitute for the requirement of section 20(2) in respect of sending a notice to every member.

Service of notice to joint shareholders - In case of joint shareholdings, the notice shall be deemed to have been duly served if the same has been served on the joint holder named first in the register of members.

Effect of shorter notice -Any resolution passed at such meeting shall not be effective unless consent is given in writing or by electronic mode—

(*i*) in the case of an annual general meeting, by not less than ninety-five per cent of the members entitled to vote thereat; and

4. Also *see Pioneer Motors (P.) Ltd.* v. *Municipal Council, Nagercoil* AIR 1967 SC 684.

(*ii*) in the case of any other general meeting, by members of the company—

(*a*) holding, if the company has a share capital, majority in number of members entitled to vote and who represent not less than ninety-five per cent of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(*b*) having, if the company has no share capital, not less than ninety-five per cent of the total voting power exercisable at that meeting:

But, where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, those members shall be taken into account for the purposes of this sub-section in respect of the former resolution or resolutions and not in respect of the latter.

A person who is present and who votes at the meeting, will not be entitled to challenge the resolution on the ground of an invalidity in the notice - *In re, British Sugar Refining Co.* [1857] 3 K & J 408.

Whom to be given - Section 101 states that notice of every meeting of the company must be sent to :

(*i*) every member of the company;

(*ii*) the legal representative of a deceased member;

(*iii*) the assignee of an insolvent member;

(*iv*) the auditor(s) of the company; and

(*v*) every director of the company.

SS- 2 issued by ICSI on 23rd April, 2015 (Effective from 1.7.2015) mandates giving of notice to Secretarial Auditor, debenture trustee and wherever so required, to other persons also.

Query: As to which Secretarial Auditor is required to attend the AGM - the one for the last financial year whose Secretarial Audit Report has been annexed to the Board's report or the one appointed for the current financial year in which AGM is being held?

Ans : The Clarification issued by ICSI vide Press Release dated 21.7.2015 (updated as on 26.8.2015), is as follows:

> "The Secretarial Auditor for the last financial year whose Secretarial Audit Report has been annexed to the Board's report is required to attend the AGM to give details about any qualifications/observations/comments or other remarks, if any, in his report and the explanations/comments given by the Board in their report and/or reply to the queries, if any, of the stakeholders on the compliance and governance aspects of the company. It is advisable that the Secretarial Auditor appointed for the current financial year in which AGM is being held also attends the AGM".

Where the company has received intimation of death of a Member, SS-2 requires that the Notice of Meeting shall be sent as under:

(*a*) where securities are held singly, to the Nominee of the single holder;

(*b*) where securities are held by more than one person jointly and any joint holder dies, to the surviving first joint holder;

(*c*) where securities are held by more than one person jointly and all the joint holders die, to the Nominee appointed by all the joint holders;

In the absence of a Nominee, the Notice shall be sent to the legal representative of the deceased Member.

SS-2 further provides that no business shall be transacted at a meeting if Notice in accordance with this Standard has not been given. However, any accidental omission to give notice to, or the non-receipt of such notice by, any member or other person who is entitled to such notice for any meeting shall not invalidate the proceedings of the meeting.

Where petitioner himself was a party to board meeting wherein date, place and agenda of general body meeting were fixed and company had proved by producing records that notice of said general meeting was sent to all shareholders by certificate of posting on correct address, petitioner could not complain that he had not received notice of meeting - *Westfort Hi-Tech Hospital Ltd.* v. *V.S. Krishnan* [2007] 76 SCL 185 (Ker.).

Contents of the notice - The notice must contain the following particulars :

1. ***Place, day and time of holding a general meeting—*** Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate* [Section 96(2)].

However, annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance[5].

Further, the Central Government may exempt any class of companies from the provisions of this sub-section subject to such conditions as it may impose.

A meeting, other than the AGM, does not appear to be subject to the aforesaid provision.

However, a Meeting called by the requisitionists shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated.

SS-2 further requires the Notice to contain complete particulars of the venue of the Meeting including route map and prominent land mark for easy location. In case of companies having a website, the route map shall be hosted along with the Notice on the website.

2. ***Agenda*** - The notice should contain a statement of the business to be transacted at the meeting (called agenda). If special business is to be transacted, an explanatory statement** shall be annexed to the notice calling such meeting, namely:—

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*In case of a Government company, AGM may be held at the registered office or such other place as the Central Government may approve in this behalf—*Vide MCA Notification dated 5-6-2015.*

**Articles of a private company may allow the company not to annex an explanatory statement—*Vide MCA Notification dated 5-6-2015.*

5. Inserted by the Companies (Amendment) Act, 2017.

The nature of concern or interest, financial or otherwise, if any, of—

(*i*) every director and the manager, if any;

(*ii*) every other key managerial personnel; and

(*iii*) relatives of the persons mentioned in (*i*) and (*ii*) above.

The statement should also contain any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Where any item of special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than two per cent of the paid-up share capital of that company, also be set out in the statement.

SS- 2 provides that no items of business other than those specified in the Notice and those specifically permitted under the Act shall be taken up at the Meeting.

A Resolution shall be valid only if it is passed in respect of an item of business contained in the Notice convening the Meeting or it is specifically permitted under the Act.

Items specifically permitted under the Act which may be taken up for consideration at the Meeting are:

(*a*) Proposed Resolutions, the notice of which has been given by Members;

(*b*) Resolutions requiring special notice, if received with the intention to move;

(*c*) Candidature for Directorship, if any such notice has been received.

Where special notice is required of any Resolution and notice of the intention to move such Resolution is received by the company from the prescribed number of Members, such item of business shall be placed for consideration at the Meeting after giving Notice of the Resolution to Members in the manner prescribed under the Act.

Any amendment to the Notice, including the addition of any item of business, can be made provided the Notice of amendment is given to all persons entitled to receive the Notice of the Meeting at least twenty-one clear days before the Meeting.

3. **Documents to accompany Notice**

SS-2 requires that the Notice of the meeting shall be accompanied, by an attendance slip and a Proxy form with clear instructions for filling, stamping, signing and/or depositing the Proxy form.

4. ***Right of a member to appoint proxy*** - The notice should also state that a member is entitled to appoint a proxy who need not be a member [Section 105(2)].

Query: Can a member who has already cast his vote through remote e-voting appoint a proxy?

Ans: The Clarification issued by ICSI *vide* Press Release dated 21.7.2015 (updated as on 26.8.2015), is as follows:

"Yes, a member who has already cast his vote through remote e-voting can appoint a proxy to attend the Meeting instead of himself, but he cannot cast his vote".

Documents accompanying the notice - The following documents should be annexed to the notice of the meeting :

(*i*) *For AGM* - audited financial statement of accounts, directors' and auditors' reports, proxy form, etc.; and

(*ii*) *For EGM* - explanatory statement, proxy form, etc.

Where any item of business refers to any document, which is to be considered at the meeting, the time and place where such document can be inspected shall be specified in the Explanatory statement [Section 101(3)].

Postponement or Cancellation of the Meeting

SS- 2 clarifies that a Meeting convened upon due Notice shall not be postponed or cancelled.

If, for reasons beyond the control of the Board, a Meeting cannot be held on the date originally fixed, the Board may reconvene the Meeting, to transact the same business as specified in the original Notice, after giving not less than three days intimation to the Members. The intimation shall be either sent individually in the prescribed manner or published in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and in an English newspaper in English language, both having a wide circulation in that district.

16.5 Meeting to be legally constituted

For a meeting to be legally constituted, there must be proper quorum[6], a proper person in the chair and proper compliance with the relevant provisions of the Articles of Association of the Act.

16.5-1 Chairman of a meeting

'Chairman' is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. He is usually a member of the body over which he is to preside. The rules and regulations of a constituted body usually designate a chairman to preside over meetings of that body. In the case of a company, the Articles usually designate the chairman of the Board of directors to preside over the general meetings of the company. Where the rules do not designate a chairman or the designated chairman is absent at the commencement of the meeting, the meeting itself elects a *pro tem* (temporary) chairman to preside over the meeting. If subsequently the designated chairman arrives, the temporary chairman vacates the chair.

Appointment of chairman - The first chairman of the company is generally named in the Articles. The Articles usually provide that the chairman of the Board of directors shall preside over the general meetings of the company in addition to presiding over Board meetings. However, it does not mean that the same person will

6. As per Regulation 44(*i*) of Table F, no business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business.

remain chairman of the Board and preside over the meetings of the company from year to year. The Board may decide to elect a new chairman every year at the Board meetings held immediately after the annual general meeting.

Regulations 46 and 47 of Table F of the Companies Act, which are incorporated in the Articles of most companies, provide that if no chairman is designated beforehand or he is not present within 15 minutes of the appointed time of the meeting or is unwilling to act as chairman of the meeting, the directors present shall elect one amongst themselves to be chairman of the meeting. If, however, no director is willing to act as chairman or if no director is present within 15 minutes after the appointed time, the members present may elect one amongst themselves to be chairman of the meeting.

Section 104(1) of the Act provides that, unless the Articles otherwise provide, the members personally present at the meeting shall elect one amongst themselves to be chairman of the meeting on a show of hands.

Section 104(2) provides that, if a 'poll' is demanded on the election of chairman, it must be taken forthwith in accordance with the provisions of this Act, and the chairman elected on show of hands shall exercise all powers of the chairman till the poll is taken. If some other person is elected chairman on the results of the 'poll', he shall be chairman for the rest of the meeting*.

SS-2 contains similar provisions with respect to appointment of a chairman

Role and Powers of chairman - Role and Powers of the chairman of a meeting are :

(*a*) *To maintain order and decorum* - The chairman has the power to maintain order and decorum at a meeting, *i.e.,* to prevent the use of improper language and disorderly behaviour of members. If his directions are not obeyed, he may adjourn the meeting or have the offending member(s) expelled.

(*b*) *To give ruling on points of order* - Sometimes members raise points of order, *i.e.,* questions relating to rules and regulations governing the meeting. The chairman has the power to give a ruling on the interpretation of the rules and his ruling will be binding on all members.

(*c*) *To decide priority of speakers* - When more than one member express their desire to speak on the motion, the chairman has the power to decide the priority in which the members will be allowed to speak.

(*d*) *To maintain relevancy and order in debate* - The Chairman has the power to stop discussion on a motion when it has continued for a sufficiently long time and discussion seems to be endless or when the discussion becomes irrelevant, that is, when it is not within the scope of the meeting or the motion under discussion.

(e)[7] *The Chairman shall explain the objective and implications of the Resolutions before they are put to vote at the Meeting:* The Chairman shall provide a fair opportunity to Members who are entitled to vote to seek clarifications and/

*Articles of a private company may provide otherwise— *Vide MCA Notification dated 5-6-2015.*

7. As per SS- 2. This may also be called as a duty of the Chairman.

or offer comments related to any item of business and address the same, as warranted.

(*f*)[8] *In case of public companies, the Chairman shall not propose any Resolution in which he is deemed to be concerned or interested nor shall he conduct the proceedings for that item of business:* If the Chairman is interested in any item of business, without prejudice to his Voting Rights on Resolutions, he shall entrust the conduct of the proceedings in respect of such item to any Dis-Interested Director or to a Member, with the consent of the Members present, and resume the Chair after that item of business has been transacted.

(*g*) *To adjourn a meeting* - The chairperson may, with the consent of any meeting at which a quorum is present and shall, if so directed by the meeting, adjourn the meeting from time to time and place to place [*Reg. 49(i) of Table F*].

If the meeting is adjourned for thirty days or more, notice of the adjourned meeting shall be given as in the case of an original meeting [*Reg. 49(iii) of Table F*].

Again, no business other than the business left unfinished can be taken up at an adjourned meeting [*Reg. 49(ii) of Table F*].

(*h*) *To exercise a casting vote* - Ordinarily, a chairman has only a deliberative vote, *i.e.,* the right to cast a vote as a member. But if the rules expressly allow, the chairman can cast a second vote, known as casting vote, to break a tie, *i.e.,* equality of affirmative and negative votes. The Articles of a company usually confer this right on the chairman of a company meeting.

Duties of chairman : Duties of a chairman include the following :

(*a*) To see that the meeting is properly convened and duly constituted.

(*b*) To see that the proceedings of the meeting are conducted according to rules and the business is discussed in the order set out in the agenda.

(*c*) The chairman must see that no discussion is allowed unless there is a specific motion before the meeting, properly moved and seconded and that the motion is within the scope of the meeting.

(*d*) To maintain order and decorum in the meeting.

(*e*) To see that all members get equal opportunity to express their views. If necessary, he should fix time limit for speakers.

(*f*) He should see that the sense of the meeting is properly ascertained on each and every motion. He should put all motions and amendments to vote in the manner provided in the rules, supervise the counting of votes to ensure correct assessment of the opinion and declare the result of voting.

(*g*) If poll is demanded, to see that the poll is taken according to the provisions of the Act.

(*h*) To exercise his casting vote *bona fide* in the interest of the company.

(*i*) To exercise judicially his power of adjournment.

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8. As per SS- 2. This may also be called as a duty of the Chairman.

16.5-2 Quorum

Meaning - The word 'quorum' is derived from Latin and may be defined as the minimum number of members who must be present at a meeting as required by law/rules. The main purpose of having a quorum is to avoid decisions being taken at a meeting by a small minority which may be found to be unacceptable to the vast majority of members.

Quorum for general meeting (Section 103): Unless the articles of the company provide for a larger number,—

(*a*) **In case of a public company**,—

(*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.

(*b*) **In the case of a private company**, two members personally present, shall be the quorum for a meeting of the company*.

Rules regarding quorum - As regards quorum at general meetings, the following rules must be followed:

(*a*) For the purpose of ascertaining quorum, only members present in person, and not by proxies, are to be counted. However, exception to this rule is contained in sections 98 and 100. We shall study about the same a little later.

(*b*) Preference shareholders present in the meeting and equity shares without voting rights are not to be counted for the purpose of quorum except where the proposed business includes any item directly affecting preference shareholders.

(*c*) *Joint holders of shares are treated as single member* for purposes of counting quorum.

(*d*) *A member present in two or more capacities, e.g.,* as an individual member and as a trustee, may be counted as two members personally present for the purposes of quorum.

(*e*) *If a company is a member* of another company, it may authorise a person by a resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purposes of quorum (Section 113).

Where two or more companies being members of another company appoint a single person as their representative, then each of such companies will be counted in quorum at a meeting of the latter company.

Query: ABC Ltd. (a public company) having 800 members convened a general meeting upon due notice, however, only two members were person-

*Articles of a private company may provide otherwise—*Vide MCA Notification dated 5-6-2015.*

ally present at the meeting, one of whom is authorized representative of five bodies corporate. Is this valid quorum for meeting?

Ans: The answer provided by ICSI, *vide* its Press Release dated 21.7.2015 (updated as on 26.8.2015), is as follows:

"Yes. If two or more corporate bodies who are members of a company are represented by a single individual, each of the bodies corporate will be treated as personally present through that individual representing it. An authorized representative of five bodies corporate cannot form a quorum by himself but can do so if at least one more member is personally present".

(*f*) Where the President of India or the Governor of a State holds shares in a company and appoints a person to act as his representative at a meeting of that company, then such person shall be deemed to be a member present in person and counted for the purposes of quorum (Section 112).

(*g*) Where the total number of members of a company is reduced below the quorum fixed by the Articles, the rule as to quorum will be deemed to be satisfied if all the members of the company attend the meeting in person.

Course of action in case of quorum not being present at general meetings (Section 103) - In a general meeting—

(*i*) if within 1/2 hour from the time appointed for holding the meeting, the quorum is not present, the meeting, if called upon the requisition of members, shall stand dissolved;

(*ii*) in any other case, the meeting shall be adjourned to the same day in the next week at the same time and place or to such other day, time and place as the Board of directors may determine and notify accordingly.

Thus, if the Board decides to change the day, time or place of meeting, the company shall give not less than three days notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated.

(*iii*) if at the adjourned meeting also, quorum is not present within 1/2 hour from the appointed time, the members present shall be the quorum.

Query: In case resolutions are put to vote by remote e-voting and requisite majority has approved but quorum is not present at the General Meeting, what would be the implication?

Ans : ICSI, vide its Press Release dated 21.7.2015 (updated as on 26.8.2015), has made the following observation:

"Whether the Resolution has been approved by the requisite majority through e-voting can be ascertained only after the Meeting. In case, quorum is not present at the Meeting, the Meeting shall stand adjourned as per applicable provisions, for want of quorum. The fate of the Resolution would be decided at such adjourned meeting."

One man meeting - Normally, one person cannot validly constitute a meeting even if he holds proxies for all members. However, in the following circumstances, one person shall form the quorum for a general meeting:

(1) In case of a 'class meeting' (*i.e.*, a meeting of a class of shareholders) if all the shares of a particular class are held by one person - ***East* vs. *Bennet Bros. Ltd.* [1911]** .

The Tribunal may issue directions under section 97 (AGM) or section 98 (EGM) that one member, present in person or by proxy shall constitute quorum.

Quorum when to be present - Regulation 44 (i) of Table F provides that "no business shall be transacted at any general meeting unless a quorum of members is present at the time when the meeting proceeds to business".

However, as per SS -2, Quorum shall be present throughout the Meeting. It should not only be present at the time of commencement of the Meeting but also while transacting business. You may note that SS-2 is a mandatory standard and shall, therefore, override Regulation 44 of Table 'F'.

Presumption as to quorum - Quorum will always be presumed unless it is questioned at the meeting or the records show that a quorum was not, in fact, present.

16.5-3 Presence of Directors and Auditors

SS-2, in this regard provides as follows:-

Directors

If any Director is unable to attend the Meeting, the Chairman shall explain such absence at the Meeting.

The Chairman of the Audit Committee, Nomination and Remuneration Committee and the Stakeholders Relationship Committee, or any other Member of any such Committee authorised by the Chairman of the Committee to attend on his behalf, shall attend the General Meeting.

Auditors

The Auditors, unless exempted by the company, shall, either by themselves or through their authorised representative, attend the General Meetings of the company and shall have the right to be heard at such Meetings on that part of the business which concerns them as Auditors.

The authorised representative who attends the General Meeting of the company shall also be qualified to be an Auditor.

Secretarial Auditor

The Secretarial Auditor, unless exempted by the company shall, either by himself or through his authorised representative, attend the Annual General Meeting and shall have the right to be heard at such Meeting on that part of the business which concerns him as Secretarial Auditor.

The Chairman may invite the Secretarial Auditor or his authorised representative to attend any other General Meeting, if he considers it necessary.

The authorised representative who attends the General Meeting of the company shall also be qualified to be a Secretarial Auditor.

16.6 Meeting to be properly conducted

Proper conduct of the meeting means that proper rules for ascertaining the sense of the meeting, the rules for discussion and order in debate must be observed. Also, the proceedings should be recorded properly.

16.6-1 Ascertaining the sense of the general meeting

Unanimity on all matters before a meeting is always not obtained. In the absence of unanimity, the chairman may want to know the wishes of the persons present in the meeting. This is known as ascertaining the sense of the house and for this purpose, he has to put the matter before the members. There are various methods which can be adopted by the chairman to put the matter to vote in order to ascertain the wishes of the members. They are as follows :

(*i*) *By acclamation* - When persons present in a meeting indicate their approval or disapproval of the motion by clapping of hands, cheering or applause, it is known as voting by acclamation. This method is adopted where there is an almost unanimous approval or disapproval. For example, the motion of thanks to the chair is generally adopted by this manner. But, this method should not be adopted if there is a sharp difference of opinion among the members on the issue before them.

(*ii*) *By voice vote* - In this case, the chairman puts the proposition before the meeting and persons who are in favour of the proposition say 'yes' and those who are against it say 'no'. The chairman hears both the voices of 'yes' and 'no' and gives his decision after ascertaining the numbers of 'yes' and 'no'. At this stage, a member who is dissatisfied with the chairman's decision on the basis of voice vote may demand a vote by show of hands.

(*iii*) *By division* - Under this method, the Chairman requests the members present in the meeting to divide themselves into two blocks - one in favour of the proposal and another against it. The chairman, with the help of the secretary, counts the number of persons in favour and against the proposal and gives his verdict based on majority principle.

(*iv*) *By show of hands* - Under this method, the chairman asks all those in favour of the resolution to raise their right hand and when that number is noted, asks all those against, to do likewise. The Chairman then declares the result of the voting indicating whether the proposal has been carried or lost, by accepting the number which is larger.

(*v*) *By ballot* - Under this method, every person present records his vote on a ballot paper and deposits it in the ballot box provided for that purpose. The counting of ballots cast for and against the motion reveals the results. This method ensures secrecy in casting votes.

(*vi*) *By poll* - In company meeting, voting by poll is according to the number of shares held by a member. The voting by show of hands may not always reflect the opinion of members upon a value basis. Also, there may be a number of proxies who can vote only by poll and not by show of hands.

It is possible that some of the members present may keep quiet in the voting without expressing 'yes' or 'no' or they may not at all take part in the voting. Under that circumstance they will not be counted on either side.

16.6-2 Rules in respect of voting

As per the provisions of the Companies Act, 2013, rules regarding voting may be noted as follows:

(1) ***Voting rights of equity shareholders*** - Every holder of equity shares carrying voting rights shall have a right to vote on every resolution placed before the company [Section 47(1)*].

Right of an equity shareholder to vote cannot be prohibited on the ground that he has not held his shares for any specified period before the meeting or on any other ground (Section 106) - *Ananthalakshmi* v. *H.I. & F. Trust* (1951). The provision in the Articles of a company that only those shareholders would be entitled to vote whose names have been there on the Register for two months before the date of the meeting was held to be in contravention of the Act.

The only grounds on which the right of an equity shareholder to vote may be excluded are: (*i*) non-payment of calls by a member; (*ii*) non-payment of other sums due against a member; (*iii*) where the company has exercised the right of lien on his shares [Section 106]**.

(2) ***Voting rights of preference shareholders [Section 47(2)*]*** - Preference shareholders have a right to vote only on resolutions placed before the company:

(*i*) which directly affect the rights attached to his preference shares;

(*ii*) any resolution for the winding up of the company;

(*iii*) any resolution for the repayment or reduction of its equity or preference share capital; and

(*iv*) where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

Voting rights of a preference shareholder shall, on a poll, shall be in proportion to his share in the paid-up preference share capital of the company.

(3) ***Effect of pledge or attachment*** - Voting rights of a member are not affected by the fact that his shares have been attached or pledged or a receiver has been appointed - *Balkrishan Gupta* vs. *Swadeshi Polytex Ltd.* [1985].

(4) ***Voting, in the first instance, to be by show of hands****** (Section 107) - At any general meeting, a resolution put to the vote of the meeting shall, unless a poll is demanded under section 109 or the voting is carried out electronically, be decided on a show of hands.

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*Section 47 shall not apply to a private company if Memorandum or Articles of Association so provides—*Vide MCA Notification dated 5-6-2015.*

**Articles of a private company may provide for other grounds also—*Vide MCA Notification dated 5-6-2015.*

***Articles of a private company may provide otherwise—*Vide MCA Notification dated 5-6-2015.*

A declaration by the Chairman of the meeting of the passing of a resolution or otherwise by show of hands and an entry to that effect in the books containing the minutes of the meeting of the company shall be conclusive evidence of the fact of passing of such resolution or otherwise.

(5) ***Demand for poll*** - Section 109** provides that before or on declaration of the result of the voting on any resolution on a show of hands, a poll may be ordered to be taken by the Chairman of the meeting of his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the person or persons specified below, namely :

(*a*) ***In the case of a company having a share capital***, by any member or members present in person or by proxy and holding shares in the company:

(*i*) which confer a power to vote on the resolution not being less than 1/10th of the total voting power, or

(*ii*) on which an aggregate sum of not less than five lakh rupees or such higher amount as may be prescribed has been paid-up;

(*b*) ***In the case of any other company***, by any member or members present in person or by proxy and having not less than 1/10th of the total voting power.

The demand for a poll may be withdrawn at any time by the persons who made the demand.

(6) ***Time of taking poll*** - On a valid demand for poll having being made, the chairman must order the poll to be taken forthwith where demand for poll relates to : (*i*) Adjournment (Section 109**); (*ii*) Election of Chairman of the meeting [Section 104].

Where demand for poll relates to any other question, a poll must be taken at such time not being later than forty-eight hours from the time when the demand was made, as the Chairman may direct.

Where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinize the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed.

The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

(7) ***Voting by companies and Government as members*** (Sections 112 and 113) - Where a company or a corporation is a member of another company, it may attend the meetings of the other company through a representative. The representative must be appointed by a resolution of the Board of directors or the governing body. Where the Central Government or a State Government is a member, the President or the Governor of a State, as the case may be, has the power to appoint representatives to attend meetings of the company. The person nominated shall hold the position of a proxy but is counted for purposes of quorum as the member personally present.

(8) ***Voting through electronic means*** - Section 108 provides that the Central Government may prescribe the class or classes of companies and manner in which

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**Provisions of section 109 shall not apply if Articles provide otherwise—*Vide MCA Notification dated 5-6-2015.*

a member may exercise his right to vote by the electronic means. Rule 20 of the Companies (Management and Administration) Rules, 2014, as amended by the Companies (Management & Administration) Rules, 2015 and 2016 in this regard, provides as follows :

1. Companies having its equity shares listed on a recognised stock exchange or a company having not less than one thousand members, shall provide to its members facility to exercise their right to vote on resolutions proposed to be considered at general meetings by electronic means.

However, a Nidhi company and an institutional investor is not required to provide the facility to vote by electronic means.

2. The aforesaid rule shall, however, be not applicable to: (*i*) small and medium enterprises, namely, companies whose post issue face value capital is up to Rs. 25 crores and whose shares are listed on SME Exchange. (*ii*) Companies listed on the Institutional Trading Platform[9].

16.6-3 Passing of resolutions by postal ballot [Section 110 read along with Rule 22 of the Companies (Management and Administration) Rules, 2014 as amended by Amendment Rules, 2016]

Section 110 allows casting of votes by a member through postal ballot in certain cases and subject to certain conditions. Voting by postal ballot means voting by post or through any electronic mode [Section 2(*65*)]. The provisions of Section 110 with respect to voting by postal ballot are as follows:

Notwithstanding anything contained in this Act, a company—

(*a*) **shall**, in respect of such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot; and

(*b*) **may**, in respect of any item of business (other than ordinary business and any business in respect of which directors or auditors have a right to be heard at any meeting) transact by means of postal ballot, in such manner as may be prescribed, instead of transacting such business at a general meeting.

List of items that must be transacted through postal ballot

The following items of business shall be transacted only by means of voting through a postal ballot-

(*a*) alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum;

(*b*) alteration of articles of association in relation to insertion or removal of provisions which, under sub-section (68) of section 2, are required to be included in the articles of a company in order to constitute it a private company;

(*c*) change in place of registered office outside the local limits of any city, town or village as specified in sub-section (5) of section 12;

9. Rule 20 read along with SS- 2.

(*d*) change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised under sub-section (8) of section 13;

(*e*) issue of shares with differential rights as to voting or dividend or otherwise under sub-clause (ii) of clause (*a*) of section 43;

(*f*) variation in the rights attached to a class of shares or debentures or other securities as specified under section 48;

(*g*) buy-back of shares by a company under sub-section (1) of section 68;

(*h*) election of a director under section 151 of the Act;

(*i*) sale of the whole or substantially the whole of an undertaking of a company as specified under sub-clause (*a*) of sub-section (1) of section 180;

(*j*) giving loans or extending guarantee or providing security in excess of the limit specified under sub-section (3) of section 186:

However, any item of business required to be transacted by means of postal ballot may be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108, in the manner provided in that section[10].

You may note that 'One Person Company' and other companies having members up to two hundred are not required to transact any business through postal ballot.

Procedure to be followed

Where a company decides to pass any resolution by resorting to postal ballot, it shall follow the following procedure:

(1) It shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefor, and requesting them to send their assent or dissent in writing on a postal ballot (postal ballot means voting by post or through electronic means) within a period of thirty days from the date of dispatch of the notice.

(2) The notice shall be sent either (*a*) by Registered Post or speed post, or (*b*) through electronic means like registered 'e-mail id', or (*c*) through courier service for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period of thirty days.

(3) An advertisement containing the prescribed information shall be published in a leading English newspaper of the district and having wide circulation and in one principal vernacular newspaper circulating in the district and having wide circulation about having dispatched the ballot papers.

(4) The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members and such notice shall remain on such website till the last date for receipt of the postal ballots from the members.

10. Inserted by the Companies (Amendment) Act, 2017.

(5) The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner.

(6) The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof.

16.6-4 Proxy (Section 105)*

Meaning - A proxy is a person, being a representative of a shareholder at a meeting of the company who may be described as his agent to carry out which the shareholder has himself decided upon - Lord Hansworth in *Cousins* v. *International Brick Co. Ltd.* [1931].

Appointment of a Proxy - Any member of a company entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.

Notice of the meeting to mention right of a member to appoint proxy [Section 105(2)]: In every notice calling a meeting of a company which has a share capital or the articles of which permit voting by proxy, there must appear with reasonable prominence :

(*i*) that a member entitled to attend and vote is entitled to appoint a proxy or proxies; and

(*ii*) that a proxy need not be a member.

However, as per Rule 19 of the Companies (Management and Administration) Rules, 2014 a member of a company registered under section 8 (i.e. association not for profit) shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

If default is made in complying with section 105(2) as regards any meeting, every officer of the company who is in default shall be liable to a penalty of five thousand rupees [sub-section (3)].

The appointment of a proxy must be made by a written instrument signed by the appointer or his duly authorised attorney in writing. If the appointer is a body corporate, then it must be under its seal or be signed by an officer or an attorney duly authorised by it. [Section 105(6)].

According to the proviso to sub-section (1) of section 105, *unless articles otherwise provide* a member of a company having no share capital cannot appoint a proxy.

Again, the Central Government may prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.

As per Rule 19 of the Companies (Management and Administration) Rules, 2014:

(1) The appointment of proxy shall be in the Form No. MGT.11

(2) A person can act as proxy on behalf of members not exceeding fifty and holding in the aggregate not more than ten percent of the total share capital of the company carrying voting rights. However, a member holding more than ten percent, of the total share capital of the Company carrying voting rights may appoint a single person as proxy and such person shall not act as proxy for any other person or shareholder.

*Articles of a private company may contain provisions different from those of section 105 in relation to proxies—*Vide MCA Notification dated 5-6-2015.*

Section 105(7) provides that an instrument appointing a proxy, if in the Form No. MGT.11, shall not be questioned on the ground that it fails to comply with any special requirements specified for such instrument by the Articles.

The instrument of proxy must be deposited with the company *forty-eight hours* before the meeting. If a period longer than forty-eight hours is specified, it shall have effect as if a period of forty-eight hours had been specified [Section 105(4)].

Rights of proxy - According to proviso to sub-section (1) of section 105:

(*i*) a proxy cannot vote except on a poll.

(*ii*) A proxy shall not have any right to speak at the meeting.

Inspection of proxy forms - A member entitled to vote at a meeting of the company, or on any resolution to be moved thereat can inspect the proxy forms deposited with the company provided he had given at least three days' notice in writing to the company of his intention to so inspect. Inspection can, however, be done during the period beginning twenty-four hours before the commencement of meeting and ending with the conclusion of the meeting [Section 105(8)].

Invitation to members prohibited - Section 105(5) prohibits any invitation to appoint as proxy any person or one of a number of persons specified in the invitation which may be issued at the company's expense to any member entitled to have a notice of the meeting and to vote thereat by proxy. Every officer of the company who knowingly issues invitation as aforesaid or wilfully authorises or permits the issue of the invitation shall be liable to a fine which may extend to one lakh rupees. This, however, does not prevent an officer of the company issuing a form of proxy or a list of persons willing to act as proxy at the request of a member received in writing, provided that the form of proxy or list is available on request in writing to every member entitled to vote at the meeting and not merely to a selected few.

Revocation of proxy - Subject to articles, proxy may be revoked unless made irrevocable for valuable consideration.

If the shareholder, after appointing a proxy himself attends the meeting, he can vote in person; the proxy stands revoked - *Cousins* v. *International Brick Company* [1931]. The right of the shareholder to vote in person is paramount to the right of the proxy. The presence of the shareholder does not avoid the instrument of proxy; but if he votes before his proxy has voted for him, he impliedly revokes the proxy - *Knight* v. *Bulkeley* [1859].

The death of a shareholder who has appointed a proxy, in the absence of provision in the articles, revokes the authority of the proxy, but articles usually provide that a proxy shall be valid notwithstanding the previous death or insanity of, or revocation by, the person giving it, unless the company has received notice of such death, insanity or revocation, as the case may be. Such a provision is obviously necessary in order to ensure that resolutions apparently validly passed at an apparently valid meeting were indeed validly passed - *Palmer's Company Law*, 24th Edition, Para 56-13.

Proxy for adjourned meeting - Proxy deposited in due time before the original meeting is also valid for the adjourned meeting. Proxy may, however, be appointed for the adjourned meeting though member had himself attended the original meeting.

16.6-5 Motion, amendment, point of order

Motion - The term 'motion' indicates a proposal made at a meeting by any member. Such a motion may be passed without any change or modification. But, if some members feel that the motion in the form proposed needs some change or modification, they may move an amendment. A motion when passed, with or without amendment, is called a resolution.

A motion should always be in writing and before it is brought before the meeting, the necessary notice, if any required, must be given. A person proposing a motion is called the mover and the motion should be signed by him.

Amendment - An 'amendment' is a proposed alteration or modification in the terms or wording of the motion which is yet to be considered by the meeting. An amendment to a motion may—

(*i*) add some new words to the motion, or

(*ii*) replace some words of the motion by some other words, or

(*iii*) drop some words from the motion, or

(*iv*) change the place or position of words or certain phrases in the motion.

General rules regarding amendment - An amendment to be valid should comply with the following rules :

(*a*) the amendment should generally be worded in the affirmative;

(*b*) it should be seconded;

(*c*) it should not be a counter proposal;

(*d*) if the amendment is carried, the chairman should incorporate the same in the main motion;

(*e*) when the amended motion is put to the meeting, it becomes a substantive motion, and when passed, it becomes a resolution;

(*f*) an amendment cannot be withdrawn without the permission of the meeting.

Formal motion - A 'formal motion' is a motion relating to the procedure at a meeting and is moved for the purpose of interrupting or delaying or speeding up the discussion on a motion. Formal motions are also known as procedural or 'dilatory' motions. A 'formal motion' takes precedence over all other motions. A 'formal motion' need not be in writing, nor does it require any previous notice. The principal types of formal motions are :

(*i*) The closure motion, (*ii*) Previous question, (*iii*) Next business, and (*iv*) Adjournment.

(*i*) ***The closure motion*** - This motion is moved in order to close a prolonged and useless discussion on a motion. Any member may move closure motion by moving that the question be now 'put' (*i.e.*, put to vote). After it is seconded, it is put to vote. If the motion is carried, discussion on the main motion immediately stops. If the closure motion is lost, discussion on the main motion is resumed.

(*ii*) ***Previous question*** - The object of moving this motion is to prevent a vote being taken on the main motion under discussion. Any member who has not already spoken on the main motion may move this motion. This motion can be moved with regard to a main motion only and has to be properly seconded. The formal motion is then put to vote and, if it is carried, discussion on the main motion automatically ceases and it cannot be taken up again at the same meeting. If the motion is lost, the main motion is immediately put to vote without any further discussion.

The chairman may not permit the moving of such a motion if he thinks that it is being used improperly.

(*iii*) ***Next business*** - This motion is moved in order to shelve discussion on the main motion before the meeting. Any member may move 'that the meeting do proceed to the next business'. After it is seconded, it is put to vote and if it is carried, the main motion under discussion is dropped at once. If it is lost, discussion on the motion is resumed.

(*iv*) ***Adjournment*** - The object of moving this motion is to suspend either entirely or partially the proceedings of the meeting either for a particular period or indefinitely (*i.e., sine die*). This motion may also be used to postpone discussion on a motion. Any member may rise and move that the meeting be now adjourned. After seconding, the motion is put to vote. If the motion is carried, the proceedings of the meeting cease forthwith. The date, time and place at which adjourned meeting will be resumed are generally fixed at the same meeting unless it is adjourned *sine die*.

Point of order - A point of order deals with the conduct or procedure of the meeting. There are four bases upon which points of order can be called :

(*a*) *Incorrect procedure* - It implies that some member is contravening the rules of the meeting, *e.g.,* speaking far longer than the time allowed, proposing an amendment incorrectly, speaking out of turn, and so on.

(*b*) *Irrelevance* - When the speaker is speaking outside the scope of the notice then it is known as irrelevancy.

(*c*) *Unparliamentary language* - It is bad language, such as personal abuse. Also, it implies something derogatory to the association, place or person.

(*d*) *Transgressing the rules of the organization* - The procedure laid down in the standing orders of the organization should be followed. If that is not followed, a point of order can be raised.

As soon as a point of order is raised, debate on the main motion will stop. The chairman has to give his ruling or decision on a point of order at once. His ruling on any matter of procedure is final. If he rules out the point of order, debate on the motion will be resumed.

16.7 Resolutions

Once the motion has been put to the members and they have voted in favour of it, it becomes a resolution.

With respect to general body meetings, there are three kinds of resolutions : (*i*) ordinary resolution; (*ii*) special resolution; (*iii*) resolution requiring special notice.

16.7-1 Ordinary resolution [Section 114(1)]

When a motion is passed by simple majority of the members voting at a general meeting, it is said to have been passed by an ordinary resolution. In other words, votes cast in favour of the resolution (including the casting vote, if any, of the chairman) are more than the votes cast against the resolution, if any.

All matters which are not required by the Companies Act or the company's articles to be done by a special resolution can be done by means of an ordinary resolution. Some of the cases in which only ordinary resolution is required are : alteration of authorised capital, declaration of dividend, appointment of auditors and fixation of their remuneration, election of directors.

16.7-2 Special resolution

According to section 114(2), a resolution is a special resolution when—

(*a*) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members;

(*b*) the notice required under the Companies Act (*i.e.*, at least 21 clear days' notice) has been duly given of the general meeting;

(*c*) the votes cast in favour of the resolution (whether by show of hands or on poll), by members present in person or by proxy are not less than 3 times the number of votes, if any, cast against the resolution. Abstentions, if any, are not to be taken into account.

In construing whether a resolution is passed by three-fourths majority present and voting, what is to be taken into consideration in calculating majority is not number of persons present and voting, but number of valid votes polled in such meeting which includes only votes which are indicative of mind of voters for or against resolution - *Kirloskar Electric Co. Ltd.*, In re [2003] 43 SCL 186 (Kar.).

Voting for or against motion subject to conditions stipulated in vote is no voting in the eyes of law - *Kirloskar Electric Co. Ltd.*, In re [2003] 43 SCL 186 (Kar.).

Some of the matters for which special resolution is required to be passed are :

(1) to alter objects clause of memorandum;

(2) to change the registered office of the company from one State to another;

(3) to reduce share capital of the company; and

(4) to alter Articles of Association.

16.7-3 Resolutions requiring special notice

Section 115 deals with resolutions requiring special notice. Where, by any provision contained in this Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of **members holding not less than one per cent of total voting power or holding shares on which such aggregate sum not less than five lakh**

rupees, as may be prescribed, has been paid-up. The company, in turn, shall give its members notice of the resolution in such manner as may be prescribed.

Rule 23 of the Companies (Management and Administration) Rules, 2014[11], in this regard, provide as follows:

(*i*) The notice shall be **sent by members** to the company **not earlier than three months but at least fourteen days before the date of the meeting** at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.

(*ii*) **The company shall** immediately after receipt of the notice, give its members **notice of the resolution at least seven days before the meeting**, exclusive of the day of dispatch of notice and day of the meeting, in the same manner as it gives notice of any general meetings.

(*iii*) Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated and such notice shall also be posted on the website, if any, of the Company.

(*iv*) The notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

Special notice is required to move, besides the resolution mentioned in the Articles, the following resolutions:

(1) a resolution appointing an auditor other than the retiring one [Section 140];

(2) a resolution purporting to remove a director before the expiry of his period of office [Section 169]; and

(3) a resolution to appoint another director in place of the removed director [Section 169].

16.7A Validity of votes

Voting is formal expression of will or opinion by person entitled to exercise right on subject or issue in question which has to be either in affirmative or negative, and any writing on ballot paper suggesting condition or reservation cannot be said to be an expression of will or opinion either for or against proposition and those votes have to be necessarily treated as invalid or void as such votes are no votes leading either way - *Arvind Mills Ltd.,* In re [2002] 37 SCL 660 (Guj.).

16.8 Circulation of members' resolutions [Section 111]

When some members of a company want (*i*) to propose a resolution at the company's next annual general meeting; or (*ii*) desire to circulate to members any statement with respect to the matter referred to in any proposed resolution or any business to be dealt with at any general meeting, the Act allows them to use the administrative machinery of the company for the purpose.

11. As amended by Companies (Management and Administration) Amendment Rules, 2015.

If the requisite number of members make a requisition as aforesaid, the company shall be bound to :

(*i*) give a notice of the resolution intended to be moved at the next AGM;

(*ii*) circulate the statement among the members entitled to notice of any general meeting.

However, before the obligation of the company, in respect of the above may arise, the following conditions shall have to be satisfied:

(1) The requisition must have been signed by such number of members, as required in section 100 (**See under discussion on EGM)**

(2) The requisition must have been deposited at the registered office of the company :

(*a*) at least six weeks before the meeting in case of a requisition requiring notice of a resolution. Where an annual general meeting is called on a date within six weeks after the copy has been deposited, it shall be deemed to have been deposited in time; and

(*b*) at least two weeks before the meeting in case of any other requisition.

(3) The requisitionists must have deposited with the company a sum reasonably sufficient to meet the expenses of the requisition.

Penalty

If default is made in complying with the provisions of this section, every officer of the company who is in default, shall be punishable with fine which may extend to twenty five thousand rupees.

Exceptions : Section 111 authorises a company not to circulate a resolution or statement of the requisition where the Central Government, on the application of the company or any other aggrieved party, is satisfied that the right so conferred is being abused to secure needless publicity for defamatory matters.

In *Torrent Power Ltd.* v. *Sureshchandra V. Parekh* [2013] 32 taxmann.com 27 (CLB - Mumbai), respondent shareholders sent a notice to petitioner-company for moving a resolution for removal of 'K', an independent director, on ground that he was involved in criminal cases. Petitioner-company claimed that shareholding of respondents was below statutory and numerical requirement of section 188 for moving such resolution. It was further claimed that respondents issued notice just because 'K' was also Vice Chairman and Managing Director of HDFC, with whom respondents had a long history of litigation. Held that since requirement under section 188 [now section 111] was not fulfilled and notice for moving resolution for removal of director was sent to abuse process of law and secure needless publicity for a defamatory matter, petitioner-company was not bound to publish and circulate resolution in general meeting. Again, *in Reliance Industries Ltd.*, In re [2013] 31 taxmann.com 401 (CLB - Mumbai), it was held that member seeking resolutions to be included for circulation must have requisite shareholding as stipulated in section 188 [now section 111] and he must come with clean hand.

16.9 Registration of certain resolutions and agreements [Section 117]

A copy of the following resolutions or agreements together with the explanatory statement and the prescribed fees must within thirty days after their passing or making be forwarded to the Registrar of Companies who shall record the same:

(*a*) special resolutions;

(*b*) resolutions which have been agreed to by all the members of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions;

(*c*) any resolution of the Board of Directors of a company or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;

(*d*) resolutions or agreements which have been agreed to by any class of members but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a specified majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members;

(*e*) resolutions requiring a company to be wound up voluntarily passed in pursuance of section 59 of the Insolvency and Bankruptcy Code, 2016*;

(*f*) resolutions passed in pursuance of sub-section (3) of section 179 that is resolutions passed in the meetings of the Board of directors**. However, no person shall be entitled under section 399 to inspect or obtain copies of such resolutions. Further, the requirement of filing the resolution with the ROC shall not apply to a banking company in respect of a resolution passed at a meeting of the Board of directors to grant loans, or give guarantee or provide security in respect of loans in the ordinary course of its business; and

(*g*) any other resolution or agreement as may be prescribed and placed in the public domain.

If any company fails to file the resolution or the agreement under sub-section (1) before the expiry of the period specified therein, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of twenty-five lakh rupees and every officer of the company who is in default including liquidator of the company, if any, shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees [*Sub-section (2) inserted by Companies (Amendment) Act, 2019*]

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*W.e.f. 15-11-2016.

**Private companies have been exempted from this requirement—*Vide MCA Notification dated 5-6-2015.*

16.10 Minutes [Section 118]

'Minutes' may be defined as the written record of the business transacted at a meeting. Section 118 imposes a statutory obligation on every company to cause minutes of the proceedings of every general meeting of any class of shareholders or creditors, and every resolution passed by postal ballot and every meeting of its Board of Directors or of every committee of the Board to be recorded. The section further requires that every company shall keep minutes containing a fair and correct summary of all proceedings of the meetings as aforesaid in books kept for that purpose.[12]

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/IPC/ FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. "Every meeting, in order to be valid must be duly convened, properly constituted and conducted." Elucidate.
2. State the requisites of a valid meeting of the members.
3. The auditor of a company complains that he was not given notice of a recently held general meeting of the company. The secretary of the company contends that as no part of the business of that meeting concerned the auditor, no notice was required to be given to him :
   (*i*) Do you agree with the contention of the secretary ?
   (*ii*) If the auditor attends a general meeting, can he participate in the meeting ?
4. Define quorum. What is the quorum for a general meeting and a Board meeting ? What course of action should be adopted when the quorum is not complete at a general meeting ?
5. Define 'quorum'. Explain the legal provisions with regard to 'quorum'. What is the quorum required for a general meeting in the case of:—
   (*i*) a public limited company;
   (*ii*) a private company; and
   (*iii*) an adjourned meeting ?
6. Under what circumstances can one person form the quorum for a general meeting ?
7. Discuss the legal position in the following cases :
   (*i*) The required quorum is not present within ten minutes of the scheduled time of holding of annual general meeting.
   (*ii*) Four persons, who are members of a company, are present at its annual general meeting. One of them is also a representative of a corporate member of the company.
8. Explain 'ordinary business' and 'special business', which may be transacted at general meetings of a company. State also the meetings in which such businesses are transacted.
9. Point out the difference between the following :
   (*i*) Adjournment, postponement and dissolution of a meeting.
   (*ii*) 'Special resolution' and 'Resolution requiring special notice'.

12. For details please see discussion under 'Minutes Book' in chapter on 'Registers and Returns'.

10. "Every item of special business requires an explanatory statement". Discuss the validity of this statement. What are the points to be kept in mind while drafting an explanatory statement? What type of resolution, whether ordinary or special, is required to pass special business items ?

11. M, a member of a public limited company who is entitled to vote at the ensuing annual general meeting of the company, intends to inspect the proxies lodged. How would you deal with it under the provisions of the Companies Act, 2013?

12. State the legal position in the following circumstances :

(*i*) At an extraordinary general meeting, no director is willing to act as chairman.

(*ii*) At an adjourned extraordinary general meeting of a public limited company only three members are personally present.

13. What is the status of the joint shareholders for the purpose of the quorum at the general meeting? Many a time all the joint shareholders come over to attend the meeting. Are all of them to be counted for the aforesaid purpose?

14. (*a*) Who are the persons entitled to receive notices of general meetings ?

(*b*) If an auditor attends a general meeting, can he participate in the meeting ?

15. Discuss the validity of the following :

ABC Pvt. Ltd. provides in the articles of association of the company special requirements for the form of proxy. Z, a member, submits a form of proxy to the company in the **Form No. MGT.11.**

The company rejects the proxy.

16. Explain the provisions of the Companies Act with regard to the 'resolutions requiring special notice'. When is such a special notice required ?

17. Explain the provisions of the Companies Act with regard to 'proxies' at general meetings.

18. Discuss the provisions of the Companies Act relating to the time within which a proxy must be deposited with the company. Is it possible for a member to appoint a proxy after the meeting is held, in case the meeting is postponed for taking the poll or adjourned for some other reasons?

19. Explain the provisions regarding registration with Registrar of Companies of certain resolutions and agreements.

20. Discuss the right of the shareholders to use the company's machinery for giving publicity among all the shareholders of the company for resolution which they intend to propose or for statement which they want to make at an annual general meeting.

21. When a poll can be demanded in a general meeting of a company? Who can demand such a poll ?

22. Explain the provisions of the Companies Act, 2013 relating to the procedure to be followed for transacting business of the general meeting of members of a company through postal ballot?

23. Discuss the powers of the Tribunal to call general meetings of the company.

24. Advise the company on the following matters in the case of adjournment of general meeting :

(*i*) Issue of fresh notice for adjourned meeting.

(*ii*) Consideration of new business at the adjourned meeting.

(*iii*) Members appointing fresh proxy for the adjourned meeting.

25. How would you deal with the appointment of a representative or a proxy at a general meeting of the company and exercising the rights of a proxy in the following cases :

(*i*) When a body corporate is a member in the company which has called a general meeting ; and

(*ii*) When a foreign company is a member in the company

26. The quorum for a general meeting of a company is 10 members personally present according to the provisions in the articles of association of the company. Examine with reference to the relevant provisions of the Companies Act, 2013 whether there is proper quorum at a general meeting of the company which was attended by the following persons :

(*i*) 7 members personally present out of which 2 members are also proxies for 5 members;

(*ii*) 5 members represented by proxies who are not members of the company; and

(*iii*) One person representing two member companies

27. Write a short note on notice of meeting.

28. Sum up the legal provisions relating to voting rights of shareholders and recording of minutes of general meeting.

29. Explain the procedure for ascertaining the sense of general meeting of a company.

30. How can a proxy be validly appointed for an AGM of a public company? For appointment of a proxy by 3 joint holders, who are to execute the proxy form ?

31. What are the functions of a Company Secretary in regard to convening and holding an AGM of a public company ?

Hints : A company secretary is essentially to ensure compliance of various provisions of the Companies Act as well as the requirements of the articles of the company. For details *see* under 'Requisites of a valid meeting'.

32. The Managing Director of M. Ltd. desires to discuss an item which has not been included in the notice of the Annual General Meeting. The notice convening the meeting has been already despatched to the members. Advice.

Hints : It cannot be discussed. No item of business can be taken up in a general meeting unless a specific notice of the same had been given.

33. The Articles of association of a company require the instrument appointing proxy to be received by the company seventy two hours before the General Meeting. Is it as per the law ?

34. Explain briefly the statement, "All special businesses require special notice".

35. Is it mandatory to attach an explanatory statement to an item of ordinary business?

Hints : No. It is mandatory only in case of special business.

36. Explain the terms : Notice, agenda, quorum, minutes, proxy, poll, adjournment of a meeting and casting vote.

37. A proxy-holder demands that he should be counted for quorum in a general meeting. He also insists that being a holder of more than 10% voting power, he should be allowed to demand poll on this issue. Advise.

38. Mrs. Swapna Mitra and Mrs. Bharati Roy are joint holders of 500 shares in ABC Ltd. For the general meeting of the Company, Mrs. Swapna Mitra, whose name stands first in the order of names executes a proxy authorising Tapan to attend the meeting. Is the proxy valid ? Give reasons.

PRACTICAL PROBLEMS

1. Mr. M, a member, appointed Mr. P as his proxy for the annual general meeting of a company in the form as set out in **Form No. MGT.11.**. The company did not permit Mr. P to attend the

meeting on the ground that the special requirements for the instrument in the articles have not been fulfilled.

Hints : Company's stand is not correct. *See* section 105(7).

2. (*a*) State whether the following persons can be counted for the purpose of quorum in a general meeting of a public company :

(*i*) A person representing three member companies.

(*ii*) Both the joint owners of shares are present at the meeting.

(*b*) State also whether it is possible for a single member to constitute a meeting of a company.

Hints : (*a*)(*i*). To be counted as three members personally present.

(*ii*) To be counted as one member personally present.

(*b*) yes. (*i*) under section 97 [*AGM convened or directed to be convened by the Tribunal*]; (*ii*) under section 98 [EGM at the direction of *the Tribunal*]; (*iii*) in case of class meetings.

3. Diyas Limited issued a notice for holding of its Annual General Meeting on 7th November, 2013. The notice was posted to the members on 16-10-2013. Some members of the company allege that the company had not complied with the provisions of the Companies Act with regard to the period of notice and as such the meeting was not validly called. Decide :

(*i*) Whether the meeting has been validly called ?

(*ii*) If there is a shortfall in the number of days by which the notice falls short of the statutory requirement, state and explain by how many days does the notice fall short of the statutory requirement?

(*iii*) Can the shortfall, if any, be condoned ?

Hints : (*i*) 21 days' clear notice of an AGM must be given [section 101]. In case of notice by post, section 20 read along with the Rules made thereunder provide that the notice shall be deemed to have been received on expiry of 48 hrs. from the time of its posting. Besides, for working out clear 21 days, the day of the notice and the day of the meeting shall be excluded. Accordingly, 21 clear days' notice has not been served (only 19 clear days' notice is served) and the meeting is, therefore, not validly convened.

(*ii*) Worked as per (*i*) above, notice falls short by 2 days.

(*iii*) According to section 101(2), an AGM called at a notice shorter than 21 clear days shall be valid if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting. Thus, if 95% of the members entitled to vote thereat approve the shorter notice, shortfall may be condoned.

4. Annual general meeting of a public company was scheduled to be held on 15-12-2013. Mr. X, a shareholder, issued two proxies in respect of the shares held by him in favour of Mr. A and Mr. B. The proxy in favour of B was lodged on 12-12-2013 and the one in favour of Mr. A was lodged on 15-12-2013. The company rejected the proxy in favour of Mr. B as the proxy in favour of Mr. B was dated 12-12-2013 and that in favour of Mr. A was dated 13-12-2013. Is the rejection by the company in order ?

Hints : In case more than one proxies have been appointed by a member in respect of the same meeting, one which is later in time shall prevail and the earlier one shall be deemed to have been revoked. Thus, in the normal course, the proxy in favour of Mr. A, being later in time, should be upheld as valid. But as per section 105, a proxy should be deposited 48 hours before the time of the meeting. In this case, the proxies should have, therefore, been deposited on or before 13-12-2013 (the date of the meeting being 15-12-2013). But Mr. A deposited the proxy on 15-12-2013. Therefore, proxy in favour of Mr. A has become invalid. Thus, rejecting the proxy in favour of Mr. B is unsustainable. Proxy in favour of Mr. B is valid since it is deposited in time.

5. 40 out of 100 members of a company submitted a requisition for holding of an extraordinary general meeting in order to remove managing director from office. On the failure of the company to call the meeting, the requisitionists themselves called the meeting at the registered office of the company. On the appointed day, they could not hold the meeting at the registered office, as it was kept under lock and key by the managing director himself. The members held the meeting elsewhere and adopted resolution removing the managing director from office. Is the resolution valid ?

Hints : Section 100 (4) of the Companies Act, 2013 contains provisions regarding holding of extraordinary general meetings. It provides that if directors fail to call a properly requisitioned meeting, the requisitionists may call a meeting to be held on a date fixed within 3 months of the date of the requisition.

Where a meeting is called by the requisitionists and the registered office is not made available to them, it was decided in *R. Chettiar* v. *M. Chettiar* that the meeting may be held anywhere else.

Further, resolutions properly passed at such a meeting, are binding on the company.

Thus, in the given case, since all the abovementioned provisions are duly complied with, resolution removing the managing director shall be valid.

6. A company served a notice of a general meeting upon its members. The notice stated that a resolution to increase the share capital of the company would be considered at such meeting. A shareholder complains that the amount of the proposed increase was not specified in the notice. Is the notice valid ?

Hints : Section 102 of the Companies Act, 2013 requires a company to annex an explanatory statement to every notice for a meeting of company, at which some 'special business' is to be transacted. This explanatory statement is to bring to the notice of members information and facts that may enable members to understand the meaning, scope and implications of each item of special business and to take decision thereon. Section 102 further specifies that all business in case of any meeting other than the annual general meeting is regarded as special business. Thus, the objection of the shareholder is valid since the details on the item to be considered are lacking. The information about the amount is a material fact with reference to the proposed increase of share capital. The notice is, therefore, not a valid notice under section 102 of the Companies Act, 2013.

7. A general meeting was properly convened and was subsequently adjourned by the chairman for want of quorum. No fresh notice is given for the adjourned meeting which is held subsequently. State whether the adjourned meeting is valid ?

Hints : According to section 103 of the Companies Act, 2013, if within half an hour from the time appointed for holding a meeting of the company, quorum is not present, the meeting, shall stand adjourned to the same day in the next week, at the same time and place unless the directors determine otherwise. However, in case of a change of day, time or place of meeting under clause (*a*), the company shall give not less than three days notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated. In the given case, no fresh notice is, therefore, required to hold the adjourned meeting. Thus, the adjourned meeting in question is valid.

8. The secretary of a company while sending out to members of the company notices of a special resolution to be proposed at the Annual General Meeting inadvertently omitted to send notice to one member. The resolution was passed at the meeting. Discuss whether the resolution is valid or not ?

Hints : Section 101(3) of the Companies Act requires that proper notice must be served on all the persons entitled to receive such notice. Deliberate omission to give notice even to a single member entitled to notice, shall invalidate the proceedings of the meeting. But, it provides that an accidental omission to give notice to a member or if the member does not receive the

notice, the meeting cannot be held invalid [Sub-section (4)]. Thus, in the present case, the resolution shall be a valid one and binding since the omission is stated to be inadvertent (*i.e.,* unintentional).

9. A Company has 100 members. It sends notice of the general meeting to all of them. 20 members do not attend the meeting. Out of 80 members who are present 20 abstain from voting. How many members should vote in favour of a resolution if it is to be passed as a Special Resolution ?

[**Hints :** As per section 114(2), for a valid special resolution, votes cast in favour must at least be 3 times the votes cast against the resolution, if any. Those who abstain are not to be counted. Thus, 3/4th of 60, *i.e.,* at least 45 members must vote in favour of the resolution.

10. 'A' appoints 'B' as proxy. Just before the meeting 'A' comes to attend the meeting.

Explain the position of proxy appointed by 'A'.

[**Hints:** Subject to articles, proxy may be revoked unless made irrevocable for valuable consideration.

If the shareholder, after appointing a proxy himself attends the meeting, he can vote in person, the proxy stands revoked - *Cousins* v. *International Brick Company* [1931] 2 Ch. 90.]

11. A, a non-member of XYZ Ltd., had been appointed as a director of the company. Later on, he became Chairman of the company. In an annual general meeting of XYZ Ltd., A presided over the meeting. Z, a member of the company, objected to his chairmanship on the ground that A is not a member of the company. Discuss the validity of Z's claim.

Hints : 'Chairman' is the person who has been designated or elected to preside over and conduct the proceedings of a meeting. He is *usually* a member of the body over which he has to preside. However, the Articles of a company usually designate the Chairman of the Board of Directors to preside over the general meetings of the company.

Since a director need not be a member of the company (unless Articles otherwise provide), a non-member may well be a chairman. Objection of Z may, therefore, be not sustainable.

12. The auditor of a company complains that he was not given notice of a recently held general meeting of the company. The secretary of the company contends that as no part of the business of that meeting concerned the auditor, no notice was required to be given to him.

(*i*) Do you agree with the contention of the secretary ?

(*ii*) If the auditor attends a general meeting, can he participate in the meeting ?

Hints : (*i*) The contention of the secretary is not correct. The auditor has a statutory right under section 101(3)(a) as well as under section 146 of the Companies Act, 2013 to receive all notices of, and other communications relating to any general meeting of a company which any member is entitled to have sent to him.

Failure to send notice of a general meeting to the company's auditor, whether he is concerned or not with any part of the business to be transacted at the meeting, amounts to a default on the part of the company.

(*ii*) Section 146 further entitles the auditor of a company to attend any general meeting of the company either by himself or through his authorized representative, who shall also be qualified to be an auditor. He cannot participate in the meeting but he is entitled to be heard on any part of the business which concerns him as auditor.

13. A meeting was properly convened and was subsequently adjourned by the Chairman because quorum was not present. No fresh notice is given for the adjourned meeting which is held subsequently. State whether the adjourned meeting is valid.

Hints : According to section 103 of the Companies Act, 2013, if within half an hour from the time appointed for holding a meeting of the company, a quorum is not present, the meeting shall stand adjourned to the same day in the next week, at the same time and place unless the directors determine otherwise. No fresh notice is, therefore, required to hold the adjourned

meeting in case the same is held on the same day, next week, at the same time and place. But, in case of a change of day, time or place of adjourned meeting, the company shall give not less than three days notice to the members either individually or by publishing an advertisement in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated.

14. How would you deal with the appointment of a representative or a proxy at a general meeting of the company and exercising the rights of a proxy in the following cases :

(*i*) When a body corporate is a member in the company which has called a general meeting ?

(*ii*) When a foreign company is a member in the company ?

Hints : *Appointment of Proxy :* The appointment of a representative or a proxy at a general meeting of the company and exercising the rights of a proxy in the cases given in the question can be dealt with by the provisions of the Companies Act, as explained hereunder :

(*i*) *When a body corporate is a member in the company which has called a general meeting: Section 103 says that a body corporate, whether a company within the meaning of this Act or not* may, by resolution of its Board of Directors or other governing body, authorize such person as it thinks fit to act as its representative at any meeting of the company, or at any meeting of any class of members of the company.

A person authorised by resolution as aforesaid shall be entitled to exercise the same rights and powers (including the right to vote by proxy) on behalf of the body corporate which he represents as that body could exercise if it were an individual member or creditor of the company.

(*ii*) *When a foreign company is a member in the company* :

Since Section 103 of the Companies Act, 2013 covers all body corporate, the procedure required shall be the same as under (i) above.

15. A proxy was appointed by a member on an instrument duly executed. Will the vote cast by the proxy be valid in the following cases:

(*i*) When the member himself attended and cast his vote at the meeting without revoking the authority of the proxy; and

(*ii*) When the member died in the meantime?

Hints : (*i*) Section 105 is silent with respect to revocation of a proxy. Thus, provisions in the articles determine right of a member to revoke the proxy. In the absence of any provision in the articles, right of a member to revoke his proxy has been held to be unfettered. The proxy stands revoked if the member attends the meeting personally. Thus, in this case, the vote given by the proxy will not be valid. [*Cousins* v. *International Bricks Co. Ltd.* [1932] 2 Comp. Cas. 108]. But the revocation should be communicated before the meeting. Revocation will be too late if communicated after the meeting has commenced. In such a case, the votes cast by the proxy will be valid in a poll [*Spiller* v. *Mayo (Rhodestina) Development Co. (1908) Ltd.* (1926) WN 78].

(*ii*) The vote cast by the proxy shall be invalid if the member appointing the proxy dies and company comes to know of the death of the member before the commencement of the meeting. However, if the company has no notice of such death, the vote cast by the proxy shall be valid.

16. With reference to the provisions of the Companies Act, 2013, examine the validity of the following :

(*i*) J, a member of a private company, being unable to attend a meeting of the members of the company appoints more than one proxy on the same occasion. The Articles of Association of the company are silent on this issue.

(*ii*) D, a member of MR & Co. Ltd., holding shares in his own name on which final call money has not been paid is denied voting right at a general meeting on the ground that

the Articles of Association do not permit a member to vote if he has not paid the calls on the shares held by him.

Hints : (*i*) According to sub-section (2) of section 105, a member of a company whether public or private company may, *where that is allowed*, appoint more than one proxy to attend on the same occasion. Since in the given problem, articles are silent on the subject, appointment of more than one proxy by J shall be invalid.

(*ii*) Section 106 of the Companies Act, 2013 lays down the grounds on which right of a shareholder to vote at the general meeting may be excluded. These are :

(*a*) non-payment of calls by a member ;

(*b*) non-payment of other sums due against a member ;

(*c*) where company has exercised the right of lien on his shares.

Since the stipulation in the Articles relates to one of the grounds permitted under section 106, the same is valid. D's protest is thus invalid.

17. At a general meeting of a company, a matter was to be passed by a special resolution. Out of forty members of the company, twenty voted in favour of the resolution, five voted against it and five votes were cancelled. The remaining ten members abstained from voting. The chairman declared resolution as passed. Is the decision of the chairman valid ?

Hints : Under section 114(2) of the Companies Act, 2013, for a valid special resolution, the following conditions need be satisfied :

(*i*) The intention to propose the resolution as a special resolution must have been specified in the notice calling the general meeting or other intimation given to the members of the resolution;

(*ii*) The notice required under the Companies Act must have been duly given of the general meeting;

(*iii*) The votes cast in favour of the resolution (whether by show of hands, or electronically, or on poll, as the case may be) by members who, being entitled so to do, vote in person or by proxy or by postal ballot, are required to be not less than three times the number of the votes, if any, cast against the resolution by members so entitled and voting.

Thus, in terms of the requisite majority, votes cast in favour have to be compared with votes cast against the resolution. Abstentions or cancellations, if any, are not to be taken into account. Accordingly, in the given problem, the votes cast in favour (20) being more than 3 times of the votes cast against (5), if other conditions of section 114(2) are satisfied, the decision of the chairman is in order.

18. The chairman counts six votes in favour and seven against the resolution. Can the chairman cast his own vote, which he had not exercised earlier, in favour of the resolution and also casting vote which the Articles authorise and declare the resolution as passed ?

Hints : The Chairman after ascertaining the sense of the meeting by show of hands, that 6 votes are in favour and 7 are against the resolution may before declaration of result cast his vote in favour of the resolution and also the casting vote and declare the resolution as passed.

19. The chairman of the meeting of a public limited company adjourns the general meeting of a company against the wishes of the majority of members present in person or by proxy. Examine the validity of the decision of the chairman.

Hints : Unless Articles of the company specifically authorise the chairman to adjourn a general body meeting even against the wishes of the majority, Regulation 49 of Table F shall become applicable. Under Regulation 49 of Table F, the chairman is not empowered to adjourn the meeting against the wishes of the majority of members present in the meeting.

20. The articles of association of M/s PQR Private Limited provide that 5 members present in person constitute the quorum. The total number of members of the company is also 5. A general meeting of the company was held on 25-1-2014 and it was attended by 4 members

as the 5th member had expired sometime earlier. In the said meeting a resolution was passed by a majority of 3 to 1 removing one Mr. Doubtful as a director for indulging in anti company activities. Mr. Doubtful challenges the validity of the resolution on the ground of lack of quorum in terms of the articles of association. Discuss with reference to the relevant provisions of Companies Act whether the contention of Mr. Doubtful is correct.

Ans. Section 103 of the Companies Act, 2013 stipulates that unless the articles of association of the company provide for a larger number, two members personally present shall constitute quorum in case of a private company. Hence a private company may provide a larger number for quorum. The general principle is that if no quorum is present, the meeting and the proceedings are void. However, there can be situations when quorum becomes immaterial. If all the members are present, it is immaterial that the quorum required is more than the total number of members - [*Re Express Engineering Works Ltd. (1920) Ch 466 & Rs. Oxted Motor Co. Ltd. (1921) 3 KB 32*]. Thus, in this case Mr. Doubtful cannot successfully challenge the resolution.

21. The Articles of Association of X Ltd. require the personal presence of six members to constitute quorum of general meetings. The following persons were present at the time of commencement of an Extraordinary General meeting to consider the appointment of Managing Director :

(1) Mr. G, the representative of Governor of Gujarat.

(2) Mr. A and Mr. B, shareholders of Preference Shares.

(3) Mr. L, representing M Ltd., N Ltd. and Y Ltd.

(4) Mr. P, Mr. Q, Mr. R and Mr. S, who were proxies of shareholders.

Can it be said that quorum was present ? Discuss.

Hints : In this case the quorum for a general meeting is six members to be personally present. For the purpose of quorum only those members are counted who are entitled to vote on resolution proposed to be passed in the meeting. Again, only members present in person and not by proxy, are to be counted. Hence, proxies whether they are members or not will have to be excluded for the purpose of quorum.

If a company is a member of another company, it may authorise a person by resolution to act as its representative at a meeting of the latter company, then such a person shall be deemed to be a member present in person and counted for the purpose of quorum (section 113).

Where two or more companies which are members of another company, appoint a single person as their representative, then each of such company will be counted in quorum at a meeting of the latter company.

Again, section 112, provides that the President of India or Governor of a State, if he is a member of a company may appoint such person, as he thinks fit, to act as its representative at any meeting of the company. A person so appointed shall be deemed to be a member of such a company and, thus, considered as member personally present.

In view of the above, there are only four members personally present, namely, Mr. G and Mr. L (representing three companies and thus effectively equal to three members). Mr. A and Mr. B, the preference shareholders have been excluded since the agenda being the appointment of Managing Director, their rights cannot be said to be directly affected and, therefore, they shall not have any voting rights.

Thus, it can be said that the requirement of quorum being six, four members personally present shall not constitute a valid quorum.

SPECIMEN OF NOTICE, AGENDA, PROXY, MINUTES, RESOLUTIONS, ETC.

NOTICE AND AGENDA OF ANNUAL GENERAL MEETING

[SPECIMEN]

1. NOTICE

Notice is hereby given that the 10th Annual General Meeting of the Members of XYZ Ltd. will be held on Saturday, the 15th day of December, 2013, at the Registered Office of the Company at Plot Nos. 16-18, New Electronics Complex, Chambaghat, Distt. Solan (HP), at 10.00 a.m. to transact the following business:—

Ordinary business :

1. To receive, consider and adopt the Audited Balance Sheet of the company as on 31st March, 2013 and the Financial Statements for the year ended on that date and the Directors' and Auditors' Reports thereon.
2. To declare dividend for the year ending 31st March, 2013.
3. To appoint a director in place of Mr. S. S. Sandhu who retires by rotation and being eligible, offers himself for re-appointment.
4. To appoint a Director in place of Mr. P. N. Handa who retires by rotation and being eligible, offers himself for re-appointment.
5. To appoint Statutory Auditors of the company and fix their remuneration.

   Special business :

6. To consider and, if thought fit, to pass with or without modification(s) the following resolution as an ordinary resolution :

   "Resolved that pursuant to the provisions of sections 203, 197 and other applicable provisions, if any, of the Companies Act, 2013 the consent of the Company be and is hereby accorded to the re-appointment of and remuneration payable to Mr. P. S. Gill as Managing Director for a period of five years w.e.f. 1st July, 2014 on the following terms and conditions :

   (A) Salary : Rs. 5,00,000 per month.

   (B) Perquisites :

   (*i*) Medical reimbursement :

   Expenses incurred for self and family subject to a ceiling of one month salary in a year or three months' salary over a period of three years.

   (*ii*) Leave travel concession for self and family once in a year in accordance with the Rules of the Company.

   (*iii*) Club fee :

   Fees of clubs, subject to a maximum of two clubs provided that no life membership or admission fee will be allowed.

   (*iv*) Personal accident insurance :

   Premium not to exceed Rs. 10000.

   (*v*) Company's contribution towards pension/superannuation fund as per Rules of the Company for the time being in force but such contribution together with P.F. shall not exceed 25% of the salary or such other increased amount provided that the same is not taxable under the Income-tax Act.

(*vi*) Company's contribution towards P.F. as per rules of the company for the time being in force but not exceeding 10% of the salary.

(*vii*) Gratuity not exceeding half month's salary for each completed year of service subject to a ceiling of Rs. 10 lakhs.

(*viii*) Free use of the telephone at residence but personal long distance calls shall be billed by the company.

(*ix*) Free use of company's car with driver for the business of the company.

(*x*) Earned/Privilege Leave :

One month's leave with full pay and allowances for every 11 months of service subject to the condition that leave accumulated but not availed of will not be allowed to be encashed.

For and on behalf of Board of Directors

Chairman of the Meeting

16-18, New Electronics Complex,

Chambaghat,

Distt. : Solan (HP)

Dated : Oct. 31, 2007

Notes :

- A member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of himself and the proxy need not be a member of the company.
- Explanatory statement relating to special business is annexed to this Notice as required under section 102 of the Companies Act, 2013.
- The Register of Members and the Share Transfer Books of the Company will remain closed from 7th day of December, 2013 to 15th day of December, 2013, both days inclusive.
- Members are requested to notify immediately change of address, if any, to company's Registered Office. While communicating to the company, please quote the folio number.
- Shareholders desirous of obtaining any information concerning the accounts and operations of the company are requested to address their questions to the company's Head Office, so as to reach at least 5 days before the date of the meeting so that the information may be made available at the meeting to the best extent possible.

ANNEXURE TO THE NOTICE

Explanatory statement to the proposed special business pursuant to provisions of section 102(2) of the Companies Act, 2013 :

Item No. 6

Mr. P. S. Gill was appointed as Managing Director of the Company for a period of five years up to 30-6-2014. In the Board meeting held on 9th September, 2014, it was decided to reappoint the Managing Director for another term of five years at revised terms and conditions from 1st July, 2014 keeping in view the utility of his services for the growth of the business of the company in future. Accordingly, the Board recommends the resolution to be passed by the shareholders as per the requirements of the Companies Act, 2013.

None of the Directors except Mr. P. S. Gill is interested in the resolution.

2. NOTICE OF EXTRAORDINARY GENERAL MEETING

[SPECIMEN]

XYZ Ltd.

(Registered Office.....)

Notice is hereby given that an Extraordinary General Meeting of the members of the company will be held at the Registered Office of the Company, 10 ABC Street, Bombay-400071 on Wednesday, the 7th March, 2014 at 11.00 a.m. to consider and if thought fit, to pass with or without modifications the following resolution :

1. *As a special resolution* - "Resolved that approval be and is hereby accorded to the Company commencing all or any of the business as manufacturers, buyers, sellers, exporters, importers of and dealers in beltings of all descriptions including without limitation Conveyor Beltings, Automotive fan and V-Belts."

By order of the Board

Registered Office :
10 ABC Street,
Bombay-400071
7th Feb. 2006.

Secretary

Notes :

1. A member who is entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote in his stead and such proxy need not be a member of the company. Proxy in order to be effective must be deposited with the company not less than 48 hours before the meeting.
2. An explanatory statement as required under section 102(2) of the Companies Act, 2013, is attached.

Explanatory Statement under section 102(2) of the Companies Act, 2013.

Item 1 - The Company is presently engaged, *inter alia*, as manufacturers of and dealers in tea, machinery, industrial fans, dust collectors, switchgears.

The Board of directors of the Company (the Board) considers that it would be both advantageous and convenient for the Company to diversify its existing business and enlarge its operations by undertaking the businesses specified in the Resolution. Sub-clause (1) of clause 3 of the Memorandum of Association in the Company authorises the Company to undertake the business.

In view of Regulation 20 of the Articles of Association, any business which is not germane to the existing business of the Company, cannot be commenced by the Company until such commencement has been approved by the Company in general meeting by a Special Resolution.

The Board is of the opinion that the business sought to be undertaken would prove to be beneficial to the Company and, therefore, recommends passing of the Resolution.

No Director of the Company is interested or concerned in the Resolution.

3. SPECIMEN RESOLUTIONS

(i) Resolution for increase of capital of the company - Resolved that pursuant to the provisions of section 61(1) and other applicable provisions of the Companies Act, 2013, the authorised capital of the company be increased from Rs..... to Rs.....by creation of .....further equity shares of Rs..... each ranking *pari passu* with

existing equity shares and clause..... of the Memorandum of Association be altered accordingly.

[If the articles of the company contain no provisions to alter the capital, a special resolution shall be passed amending the articles and thereafter ordinary resolution is to be passed to increase the share capital.

Kind of meeting required : General meeting

Kind of resolution required : Ordinary resolution.]

(ii) **Change of name of the company** - Resolved that pursuant to provisions of section 13 of the Companies Act, 2013 and subject to the approval of the Central Government, the name of the company be changed from Metal Box Ltd. to Metal Box Engineering and Processing Ltd.

[Kind of meeting required : General meeting

Kind of resolution required : Special resolution.]

(iii) **Resolution to re-appoint the same auditors** - "Resolved that the retiring auditors M/s. ABC & Company, Chartered Accountants be and are hereby reappointed as the Auditors of the Company to hold office from the conclusion of this meeting until the conclusion of the next Annual General Meeting of the company at a remuneration of Rs..... *plus* reimbursement of any out of pocket expenses that may be incurred by the said M/s. ABC & Company for discharging their duties as auditors of the company."

[Kind of meeting required : Annual General Meeting

Type of resolution required : Ordinary resolution.]

(iv) **Resolution to declare dividend** - "Resolved that the dividends as recommended by the Board of Directors for the year ended 31st March, 2014 at the rate of Rs..... per share on the equity capital of the company subject to deduction of tax at source be and is hereby declared for payment to those shareholders whose names appeared on the Register of Members as on .....2014."

[Kind of meeting required : Annual general meeting

Kind of resolution required : Ordinary resolution.]

(v) **Resolution to open a dividend account with a scheduled bank** - Resolved that pursuant to the applicable provisions of the Companies Act, an account styled as B.L.S. & Co. Ltd. Dividend Account (2014) be opened with Allahabad Bank, Anand Lok, New Delhi and that the said Bank be and is hereby authorised to honour dividend warrants of the company for the year ended 31st March, 2014 issued under the lithographed signatures of Messrs B and C, authorised signatories and to act on any instructions so given by the stated signatories relating to the said account of the company.

[Type of meeting required : Board meeting

Type of resolution required : Simple majority resolution.]

(vi) **Resolution to remove director and to appoint another director in his place** - "Resolved that Mr. ..... be and is hereby removed from his office as director of the company.

Resolved further that Mr. .....be and is hereby appointed a director of the company in place of Mr. ..... to hold office during such time as Mr. .....would have held the office had he not been removed."

[Type of meeting required : General meeting

Type of resolution required : Ordinary resolution of which special notice has been given.]

17 Company Meetings-II - General Body Meetings

17.1 Need for meetings

A company is an artificial person and, therefore, cannot act itself. It must act through some human intermediary. The various provisions of law empower members to do certain things. These are specifically reserved for them to be done in company's general meetings. Section 179 empowers the Board of directors to manage the affairs of the company. In this context holding of meetings of members and of directors become indispensable. In this Chapter meetings of members are dealt with while in the following Chapter, meetings of directors have been discussed. The Companies Act, 2013 has made provisions for different types of meetings of members, namely : (*i*) Annual General Meeting, (*ii*) Extraordinary General Meeting, and (*iii*) Class Meetings.

17.2 Annual General Meeting (AGM)

Annual General Meeting of a company, as the name signifies, is an annual meeting of the body of the members.

17.2-1 Which companies to hold

Every company, whether public or private, having a share capital or not, limited or unlimited must hold this meeting.

17.2-2 Gap between two AGMs (Section 96)

Section 96 contains the following provisions in this regard:

(*i*) ***First AGM*** - The first Annual General Meeting of a company shall be held within nine months from the date of the closing of its financial year. No extension of time can be allowed for holding the first AGM.

(*ii*) ***Subsequent AGMs***

(*a*) There must be one meeting held in each year, *i.e.*, calendar year. Where the first AGM of a company has been held within nine months from the

date of the closing of its financial year then it need not hold another AGM in the year of its incorporation.

The meeting adjourned to next calendar year does not become meeting of that year [*Sree Meenakshi Mills Co. Ltd.* v. *Assistant Registrar of Joint Stock Companies* [1938] 8 Comp. Cas. 175 (Mad.).]

(*b*) The gap between two AGMs must not be more than fifteen months.

(*c*) Meeting must be held not later than six months from the close of the financial year.

17.2-3 Extension of Time

The Registrar may, for any special reason, extend the time within which any annual general meeting, **other than the first annual general meeting**, shall be held, by a period not exceeding three months.

The aforesaid extension of 3 months can be given only by the Registrar. Courts are not empowered under section 166 [now section 96] to grant the said extension - *Nungambakkam Dhanarakshaka Saswatha Nidhi Ltd.* v. *R.O.C.* [1972] 42 Comp. Cas. 632 (Mad.).

The Department of Company Affairs has clarified that sections 166 and 210 when read together [Now section 96] clearly suggest that the AGM should be held on the earliest of the three relevant dates prescribed under these two sections [now section 96], *i.e.,* six months after the close of the financial year, fifteen months from the previous AGM and the last day of the next calendar year, whichever is earlier. Otherwise, one or the other section is bound to be breached [*File No. 8/16(1)/61-PR dated 19-5-1961*].

17.2-3a STAY OF AGM - In *Suzuki Motor Corpn.* v. *Union of India* [1998] 93 Comp. Cas. 771 (Delhi), the company was a joint venture between Maruti Udyog Ltd. (MUL) and Suzuki Motor Corpn. (SMU). The parties had right to designate MD by turns. On completion of terms of the nominee of 'SMC' on 27-8-1997, the 'MUL' appointed 'B' as MD on the same date. The appointment of 'B' was to be ratified at the AGM scheduled to be held on 22-9-1997. 'SMC' alleged that no concurrence and no effective consultation with it was held before the appointment of 'B' and it approached the International Court for Arbitration. Pending the arbitration, invoking section 9 of the Arbitration and Conciliation Act, 1996, the petitioner sought for stay of AGM.

Delhi High Court held that it was established from record that the consent and concurrence of SMC was not taken while nominating the present managing director. In any case, his appointment had to be concurred and approved at the AGM and it would not be in the interest of justice to restrain holding of such a meeting. 'SMC' would not suffer any irreparable injury which could not be cured at a subsequent stage when the proceedings in arbitration were concluded.

17.2-4 What about a situation where Annual Accounts are not ready

In case annual accounts are not ready for laying at the appropriate annual general meeting, it shall be open to the company concerned to adjourn the said annual general meeting to a subsequent date when the annual accounts are expected to be

ready for laying. Since consideration of annual accounts is only one of the matters to be dealt with at an AGM, directors are under a statutory obligation to hold the meeting. The proper course shall be to hold the meeting and then adjourn it to a suitable date for considering the accounts *(Department of Company Affairs Communique dated 2nd February, 1974).*

The adjourned meeting must, however be held within the maximum time limit allowed under section 166 [now section 96] - *Subal Dutta & Sons Pvt. Ltd* v. *Assistant Registrar of Companies, W.B.* [1986] 3 Comp. LJ 73.

It may be noted that if because of circumstances beyond their control (*e.g.,* pandemonium and confusion in the hall because some strangers also forced their entry into the hall) directors decide not to hold the meeting, meeting cannot be said to have commenced by mere fact that before directors' announcement, printed copies of balance sheet and agenda have been distributed to shareholders - *V. Selvaraj* v. *Mylapore Hindu Permanent Fund Ltd.* [1968] 1 Comp. LJ 93. Accordingly, resolution passed thereat cannot be upheld as valid.

Also, notice that where all members of a company were also members of the Board of directors, a meeting of the Board could well be treated as the general meeting of the company - *P.V. Damodara Reddy* v. *Indian National Agencies Ltd.* [1945] 15 Comp. Cas. 148 (Mad.).

17.2-5 Meeting beyond Statutory Time

In *Hungerford Investment Trust Ltd.* v. *Turner Morrison & Co. Ltd.* ILR [1972] Cal., the Court held that a meeting held beyond the time cannot be said to be void or illegal. If the Central Government (now Tribunal) does not extend the date of holding the AGM under section 97, the directors shall be subjected to increasing penalty but the meeting shall be a valid meeting. Otherwise, the position in law would become impossible.

The Calcutta High Court in *Ruby General Hospital Ltd.* v. *Sajal Dutta* [2012] 112 SCL 620 has held that Court has the power to condone delay in holding AGM on a date beyond statutory limit of section 166 (now section 96) as non-adherence to that is not that fatal that Court would not be able to condone.

The Kerala High Court in case of *T.V. Mathew* v. *Nadukkara Agro Processing Co. Ltd.* [2002] 36 SCL 664, has held that failure to convene annual general body meeting is a continuing default for which consequences are provided and in such circumstances what is required to be done is to direct company to convene AGM at earliest.

Voting Rights in respect of meeting held after the prescribed time limit. Voting rights of members shall be determined as at the date of the meeting and not as they would have been if the meeting had been held within the prescribed time - *Musselwhite* v. *Musselwhite & Sons Ltd.* [1962] 1 ALL ER 201.

17.2-6 Cancelling or postponing of convened meeting

According to Justice Satish Chandra in *Rajpal Singh* v. *State of U.P.* [1968] 1 Comp. LJ 21, the Board of directors has the power to postpone or cancel a meeting, notice of which has already been given. However, it cannot be exercised except for *bona fide* and proper reasons.

17.2-7 Can a general meeting properly convened be cancelled or its holding deferred?

The Act is silent on these issues. However, the Secretarial Standard SS-2 issued by the ICSI contains a view on these. **SS-2 states that a Meeting convened upon due Notice shall not be postponed or cancelled.** However, if, for reasons beyond the control of the Board, a Meeting cannot be held on the date originally fixed, the Board may reconvene the Meeting, to transact the same business as specified in the original Notice, after giving not less than three days intimation to the Members. The intimation shall be either sent individually in the manner stated in this Standard or published in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and in an English newspaper in English language, both having a wide circulation in that district. A listed company should also inform SEBI about the deferment and the fresh date.

17.2-8 Day, hour and place of AGM*

Every annual general meeting shall be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday and shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situate [Section 96(2)].

However, annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance[1]

Further, the Central Government may exempt any class of companies from the provisions of this sub-section subject to such conditions as it may impose.

17.2-9 Can a company hold two AGMs on the same day?

There is no provision in the Companies Act prohibiting the holding of two AGMs on the same day. If the Articles do not contain any provision to the contrary, AGM for the current year as also for the previous year can be held on the same day. There should, however, be separate notices for each meeting and they should be held at different timings.[2]

17.2-10 Business to be transacted [Section 102]

The business to be transacted at an AGM may comprise of:

1. ***Ordinary business*** which relates to the following matters:
   - (*i*) the consideration of financial statements and the reports of the Board of Directors and auditors;
   - (*ii*) the declaration of any dividend;
   - (*iii*) the appointment of directors in place of those retiring;
   - (*iv*) the appointment of, and the fixing of the remuneration of, the auditors

*Requirements of section 96 shall not be applicable to a section 8 company if the time, date and place of each AGM are decided beforehand by the B.O.D. having regard to the directions, if any, given in the general meeting of the company—*Vide MCA Notification dated 5-6-2015.*

1. Inserted by the Companies (Amendment) Act, 2017.
2. A. Ramaiya, Guide to the Companies Act, 1988 edn. P. 1280.

Query: SS-2 provides that ordinary business cannot be transacted through postal ballot. However, is the facility of e-voting required to be provided for transaction of ordinary business?

Ans: ICSI, *vide* its Press Release dated 21.7.2015 (update as on 26.8.2015) has answered as follows:

"As defined in SS-2, 'Voting by postal ballot' means voting by ballot, by post or by electronic means. So far as ordinary business is concerned, Postal ballot is not permitted. However, facility for e-voting, which is a substitute for voting at the General Meeting, is required to be provided for all business including ordinary business as required under Rule 20 of the Companies (Management and Administration) Rules, 2014."

2. ***Special business*** - Any other business scheduled to be transacted at the meeting will be deemed to be special business.

Where any items of business to be transacted at the meeting are deemed to be special as aforesaid, there shall be annexed to the notice calling such meeting, namely:—

the nature of concern or interest, financial or otherwise, if any, of—

(*i*) every director and the manager, if any;

(*ii*) every other key managerial personnel; and

(*iii*) relatives of the persons mentioned in (*i*) and (*ii*) above.

The statement should also contain any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

Where any item of special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than two per cent of the paid-up share capital of that company, also be set out in the statement.

17.2-11 Notice of the meeting

The company must give **clear twenty-one days' notice*** to: (*i*) every member of the company; (*ii*) the legal representative of a deceased member; (*iii*) the assignee of an insolvent member; (*iv*) the auditor(s) of the company; (*v*) every director of the company.

Any accidental omission to give notice to, or the non-receipt of such notice by, any member or other person who is entitled to such notice for any meeting shall not invalidate the proceedings of the meeting.

*A section 8 company may hold its general meeting by giving 14 clear days notice instead of 21 days—*Vide MCA Notification dated 5-6-2015.*

Notice may be given either in writing or through electronic mode in such manner as may be prescribed[3].

17.2-11a MEANING OF CLEAR DAYS - *'Clear days'* means the days must be calculated excluding the day on which the notice is served and the day on which the meeting is to be held. In case of delivery by post, such service shall be deemed to have been effected at the expiration of forty eight hours after the letter containing the same is posted - Rule 35 of the Companies (incorporation) Rules, 2014. The effect of this provision is that if notice of a general meeting is sent by post, it must be posted at such time as to give 21 clear days' notice as required by section 101, *plus* 48 hours in addition. Each of the twenty-one days must be a full calendar day, so that notice can be said to be not less than 21 days' notice - *Bharat Kumar Dilwali vs. Bharat Carbon Ribbon Mfg. Co. Ltd.* [1973]. Therefore, notice of a general meeting must be sent at least 25 days before the date of the meeting (where the service of notice is by post). If, for instance, a general meeting is to be held at 3 p.m. on 6th April, service of the notice of the meeting will be deemed to have been duly effected if it had been dispatched by post at any time before 3 p.m. on 13th March. This will satisfy the requirement of 21 clear (full) days' notice *plus* 48 hours for transmission by post.

The presumption of deemed delivery cannot be raised when at the time of posting, the post office was, within the knowledge of the company, on strike - *Bredman* vs. *Trinity Estate Plc* [1989].

Section 101 does not state at which post office or box the letter has to be posted. Presumably, it has to be posted at or near the place of the registered office of the company. The provisions in the section will not be satisfied if the posting is made deliberately at any far off place, with

17.2-11b SHORTER NOTICE : A general meeting may be called after giving a shorter notice if consent is given in writing or by electronic mode by not less than ninety-five per cent of the members entitled to vote at such meeting.

Such a consent may be received before the meeting is held or after the resolutions are passed - *Re Self-Help Private Industrial Estate Pvt. Ltd.* [1972] 42 Comp. Cas. 605 (Mad.)**;** *Re Parikh Engineering and Body Building Co. Ltd.* [1975] 45 Comp. Cas. 157**.**

17.2-11c ADVERTISEMENT OF NOTICE IN THE NEWSPAPERS - WHETHER OBLIGATORY? - It is not obligatory to advertise notice in the newspapers. However, as a matter of abundant precaution, the company may advertise in the newspapers to avoid objection from such of the shareholders as reside outside India and who accidentally may not receive the notices served through post.

17.2-11d DEFAULT IN HOLDING AGM -

1. **Tribunal to call or direct the calling of AGM:** Section 97 of the Companies Act, 2013 provides that **i**f any default is made in holding the annual general meeting of a company under section 96, the Tribunal may, notwithstanding

3. Rule 18 of the Companies (Management and Administration) Rules, 2014 provides that a notice may be sent through e-mail as a text or as an attachment to e-mail or as a notification providing electronic link or Uniform Resource Locator for accessing such notice. The e-mail shall be addressed to the person entitled to receive such e-mail as per the records of the company or as provided by the depository. The company may send e-mail through in-house facility or its registrar and transfer agent or authorise any third party agency providing bulk e-mail facility.

anything contained in this Act or the articles of the company, **on the application of any member of the company**, call, or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient.

Directions given by the Tribunal may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

A general meeting held in pursuance of sub-section (1) shall, subject to any directions of the Tribunal, be deemed to be an annual general meeting of the company under this Act.

2. **Penalty:** If any default is made in holding a meeting of the company in accordance with section 96 or section 97 or in complying with any directions of the Tribunal, the company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in the case of a continuing default, with a further fine which may extend to five thousand rupees for every day during which such default continue (Section 99).

In *Kaleidoscope Travel Consultants (P.) Ltd.* v. *Travel Agents Association of India* [2015] 54 taxmann.com 294 (CLB - Mumbai)* whether CLB (now Tribunal**) is only empowered to direct to hold an AGM only when a company defaults in holding an AGM within stipulated period prescribed in law and if any meeting is held by a company within stipulated time in accordance with law, CLB (now Tribunal)** is not empowered to adjudicate validity of meeting?

The Mumbai Bench of CLB (now Tribunal)** **held** 'Yes'.

It further held that once meeting has already been held, and result of election of office bearers also has already been declared, petitioner shareholder who actually participated in meeting and contested for election, is not entitled to get such meeting declared as null and void.

Where audited accounts of respondent company for period from 2007-08 to 2014-15 had not been placed before AGM of company for its discussion and approval, NCLT, Guwahati directed the company to convene its AGM of members and shareholders to discuss audited balance sheets and financials of company for years 2007-08 to 2014-15 - *Pradip Kumar Bajaj* v. *Doloo Tea Co.(India) Ltd.* [2016] 74 taxmann.com 192 (NCLT - Guwahati)

17.2-11e REPORT ON ANNUAL GENERAL MEETING (SECTION 121)

(1) Every listed public company shall prepare in the prescribed manner a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of this Act and the rules made thereunder.

(2) The company shall file with the Registrar a copy of the report referred to in sub-section (1) within thirty days of the conclusion of the annual general

*Also *see*, Harshad J. Bakshi *v.* Choksi Tube Co. Ltd. [2015] 58 taxmann.com 141 (CLB - Mumbai)

** W.e.f. 1.6.2016

meeting with such fees as may be prescribed, or with such additional fees as may be prescribed.

(3) If the company fails to file the report under sub-section (2) before the expiry of the period specified therein, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees and every officer of the company who is in default shall be liable to a penalty which shall not be less than twenty-five thousand rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of one lakh rupees [*Sub-section (3) inserted by Companies (Amendment) Act, 2019*]

17.3 Extraordinary General Meeting (EGM)

Clause 42 of Table F (Schedule 1) provides that all general meetings other than the annual general meeting shall be called as extraordinary general meetings.

An EGM is convened for transacting some special or urgent business that may arise in between two AGMs; *for instance,* change in the objects or shift of registered office or alteration of capital or removal of a director(s)/auditor(s).

Business to be transacted - All business transacted at such meetings is called special business. Therefore, every item on the agenda must be accompanied by a 'Statement' in terms of section 102 (Discussed under AGM above).

Who may call - An EGM may be called:

(*i*) By the Board of Directors of its own accord;

(*ii*) By the Directors on requisition;

(*iii*) By the requisitionists themselves;

(*iv*) By the Tribunal.

(*i*) ***By the Directors*** - The Board of directors may call a general meeting of the members at any time by giving not less than 21 days' clear notice (Section 101). A shorter notice may, however, be held valid if consent is accorded thereto by members of the company holding 95 per cent or more of the voting rights.

An extraordinary general meeting of the company, other than of the wholly owned subsidiary of a company incorporated outside India, shall be held at a place within India[4].

(*ii*) ***By the Directors on requisition*** *[Section 100]* - The Board of directors must convene a general meeting upon request or requisition if the following conditions are satisfied:

1. (*a*) In the case of a **company having a share capital,** the requisitionists constitute such number of members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

4. Inserted by the Companies (Amendment) Act, 2017.

(*b*) in the case of a **company not having a share capital**, such number of members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

2. The requisition must state the objects of the meeting, *i.e.,* it must set out the matters for the consideration of which the meeting is to be called.

However, the requisitionists are under no obligation to attach the explanatory statement to the requisition. It is for the Board of directors, on receipt of the requisition, to include in the notice convening the meeting the necessary explanatory statement - Supreme Court in *Life Insurance Corpn. of India* v. *Escorts Ltd. AIR* 1986 SC 1370.

There is no obligation to disclose reasons for removing a person from Directorship of a company prior to EGM where such proposal is to be considered; no injunction to hold such EGM, can be granted by Court - *Jai Kumar Arya* v. *Chhaya Devi* [2017] 87 taxmann.com 69 (Delhi)

3. Requisition must have been deposited at the registered office of the company .

4. Requisition must be signed by the requisitionists .

In case all the aforesaid conditions are satisfied, *i.e.,* a valid requisition has been received, the Board of directors must within 21 days of the receipt of the requisition proceed to call the meeting on a day not later than 45 days of the receipt of the valid requisition .

(*iii*) ***By the requisitionists themselves*** - If the Board of directors does not or fails to call the meeting as aforesaid (*i.e.,* within 21 days fixing the date of the meeting within 45 days of the deposit of a valid requisition), the meeting may be called by the requisitionists themselves within 3 months of the date of the deposit of the requisition.

A meeting under sub-section (4) by the requisitionists shall be called and held in the same manner in which the meeting is called and held by the Board. However, where the registered office is not made available to them for holding the meeting, they may hold the meeting elsewhere - *R. Chettiar* vs. *M. Chettiar* [1951] 21 Comp. Cas. 93.

Explanation to Rule 17 of the Companies (Management and Administration) Rules, 2014, as amended w.e.f. 23.9.2016 has clarified that the requisitionists should convene the meeting at Registered Office or in the same city or town where Registered Office is situated and such meeting should be convened on any day except national holiday.

Can an institutional shareholder requisition an EGM - An institutional shareholder, say LIC, has the same rights as every other shareholder to requisition an extraordinary general meeting. In LIC's case, it was proposed to remove certain number of directors of the company in which LIC held shares. The institution cannot be restrained from doing so on the ground that reasons for the proposed removals had not been stated - Supreme Court in *Life Insurance Corporation of India* vs. *Escorts Ltd. AIR* 1986 SC 1370.

Expenses to be reimbursed - Any reasonable expenses incurred by the requisitionists in calling a meeting, as aforesaid, shall be reimbursed to the requisitionists by the company and the sums so paid shall be deducted from any fee or other remunera-

tion under section 197 payable to such of the directors who were in default in calling the meeting.

(*iv*) ***By the Tribunal [Section 98]***. If for any reason it is impracticable to call a meeting of the company, other than an annual general meeting, the Tribunal may direct the calling of the meeting :

(*a*) on its own motion, or

(*b*) on an application of any director, or

(*c*) on an application of any member entitled to vote at that meeting.

For invoking section 98, applicant should be either a director or member of company entitled to vote at meeting and, secondly, it should be 'impracticable' to call an EGM of the company. Unless these two conditions are satisfied, no application will lie under section 98 - *United Shippers Ltd.* vs. *Aluminium Industries Ltd.* [2007] 73 SCL 70.

For the aforesaid meeting, the Tribunal may give directions in respect of the place, date and the manner in which the meeting be held and conducted. It may also give such ancillary or consequential directions as it thinks expedient, including a direction that one member present in person or by proxy shall be deemed to constitute a meeting.

Impracticability of convening meeting by requisitionists under section 100 is a condition precedent to invoke section 98. Thus, where the directors failed or refused to call and hold an EGM against a valid requisition, the requisitionists could themselves call and hold the meeting. Instead of exercising their right under section 100 (4), as aforesaid, they cannot rush to CLB (now Tribunal) to secure an order for calling and holding EGM [*B. Mohandas vs. A.K.M.N. Cylinders (P.) Ltd.* [1998] 93 Comp. Cas. 532]

The expression 'impracticable' as used under section 98 should be interpreted in a reasonable manner and from the common sense point of view, *e.g.,* where there was only one surviving member. In *Indian Spinning Mills Ltd.* vs. *His Excellency, the King of Nepal* AIR 1953 Cal. 355, a person was appointed as a director of the company but he did not hold the qualification shares. Some directors transferred their shares to him. A group of shareholders alleged that this was invalid. *Held,* it was impracticable to hold a meeting in these circumstances.

In *Smt. Kaushalya Atmaram Manghirmalini* vs. *Hotel Hiramani (P.) Ltd.* [2000] 29 SCL 109, the Company Law Board (now Tribunal) ordered the calling of EGM on a petition of a widow of a director-promoter. In this case after the demise of the promoters as well as shareholders of the respondent-company, the respondent-company was without any director and it was not in a position to transact its normal business which could be transacted only by a duly constituted Board of Directors. An applicant, widow and the declared legal successor of one of the promoters, moved an application under section 186 [now section 98] for an order for calling an EGM of the shareholders for appointing the interim Board of Directors authorising them to register the transfer/transmission of shares of respondent-company.

CLB (now Tribunal) held that in the facts and circumstances of the case, it would be just and proper to hold the extraordinary general meeting of the company to transact the normal business of the company. It was also desirable to appoint an

independent Chairman who would consider and decide the eligibility of the persons as members/proxies to attend and vote at the meeting.

In *Sanjay Gambhir vs. D.D. Industries Limited*[5] *[2013]*, majority shareholders directly approached the CLB (now Tribunal) to call an EGM. The CLB (now Tribunal) ordered the holding of EGM under the supervision of an observer. Held that the meeting was in order.

In *VIL Ltd.* v. *Raibareilly Allahabad Highway (P.) Ltd.* [2016] 69 taxmann.com 260 (CLB - New Delhi), the Company Law Board (Now Tribunal) held that relief under section 186 (Now section 98) can be given only in a case where it is impracticable to call a meeting, say, in a situation like where shareholders' addresses and their whereabouts are not known to company. But, where shareholders are very much present and it is not impracticable to call meeting, more especially in a case where shareholders express their willingness to attend meeting, no relief can be given under section 186 (Now section 98).

Can CLB (now Tribunal) pass an order forcing any shareholder to attend an extra-ordinary general meeting?

In *Rising Finance Ltd.* v. *Allied Secin Ventures (P.) Ltd.* [2010] 101 SCL 40 (CLB-Mum.), the Mumbai Bench of CLB [Now the power vests in Tribunal] held that it had no powers to force any shareholder to attend any meeting against his will.

17.4 Class meetings

Section 48 provides that where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class may be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class—

(*a*) if provision with respect to such variation is contained in the memorandum or articles of the company; or

(*b*) in the absence of any such provision in the memorandum or articles, if such variation is not prohibited by the terms of issue of the shares of that class.

In case variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained.

Though the section as worded applies only to cases where the share capital of a company is divided into different classes of shares, there is nothing in it to prohibit the application of the principle to cases also of variation of rights where the share capital originally consisted of one class of shares and the company wanted to vary the rights and wanted to follow the procedure laid down in the section.

It may be noted that the variation referred to is variation to the prejudice of any class of shareholders, and not any variation adding to or enhancing rights of any class. It is only where a variation involves the curtailment of the rights of any class or classes of shareholders, the consent or sanction of such class or classes will be necessary.

5. Chartered Secretary, March, 2013.

A variation which merely affects the enjoyment of a right without modifying the right itself does not come within the section [*In re, Hindustan General Electric Corporation* [1959] 29 Comp. Cas. 144: AIR 1959 Cal. 679].

Rights of dissentient shareholders - If the holders of 10 per cent of the issued shares of that class who had not assented to the variation apply to the Tribunal within 21 days of the date of the consent or the passing of the special resolution, the Tribunal may, after hearing the interested parties, either confirm or cancel the variation. The company must, within 30 days of the service of the Tribunal's order, forward a copy of the order to the Registrar.

Where any default is made in complying with the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/IPC/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Explain the statutory provisions with regard to the following points in the context of an annual general meeting:

(*i*) length and contents of notice;

(*ii*) time and place of meeting; and

(*iii*) persons entitled to receive notice.

2. The company of which you are the secretary has adopted 1st April to 31st March as its financial year. The last annual general meeting of the company was held on 30-9-2013 to approve the accounts for the year 2012-13. The audit of the financial statements for the year 2013-14 has not been completed. Your directors intend to hold the annual general meeting on 30-9-2014 to transact the business other than the consideration of the financial statements for the year 2013-14 and to adjourn the meeting to a later date for the purpose of adoption of the annual accounts for 2013-14. State whether intended procedure would be in order?

3. What is the effect of failure to convene the annual general meeting ?

4. The company of which you are the secretary is not in a position to hold an annual general meeting within the stipulated time. Draft an application to be submitted to the competent authority seeking permission for extension of time to hold the meeting.

5.(*a*) What is an extraordinary general meeting?

(*b*) When and by whom an extraordinary general meeting may be called and convened?

6. What is 'explanatory statement'? When such a statement is required to be given in a notice ?

7. Draft notice for an annual general meeting of a company to transact *inter alia* the business for according authority to the Board of directors for disposal of an undertaking to the Company.

8. The shareholders at an annual general meeting unanimously passed a resolution for payment of dividend at a rate higher than that recommended by the Directors. Discuss the validity of this resolution.

9. Explain the legal position in respect of the following :

(*i*) The financial statements are not laid before the company at the annual general meeting.

(*ii*) The financial statements are not filed with the R.O.C. because the annual general meeting is not held.

10. Draft a notice of an annual general meeting of XYZ Ltd., 11, Dalapat Roy Marg, New Delhi, to transact *inter alia* the business of increasing the strength of the Board of directors to 14 by amending the Article No. 101 of the articles of association of XYZ Ltd.

11.(*a*) Explain the provisions of the Companies Act, 2013 with regard to holding of an annual general meeting by a company.

(*b*) State the business which may be transacted at the annual general meeting of a company.

(*c*) What are the powers of the Tribunal with regard to calling of an annual general meeting?

12. Distinguish between the powers of the Tribunal to call an annual general meeting and any other general meeting.

13. Advice the company on the following matters in the case of adjournment of general meeting :

(*i*) issue of fresh notice for adjourned meeting;

(*ii*) consideration of new business at the adjourned meeting;

(*iii*) members appointing fresh proxy for the adjourned meeting.

14. MR Co. Limited could not hold its first Annual General Meeting within 9 months from the close of the first financial year. The Board of Directors of the company by a resolution decide not to call first AGM at all on the ground that most of the directors were outside India on a business trip and since the company was under gestation period it would cost the company heavily.

Referring to the provisions of the Act, as Secretary of the company examine whether

(*i*) the Board of Directors decision is legally justified;

(*ii*) what course of action is open to the company if one of the members writes to the company for holding the meeting though the statutory time limit is over ?

15. XYZ Co. Ltd. called its AGM on 7th September, 2013. The notice of AGM was posted on 16th August, 2013. One member holding 20 shares wishes to challenge the resolutions passed at the AGM on the ground that the notice was not valid. Advise him.

16. Examine with reference to the relevant provisions of the Companies Act, the possibility of holding of annual general meeting of a Private Company in New Delhi when its registered office is situated in Lucknow.

17. Always Fast Ltd., held its AGM for the year 2012-13 on 9th June, 2013. The company's financial year closes on 31st March. The company held its AGM for the following year on 23rd September, 2014. Do you think that the AGM for the year 2013-14 was held within the legally prescribed time limit? Give your answer with reasons.

Hints : The gap between these two meetings exceeds 15 months and thus is in violation of section 96 of the Act unless ROC allowed time.

18. Q.E. Ltd., desires to hold its AGM quickly, but some difficulty was felt as a notice for 21 days is required. The company has 111 members. The Chairman of the company wants to know whether there is any option in the last to hold the meeting with much

shorter notice; also he wants to know whether the company can hold an EGM in place of AGM with a shorter notice. Give your views.

Hints : It is possible to hold either meeting with a shorter notice [*vide* section 101(2)]. Whether AGM or EGM, it needs the consent of at least 95% of members carrying voting rights in the meeting.

19. 'The financial statements are required to be placed only at the AGM' - Discuss by citing appropriate provisions of the Companies Act, 2013 and the applicable case laws, if any. Also, consider the consequences of inability of the company to place the aforesaid documents at the AGM within the latest day available to the company for holding the AGM.

Hints : The financial statements have to be placed only at the AGM in terms of section 129 of the Act. If ROC has granted any extension for holding the AGM or the original AGM is adjourned then also, these have to be placed in the AGM by the latest date provided by section 96. Relevant cases are *Bejoy Kumar Karnani* v. *Asstt. ROC* [88 CWN 1073]; *Subol Dutta & Sons Pvt. Ltd.* v. *Asstt. ROC* [1986] 3 Comp. LJ 73.

If not, penal provision is attracted but AGM held after the latest day will nevertheless be valid.

PRACTICAL PROBLEMS

1. State with reasons whether it is possible for the Board of Directors of a company to refuse to call the extraordinary general meeting in the following cases:

(*i*) The requisitionists have not given reasons for resolution purposed to be moved at the meeting.

(*ii*) The shareholders requisition a meeting to compel the company to withdraw its amalgamation petition pending before the court for its sanction, when the scheme has already been approved in a meeting ordered by the Court.

Hints. (*i*) *See* decision in *L.I.C.* v. *Escorts* AIR 1986 SC 1370.

Also see decision in *Queen Kuries & Loan (P.) Ltd.* v. *Sheena Jose* [1993] 76 Comp. Cas. 821.

(*ii*) See sections 230-232. Further the Madras High Court in *Re Southern Automotive Corporation Private Ltd.* [1960] 30 Comp. Cas. 119 held that court cannot dispense with the holding of the meeting under this section on the ground that the shareholders had previously, unanimously approved of the proposal.

2. M/s XYZ Company Limited was required to hold its Annual General Meeting on or before the 30th of Sept., 2014. Two of the Directors of the company, *viz.*, A and B were due for retirement on the said date but were eligible for re-appointment. The company could not hold the Annual General Meeting by the 30th of Sept., 2014 due to the delay in the finalization of accounts for the year ended on 31st March 2014. Some of the shareholders of the company question the validity of the continuance of these persons as directors. Examine the validity of the contention of the shareholders.

Hints : The contention of the shareholders is valid. In the event of default in holding the Annual General Meeting on time as per section 96, directors due for retirement are deemed to have retired from office on the last day in which meeting ought to have been held. The directors, by omitting to summon the annual general meeting, cannot take advantage of their own default and, by that means, extend their own continuance in office for any period they please and as long as the holding of the next annual general meeting does not take place. This position has been well established by the rulings of the courts both in England and India - *In re, Consolidated Nickel Mines Ltd.* (1914) 1 Ch. 883; *B.R. Kundra* v. *Motion Pictures Association* [1976] 46 Comp. Cas. 339.

3. The Annual General Meeting of XYZ Ltd., for the financial year ending 31-3-2013 was held on 27-9-2013. But since the financial statements had not been audited, it was adjourned and finally held on 31-3-2014 at which the audited financial statements were adopted. The annual general meeting for the previous year had been held on 29-6-2012. Decide whether the holding of the annual general meeting on 31-3-2014 for the year ending 31-3-2013 is valid.

Hints : The facts of the problem have been based on the case of *Bejoy Kumar Karnani* v. *Asstt. Registrar of Companies* [1985] 58 Comp. Cas. 293 wherein it was held that even adjourned annual general meeting of a company, *inter alia*, must be held within 15 months of the previous meeting. The meeting of 31-3-2014 is, therefore, not valid.

4. M/s ABC Ltd. is a big sized public company managed by a Board of Directors consisting of 12 Directors including one Managing Director and two Joint Managing Directors. Four directors represent the financial institutions, which together hold more than 50% of the equity capital of the company. The Board of Directors took certain decisions which are opposed by the directors representing the Financial Institutions as they felt that the decisions were not in the interests of the company. The financial institutions, therefore, sought to remove the Directors under section 169 of the Companies Act and served a requisition under section 100 of the Companies Act for extraordinary general meeting. The financial institutions refused to give any reasons for the removal of the directors. The company refused to convene the meeting on various grounds including that the requisition is not accompanied by a proper explanatory statement. Discuss.

Hints : The contention of the company is not valid. The facts of the problem are based on the case of *LIC* v. *Escorts Ltd.* [1986] 59 Comp. Cas. 548. In this case, it was held that every shareholder of a company including an institutional shareholder has the right, subject to the provisions of the statute, to call an extraordinary general meeting in accordance with the provisions of the Act. He cannot be restrained from calling a meeting and he is not bound to disclose the reasons for the resolution proposed to be moved at the meeting.

Regarding explanatory statement, the Court held that it was a duty cast on the management to disclose, in an explanatory note, all material facts relating to the resolution coming up before the general meeting to enable the shareholders to form a judgment on the business before them. Section 102 does not require the shareholders calling a meeting to disclose the reasons for the resolution which they propose to move at the meeting.

5. The Annual General Meeting for the years 2012 and 2013 were convened on 7-10-2014 belatedly and with great difficulty. Notices of the meetings were dated 9-9-2014 and these were published on 12-9-2014 in a newspaper at Calcutta. D, a shareholder, holding 7 shares of Rs. 10 each and a resident of Calcutta sought an injunction that the resolutions passed at the meetings be not given effect to, on the ground that the notices were received by him only on 22-9-2014. The notices were posted to him on 16-9-2014. Discuss whether D would succeed in getting the injunction.

Hints: Section 101. Notice of 21 clear days to be given, *i.e.*, 21 days exclusive of the day of the meeting and the day of the notice. Further, section 20 read along with Rules made thereunder provide that in case of notice sent by post, the same shall be deemed to be delivered on expiry of 48 hours. (*i.e.*, 2 days) from the time of its posting. Thus, notice posted on 16-9-2014 falls short of the requirements. Notice published in a newspaper is no substitute for individual notices to be sent to all those entitled under section 101. D should, therefore, succeed in getting, the injunction.

6. SCM Limited is holding more than 1/10th of the Equity Share Capital in SPL Limited. SCM Limited pledged these shares to secure its debts and a Receiver is appointed for the recovery of the debts. The shares, however, continued to be registered in the name of SCM Limited. SCM Limited deposited a requisition, requesting the company SPL Limited to call an extraordinary general meeting. The Board of directors of SPL Limited claim the SCM Limited

is not entitled to requisition the meeting. Decide giving reasons whether the requisition made by the SCM Limited is valid.

Hints: According to section 100(2) in the case of a company having share capital, the number of members entitled to requisition a meeting in regard to any matter shall be such number of them as hold at the date of the deposit of the requisition not less than 1/10th of such of the paid-up capital of the company as at that date carries the right of voting.

Thus, in terms of shareholdings, since SCM Ltd. holds more than 1/10th of the Equity Share Capital of SPL Ltd., the condition is satisfied. Pledging of shares does not affect the right of a member either to vote or convene an EGM - *Balkrishan Gupta* v. *Swadeshi Polytex Ltd.* [1985] 58 Comp. Cas. 563.

Regarding the second issue - a Receiver having been appointed for the recovery of debts and the shares being pledged to secure debts, it was held in *Balkrishan Gupta* v. *Swadeshi Polytex (supra)* that the right of members to requisition a meeting is not lost only because a receiver has been appointed in respect of their shares.

The facts in the problem seem to be based on the aforementioned case and accordingly requisition of SCM Ltd. is valid.

7. One general meeting was called by a company in December, 2012. This meeting was adjourned to March 2013 and then held. Subsequent meeting was held in February, 2014. Is the company liable for any irregularity ?

Hints: Section 96 of the Companies Act, 2013 requires a company to hold its annual general meeting every calendar year. So there should be one meeting per year and as many meetings as there are years. Thus, in the above case the meeting held in March 2013 is actually the meeting of December 2012. Since, next meeting is held only in February 2014, the meeting of 2013 has been missed. Under these circumstances, unless permission of the Registrar was obtained for extension of time which may be granted upto a period of 3 months under certain special circumstances, the company shall be proceeded against.

In fact, the facts of the given problem are based upon the decided case of *Shree Meenakshi Mills Co. Ltd.* v. *Assistant Registrar of Joint Stock Companies* in which case similar decision was given.

18 Company Meetings-III - Board Meetings

18.1 Need for Board Meetings

A company, subject to the specific requirements of the Companies Act, any provision in the articles of association and subject to any resolution that may be passed by the company in general meeting, has to act through its Board of directors. The Board can only act by taking decisions collectively through passing resolutions made in the meetings of the Board except where the Act permits the resolution to be passed by circulation among the directors.

The decision of a Board meeting will not be considered valid unless it is properly convened and duly constituted. The Board meeting must, therefore, be convened by proper authority, by a proper notice, the proper person must be in chair and the requisite quorum must be present.

The rules regarding the holding and conduct of Board meetings are laid down by the Act and the Articles.

18.2 When to hold

18.2-1 First Meeting

According to section 173(1), every company shall hold the first meeting of the Board of Directors within thirty days of the date of its incorporation.

18.2-2 Subsequent Meetings

As per section 173(1) read along with SS-1* provides that every company must hold a minimum number of four meetings of its Board of Directors every year and the gap between two Board meetings must not be more than one hundred and twenty days**.

However, the Central Government may, by notification, exempt any class or description of companies from the aforesaid provision or make the provision

*SS-1 is the mandatory secretarial standard on meetings of the B.O.D. issued on 23 April, 2015. SS-1 shall come into effect from 1-7-2015.

**A section 8 company needs to hold at least two meetings, one in every six months—*Vide MCA Notification dated 5-6-2015.*

applicable subject to such exceptions, modifications or conditions as may be specified in the notification. [Section 173(1)]

A One Person Company, small company and dormant company shall be deemed to have complied with the provisions of this section if at least one meeting of the Board of Directors has been conducted in each half of a calendar year and the gap between the two meetings is not less than ninety days. Also the requirement as to quorum, as set out in section 174, shall not apply to One Person Company in which there is only one director on its Board of Directors [Section 173(5)].

18.3 Participation of directors through video conferencing or other audio visual means [Section 173(2)]

The participation of directors in a meeting of the Board may be either in person or through video conferencing or other audio visual means, as may be prescribed[1], which are capable of recording and recognising the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

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1. **As per Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014, as amended on 14th August, 2014,** a company shall comply with the following procedure, for convening and conducting the Board meetings through video conferencing or other audio visual means:
   (1) Every Company shall make necessary arrangements to avoid failure of video or audio visual connection.
   (2) The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care - (a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures; (b) to ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting; (c) to record proceedings and prepare the minutes of the meeting; (d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year; (e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and (f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting. However, the persons, who are differently abled, may make request to the Board to allow a person to accompany him.
   (3) (a) The notice of the meeting shall be sent to all the directors in accordance with the provisions of sub-section (3) of section 173 of the Act; (b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio visual means; (c) A director intending to participate through video conferencing or audio visual means shall communicate his intention to the Chairperson or the company secretary of the company; (d) If the director intends to participate through video conferencing or other audio visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangements in this behalf; (e) The director, who desire, to participate may intimate his intention of participation through the electronic mode at the beginning of the calendar year and such declaration shall be valid for one calendar year; (f) In the absence of any intimation under clause (c), it shall be assumed that the director shall attend the meeting in person.

(Contd. on p. 610)

(Contd. from p. 609)

(4) At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio visual means shall state, for the record, the following namely:- (a) name; (b) the location from where he is participating; (c) that he has received the agenda and all the relevant material for the meeting; and (d) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in clause (b).

(5) (*a*) After the roll call, the Chairperson or the Company Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairperson and confirm that the required quorum is complete.

Explanation.- A director participating in a meeting through video conferencing or other audio visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the rules.

(*b*) The Chairperson shall ensure that the required quorum is present throughout the meeting.

(6) With respect to every meeting conducted through video conferencing or other audio visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

(7) The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode, if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

(8) (*a*) Every participant shall identify himself for the record before speaking on any item of business on the agenda; (b) If a statement of a director in the meeting through video conferencing or other audio visual means is interrupted or garbled, the Chairperson or Company Secretary shall request for a repeat or reiteration by the Director.

(9) If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.

(10) From the commencement of the meeting and until the conclusion of such meeting, no person other than the Chairperson, Directors, Company Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

(11) (*a*) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, who dissented from the decision taken by majority; (b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio visual means.

(12) (*a*) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board; (b) Every director who attended the meeting, whether personally or through video conferencing or other audio visual means, shall confirm or give his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed; (c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

Explanation.- For the purposes of this rule, "video conferencing or other audio visual means" means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

The Central Government may, by notification, specify such matters[2] which shall not be dealt with in a meeting through video conferencing or other audio visual means.

However, where there is quorum in a meeting through physical presence of directors, any other director may participate through video conferencing or other audio visual means in such meeting on any matter so specified by the Central Government.

SS- 1, in this regard, provides that Directors participating through Electronic Mode in a Meeting shall be counted for the purpose of Quorum, unless they are to be excluded for any items of business under the provisions of the Act or any other law.

Any Director participating through Electronic Mode in respect of restricted items with the express permission of Chairman shall, however, neither be entitled to vote nor be counted for the purpose of Quorum in respect of such restricted items.

Query: Can participation of a director in a Meeting telephonically or Meeting through teleconferencing be considered as participation of a director through Electronic mode or Meetings through Electronic mode?

Ans: ICSI, in this regard, has clarified that "Video conferencing or other audio-visual" means audio-visual electronic facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting. Thus, participation of a director in a meeting telephonically or Meetings through teleconferencing cannot be considered as participation of a director through Electronic mode or Meeting through Electronic mode.

Case Law : *Rupak Gupta* v. *U.P. Hotels Ltd.* [2016] 71 taxmann.com 158 (NCLT-New Delhi)

Facts of the Case : Applicant and his mother were the directors of the company. They wanted to attend the board meeting through video-conferencing as they were going outside India. Further, they requested to participate in Board Meeting through electronic mode. As per Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014, any director who desires, to participate may express his intention of participation through the electronic mode at the beginning of the calendar year[3]. On the date of Board Meeting, Joint

2. **Vide Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014, as amended on 14th August, 2014,** the Central Government has prescribed that the following matters shall not be dealt with in any meeting held through video conferencing or other audio visual means.- (i) the approval of the annual financial statements; (ii) the approval of the Board's report; (iii) the approval of the prospectus; (iv) the Audit Committee meetings for consideration of financial statement including consolidated financial statement, if any, to be approved by the Board under sub-section (1) of section 134 of the Act; and (v) the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

3. Again, Rule 3, as amended vide *the Companies (Meetings of Board and its Powers) Second Amendment Rules, 2017 (MCA Notification dated 13th July, 2017), provides that a* director who intends to participate in the meeting through electronic mode may intimate about such participation at the beginning of the calendar year and such declaration shall be valid for one year.

   However, such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person.

Managing Director denied appellants permission for participating in Board meeting through video-conferencing by stating that appellants were not permitted to participate in board meeting through electronic mode without intimation at the beginning of the year and that it would be violation of Rule 3.

Decision : The National Company Law Tribunal held that Rule 3 provides that if intimation is given at the beginning of the calendar year, such declaration shall be valid for one calendar year. It is not said anywhere that if intimation is not given at the beginning of the year, video-conferencing is not to be provided in that calendar year. Therefore, it does not mean that the directors are not entitled to video-conferencing if intimation is not given at the beginning of the calendar year; therefore, the appellants were entitled to participate in video conferencing even if intimation was not given at the beginning of the calendar year.

Case Law : *Achintya Kumar Barua alias Manju Baruah* v. *Ranjit Barthkur* [2018] 91 taxmann.com 123 (NCL-AT)

Facts of the Case : Tribunal allowed application of respondent director seeking facility of attending board meeting through video-conferencing. Appellant director raised an apprehension that it would not be possible to ensure that no person other than concerned director was attending said meeting. According to appellant, Secretarial Standards on Meetings of Board of Directors have prescribed that such option under provisions of 2013 Act and Rules should be resorted to only when facilities were provided by Company to its Directors.

Decision : The National Company Law Appellate Tribunal held that in instant case company had all necessary infrastructure available for conducting meeting through video-conferencing and therefore to follow provisions of section 173 would be in interest of Companies as well as directors and it would not be appropriate to shut-out these provisions on mere apprehensions.

18.4 Board meeting

18.4-1 Notice of Board Meeting [Section 173]

SS-1 requires every meeting of the Board to be serially numbered.

A meeting of the Board shall be called **by giving not less than seven days' notice in writing** to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

SS – 1, in this regard, provides that the notice in writing of every Meeting shall be given to every Director by hand or by speed post or by registered post or by courier or by facsimile (fax) or by e-mail or by any other electronic means [Section 173(3)].

The Notice shall be sent to the postal address or e-mail address, registered by the Director with the company or in the absence of such details or any change thereto, any of such addresses appearing in the Director Identification Number (DIN) registration of the Director.

Where a Director specifies a particular means of delivery of Notice, the Notice shall be given to him by such means.

Proof of sending Notice and its delivery shall be maintained by the company.

SS-1 further provides that the notice shall be sent even if meetings are held on predetermined dates or predetermined intervals. Again, where notice is sent by speed post or by registered post or by courier, an additional two days shall be added for the service of the notice.

A meeting of the Board may be called at **shorter notice to transact urgent business** subject to the condition that at least one independent director, if any, shall be present at the meeting.

In case independent directors are absent from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any [Sub-section (3)].

If independent director was not present and he disapproves or abstains from ratifying the Minutes, the decision of the Board fails. The company cannot, therefore, implement such decision taken at the Board meeting until it is ratified by at least one independent director.

Penalty: Every officer of the company whose duty is to give notice under this section and who fails to do so shall be liable to a penalty of twenty-five thousand rupees [Sub-section (4)].

18.4-2 Proper authority to call meeting of Board of Directors

It must be ensured that the notice for the Board meeting is issued on proper authority. Regulation 67(ii) of Table F provides that a director may, and the manager or secretary, on the requisition of director, shall, at any time, summon a meeting of the Board.

As per SS-1, any Director of a company may, at any time, summon a Meeting of the Board, and the Company Secretary or where there is no Company Secretary, any person authorised by the Board in this behalf, on the requisition of a Director, shall convene a Meeting of the Board, in consultation with the Chairman or in his absence, the Managing Director or in his absence, the Whole-time Director, where there is any, unless otherwise provided in the Articles.

Can a director send an oral requisition to the Company Secretary to convene a Board Meeting?

ICSI has opined that a requisition by a director to convene a Board Meeting should be in writing. However, if the requisition, so received. Is not in writing, it should be put in writing by the Company Secretary and the same should be placed before the Chairman/Managing Director/Whole-time Director, as the case may be, with a copy to the director concerned who requisitions the meeting.

18.4-3 Notice - Whom to be given

The notice of the Board meeting must be given to every director. If a director is improperly or accidentally excluded from a meeting of the Board, he may sue for declaration of the entire proceedings of the meeting as invalid. Besides, section 173 (4) provides that the officer whose duty was to give the notice shall be liable to a

penalty of twenty-five thousand rupees. However, if no notice is given as required, but all the directors are either present or those who are absent do not complain about non-service of notice, then the proceedings of the meeting will not be invalid - *Bharat Fire & General Insurance Co. Ltd.* v. *P.P. Gupta* AIR 1968 Delhi 68.

18.4-4 Notice to interested directors

Notice must be given to a director even though he is precluded from voting at the meeting on the business to be transacted - *John Shaw & Sons (Salford) Ltd.* v. *Peter Shaw & John Shaw* [1935] 2 KB 113.

18.4-5 Notice of adjourned meeting

The Act does not provide for notice of adjourned meeting. Notice of adjournment of a meeting need not be given unless the Articles of Association otherwise provide - *Promod Kumar Mittal* v. *Southern Steel Ltd.* [1980] 50 Comp. Cas. 555. Since the adjournment is only a continuation of a meeting, the notice for the first meeting holds good for all the adjournments - *Kerr* v. *Wilkie* [1860] 1 LT 501. If, however, the meeting is adjourned *sine die,* a fresh notice must be given. No new business can be introduced unless notice of such new business is given - *R.* v. *Grimshaw* [1847] 10 QBD 747.

Secretarial Standard -1 of ICSI*, in this regard, provides as follows :

Notice of an adjourned Meeting shall be given to all Directors including those who did not attend the Meeting on the originally convened date. Notice thereof shall, like the original meeting, also be given not less than seven days before the Meeting. This will be so, even where the date of the meeting is decided at the original meeting itself.

18.5 Contents and Agenda of Board Meeting

SS-1 issued by the ICSI, including the clarification issued[4], in this regard, provides as follows:

1. The Agenda, setting out the business to be transacted at the Meeting, and Notes on Agenda shall be given to the Directors at least seven days before the date of the Meeting, unless the Articles prescribe a longer period.
2. Agenda and Notes on Agenda shall be sent to all Directors by hand or by speed post or by registered post or by courier or by e-mail or by any other electronic means. These shall be sent to the postal address or email address or any other electronic address registered by the Director with the company or in the absence of such details or any change thereto, to any of such addresses appearing in the Director Identification Number (DIN) registration of the Directors.
3. In case the company sends the Agenda and Notes on Agenda by speed post or by registered post or by courier, an additional two days shall be added for the service of Agenda and Notes on Agenda.
4. Where a Director specifies a particular means of delivery of Agenda and Notes on Agenda, these papers shall be sent to him by such means.

*Updated as on 26-8-2015.

4. Press Release dated 21.7.2015 (updated as on 26.8.2015)

5. Proof of sending Agenda and Notes on Agenda and their delivery shall be maintained by the company for as long as they remain current or for eight financial years, whichever is later. These may be maintained and preserved in soft form.
6. The Notice, Agenda and Notes on Agenda shall be sent to the Original Director also at the address registered with the company, even if these have been sent to the Alternate Director.
7. Notes on items of business which are in the nature of Unpublished Price Sensitive Information[5] may be given at a shorter period of time than stated above, with the consent of a majority of the Directors, which shall include at least one Independent Director, if any.
8. General consent for giving Notes on items of Agenda which are in the nature of Unpublished Price Sensitive Information at a shorter Notice may be taken in the first Meeting of the Board held in each financial year and also whenever there is any change in Directors.
9. Where general consent as above has not been taken, the requisite consent shall be taken before the concerned items are taken up for consideration at the Meeting. The fact of consent having been taken shall be recorded in the Minutes.
10. Supplementary Notes on any of the Agenda Items may be circulated at or prior to the Meeting but shall be taken up with the permission of the Chairman and with the consent of a majority of the Directors present in the Meeting, which shall include at least one Independent Director, if any. In case, there is no independent director or no independent director is present at the meeting, Supplementary Notes on any of the Agenda Items may be taken up with the consent of a majority of the Directors present in the Meeting.

Even if there is no specific agenda under the miscellaneous items, 'with the permission of the chairman', any other business may be transacted - *Kashinath Tapuriah* v. *Incab Industries Ltd.* [1995] 6 SCL 201 (Cal.).

18.6 Time and place of Board meeting

The notice must state the date, time and place of the meeting. Unlike the provisions of the Act regarding annual general meeting, there is no provision in the Act specifying that Board meetings must be general at the registered office of the

5. "unpublished price sensitive information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following:–
   (*i*) financial results;
   (*ii*) dividends;
   (*iii*) change in capital structure;
   (*iv*) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions;
   (*v*) changes in key managerial personnel; and
   (*vi*) material events in accordance with the listing agreement.

company or between business hours, namely 9 A.M. to 6 P.M. Thus, Board meetings may be held at any place and outside the business hours according to the convenience of the directors.

SS – 1, however, provides that a Meeting may be convened at any time and place, on any day, excluding a National Holiday. *"National Holiday"* includes Republic Day i.e. 26th January, Independence Day i.e. 15th August, Gandhi Jayanti i.e. 2nd October and such other day as may be declared as National Holiday by the Central Government.

Notice of the Meeting, wherein the facility of participation through Electronic Mode is provided, shall clearly mention a venue, whether registered office or otherwise, to be the venue of the Meeting and it shall be the place where all the recordings of the proceedings at the Meeting would be made.

A Meeting adjourned for want of Quorum shall also not be held on a National Holiday.

18.7 Quorum

According to section 174(1), the quorum for a meeting of the Board of directors shall be 1/3rd of its total strength (any fraction contained in that 1/3rd to be rounded off to one) or two directors, whichever is higher*. "Total strength" *shall not include* directors whose places are vacant - Explanation (ii). Again, interested director(s) shall not be counted for the purposes of quorum. "Interested director" means a director within the meaning of sub-section (*2*) of section 184[6].

The participation of the directors by video conferencing or by other audio visual means shall also be counted for the purposes of quorum.

Can Articles fix a higher quorum? In *Amrit Kaur Puri* v. *Kapurthala Flour Oil & General Mills Co. (P.) Ltd.* [1984] 56 Comp. Cas. 194 (P&H), Punjab and Haryana High Court held 'yes', articles can fix higher quorum, they cannot, however, fix a lower number.

Secretarial Standard -1 of ICSI is in agreement with the aforesaid decision of the Punjab and Haryana High Court.

Effect of vacancy in the Board: The continuing directors may act notwithstanding any vacancy in the Board; but, if and so long as their number is reduced below the quorum fixed by the Act for a meeting of the Board, the continuing directors or

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*In case of a section 8 company, the quorum shall be 8 members or 25% of the total strength of the Board, whichever is less. However, it cannot be less than 2—*Vide MCA Notification dated 5-6-2015.*

6. Sub-section (2) of section 184 reads: Every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—
   (*a*) with a body corporate in which such director or such director in association with any other director, holds more than two per cent shareholding of that body corporate, or is a promoter, manager, Chief Executive Officer of that body corporate; or
   (*b*) with a firm or other entity in which, such director is a partner, owner or member, as the case may be,
   shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting.

director may act for the purpose of increasing the number of directors to that fixed for the quorum, or of summoning a general meeting of the company and for no other purpose [Section 174(2)].

Interested directors: If, at any time, the number of interested directors exceed or is equal to 2/3rd of the total strength, the remaining directors, that is to say, the number of directors who are not interested, present at the meeting, being not less than two, shall be the quorum of such meeting [Section 174(3)].

For determination of quorum, recourse shall be had to the total strength of the Board rather than the full proposed strength as per the Articles. Thus, where the company had total strength of 6 directors though there was a provision for appointment of 15 directors and articles provided that 1/3rd of total number of directors shall form quorum, presence of 2 directors constituted a valid quorum - *Pradip Kumar Banerjee* v. *Union of India* [2001] 32 SCL 84 (Cal.).

SS-1, in this respect, provides that the Quorum shall be present throughout the Meeting.

It must be present not only at the time of commencement of the Meeting but also while transacting business.

Further, a Director shall not be reckoned for Quorum in respect of an item in which he is interested and he shall not be present, whether physically or through Electronic Mode, during discussions and voting on such item.

For this purpose, a Director shall be treated as interested in a contract or arrangement entered into or proposed to be entered into by the company:

(*a*) with the Director himself or his relative; or

(*b*) with any body corporate, if such Director, along with other Directors holds more than two per cent of the paid-up share capital of that body corporate, or he is a promoter, or manager or chief executive officer of that body corporate; or

(*c*) with a firm or other entity, if such Director or his relative is a partner, owner or Member, as the case may be, of that firm or other entity

18.8 Adjournment for want of quorum

Adjournment of the meeting – where quorum is present

SS – 1 provides that the Chairman may, unless dissented to or objected by the majority of Directors present at a Meeting at which a Quorum is present, adjourn the Meeting for any reason, at any stage of the Meeting.

If a meeting of the Board could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a national holiday, at the same time and place [Section 174(4)].

The provision of section 174 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that section could not be held for want of a quorum.

18.9 Passing of Resolutions by Circulation [Section 175]

At times it may not be possible to organise and hold a Board's/Committee of the Board's meeting or an urgent decision may be required or to save on the expenses in holding a Board's/Committee's meeting, a resolution(s) may be got passed by circulating the same among the directors/members of the Committee. A resolution passed by circulation to be valid must satisfy the provisions of section 175. Section 175, in this regard, provides as follows :

No resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation, unless:

(*i*) The resolution has been circulated in draft, together with the necessary papers, if any, to all the directors, or members of the committee, as the case may be, at their addresses registered with the company in India by hand delivery or by post or by courier, or through such electronic means as may be prescribed; and

(*ii*) has been approved by a majority of the directors or members, who are entitled to vote on the resolution.

However, where not less than one-third of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board [Sub-section (1)].

Query: In case of a proposed resolution by circulation, out of 12 directors, 7 voted in favour and 4 wanted the same to be passed in the Meeting. What would be the outcome of the resolution which has already been approved by the majority?

Ans: The answer provided by ICSI, *vide* its Press Release dated 21.7.2015 (updated as on 26.8.2015), is as follows:

> *"Proviso to section 175 provides that if not less than 1/3*rd *of the total number of directors of the company require that any resolution under circulation be decided at a meeting instead of by circulation, the Chairman shall put such resolution to be decided at a Meeting of the Board.*
>
> *Even though the majority of has voted in favour of this resolution, it cannot be treated as passed since 1/3*rd *of the directors have asked for the same to be taken up at a meeting and therefore, should be decided at a meeting."*

A resolution under sub-section (*1*) shall be noted at a subsequent meeting of the Board or the committee thereof, as the case may be, and made part of the minutes of such meeting [Sub-section (2)].

Annexure I to SS- 1 has given the following Illustrative list of items of business which shall NOT be passed by circulation and shall be placed before the Board at its Meeting.

General Business Items

Noting Minutes of Meetings of Audit Committee and other Committees. Approving financial statements and the Board's Report. Considering the Compliance Certificate to ensure compliance with the provisions of all the laws applicable to the company. Specifying list of laws applicable specifically to the company. Appointment of Secretarial Auditors and Internal Auditors.

Specific Items

Borrowing money otherwise than by issue of debentures. Investing the funds of the company. Granting loans or giving guarantee or providing security in respect of loans. Making political contributions. Making calls on shareholders in respect of money unpaid on their shares. Approving Remuneration of Managing Director, Whole-time Director and Manager . Appointment or Removal of Key Managerial Personnel. Appointment of a person as a Managing Director/Manager in more than one company. According to sanction for related party transactions which are not in the ordinary course of business or which are not on arm's length basis. Purchase and Sale of subsidiaries/assets which are not in the normal course of business. Approve Payment to Director for loss of office. Items arising out of separate meeting of the Independent Directors if so decided by the Independent Directors.

Corporate Actions

Authorise Buy Back of securities Issue of securities, including debentures, whether in or outside India. Approving amalgamation, merger or reconstruction. Diversify the business. Takeover another company or acquiring controlling or substantial stake in another company.

Additional list of items in case of listed companies

Approving Annual operating plans and budgets. Capital budgets and any updates. Information on remuneration of KMP. Show cause, demand, prosecution notices and penalty notices which are materially important. Fatal or serious accidents, dangerous occurrences, any material effluent or pollution problems. Any material default in financial obligations to and by the company, or substantial non-payment for goods sold by the company. Any issue, which involves possible public or product liability claims of substantial nature, including any judgment or order which, may have passed strictures on the conduct of the company or taken an adverse view regarding another enterprise that can have negative implications on the company. Details of any joint venture or collaboration agreement. Transactions that involve substantial payment towards goodwill, brand equity, or intellectual property. Significant labour problems and their proposed solutions. Any significant development in Human Resources/Industrial Relations front like signing of wage agreement, implementation of Voluntary Retirement Scheme etc. Quarterly details of foreign exchange exposures and the steps taken by management to limit the risks of adverse exchange rate movement, if material. Non-compliance of any regulatory, statutory or listing requirements and shareholder services such as non-payment of dividend, delay in share transfer etc.

18.10 Minutes of the Board meeting[7]

Section 118 contains provisions with respect to minutes of every meeting of Board of Directors or of every committee of the Board. In this regard, it provides as follows:

(*1*) Every company shall cause minutes of the proceedings of every meeting of its Board of Directors or of every committee of the Board, to be prepared and signed in such manner as may be prescribed.

7. Also see discussion under 'Registers and Returns'.

(2) SS-1 requires that minutes of the Board meeting shall be kept at the Registered office of the company or at such place as may be approved by the Board. The minutes shall be kept within thirty days of the conclusion of every such meeting.

(3) The minutes shall be kept in books kept for that purpose with their pages consecutively numbered.

(*4*) The minutes of each meeting shall contain a fair and correct summary of the proceedings thereat.

(*5*) All appointments made at any of the meetings aforesaid shall be included in the minutes of the meeting.

(*6*) The minutes shall also contain—

(*a*) the names of the directors present at the meeting; and

(*b*) in the case of each resolution passed at the meeting, the names of the directors, if any, dissenting from, or not concurring with the resolution.

(*7*) There shall not be included in the minutes, any matter which, in the opinion of the Chairman of the meeting,—

(*a*) is or could reasonably be regarded as defamatory of any person; or

(*b*) is irrelevant or immaterial to the proceedings; or

(*c*) is detrimental to the interests of the company.

(*8*) The Chairman shall exercise absolute discretion in regard to the inclusion or non-inclusion of any matter in the minutes on the grounds specified in (*7*) above.

(*9*) The minutes kept in accordance with the provisions of this section shall be evidence of the proceedings recorded therein.

(*10*) Where the minutes have been kept, as above then, until the contrary is proved, the meeting shall be deemed to have been duly called and held, and all proceedings thereat to have duly taken place, and in particular, all appointments of directors, key managerial personnel, etc. shall be deemed to be valid.

(*11*) Every company shall observe secretarial standards with respect to Board meetings specified by the Institute of Company Secretaries of India and approved as such by the Central Government.

(*12*) If any default is made in complying with the provisions of this section in respect of any meeting, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

(*13*) If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

SS-1 contains very elaborate requirements with respect to minutes of the Board meetings. It, *inter alia*, provides as follows:

1. Minutes shall be recorded in books maintained for that purpose.

2. A distinct Minutes Book shall be maintained for Meetings of the Board and each of its Committees.

3. Minutes may be maintained in electronic form in such manner as prescribed under the Act and as may be decided by the Board. Minutes in electronic form shall be maintained with Timestamp. "Timestamp" means the current time of an event that is recorded by a Secured Computer System and is used to describe the time that is printed to a file or other location to help keep track of when data is added, removed, sent or received.

Every company shall however follow a uniform and consistent form of maintaining the Minutes. Any deviation in such form of maintenance shall be authorised by the Board.

4. The pages of the Minutes Books shall be consecutively numbered.

This shall be followed irrespective of a break in the Book arising out of periodical binding in case the Minutes are maintained in physical form. This shall be equally applicable for maintenance of Minutes Book in electronic form with Timestamp.

In the event any page or part thereof in the Minutes Book is left blank, it shall be scored out and initialled by the Chairman who signs the Minutes.

5. Minutes shall not be pasted or attached to the Minutes Book, or tampered with in any manner.

6. Minutes of the Board Meetings, if maintained in loose-leaf form, shall be bound periodically depending on the size and volume and coinciding with one or more financial years of the company.

There shall be a proper locking device to ensure security and proper control to prevent removal or manipulation of the loose leaves.

7. Minutes of the Board Meeting shall be kept at the Registered Office of the company or at such other place as may be approved by the Board.

8. Contents of Minutes

A. General Contents

1. Minutes shall state, at the beginning the serial number and type of the Meeting, name of the company, day, date, venue and time of commencement and conclusion of the Meeting.

In case a Meeting is adjourned, the Minutes shall be entered in respect of the original Meeting as well as the adjourned Meeting. In respect of a Meeting convened but adjourned for want of quorum, a statement to that effect shall be recorded by the Chairman or any Director present at the Meeting in the Minutes.

2. Minutes shall record the names of the Directors present physically or through Electronic Mode, the Company Secretary who is in attendance at the Meeting and Invitees, if any, including Invitees for specific items.

The names of the Directors shall be listed in alphabetical order or in any other logical manner, but in either case starting with the name of the person in the Chair.

The capacity in which an Invitee attends the Meeting and where applicable, the name of the entity such Invitee represents and the relation, if any, of that entity to the company shall also be recorded.

3. Minutes shall contain a record of all appointments made at the Meeting.

B. Specific Contents

Minutes shall *inter-alia* contain:

(*a*) Record of election, if any, of the Chairman of the Meeting.

(*b*) Record of presence of Quorum.

(*c*) The names of Directors who sought and were granted leave of absence.

(*d*) The mode of attendance of every Director whether physically or through Electronic Mode.

(*e*) In case of a Director participating through Electronic Mode, his particulars, the location from where and the Agenda items in which he participated.

(*f*) The name of Company Secretary who is in attendance and Invitees, if any, for specific items and mode of their attendance if through Electronic Mode.

(*g*) Noting of the Minutes of the preceding Meeting.

(*h*) Noting the Minutes of the Meetings of the Committees.

(*i*) The text of the Resolution(s) passed by circulation since the last Meeting, including dissent or abstention, if any.

(*j*) The fact that an Interested Director was not present during the discussion and did not vote.

(*k*) The views of the Directors particularly the Independent Director, if specifically insisted upon by such Directors, provided these, in the opinion of the Chairman, are not defamatory of any person, not irrelevant or immaterial to the proceedings or not detrimental to the interests of the company.

(*l*) If any Director has participated only for a part of the Meeting, the Agenda items in which he did not participate.

(*m*) The fact of the dissent and the name of the Director who dissented from the Resolution or abstained from voting thereon.

(*n*) Ratification by Independent Director or majority of Directors, as the case may be, in case of Meetings held at a shorter Notice and the transacting of any item other than those included in the Agenda.

(*o*) The time of commencement and conclusion of the Meeting.

9. Apart from the Resolution or the decision, Minutes shall mention the brief background of all proposals and summarise the deliberations thereof. In case of major decisions, the rationale thereof shall also be mentioned.

10. Recording of Minutes

a. Minutes shall contain a fair and correct summary of the proceedings of the Meeting.

The Company Secretary shall record the proceedings of the Meetings. Where there is no Company Secretary, any other person duly authorised by the Board or by the Chairman in this behalf shall record the proceedings.

The Chairman shall ensure that the proceedings of the Meeting are correctly recorded.

The Chairman has absolute discretion to exclude from the Minutes, matters which in his opinion are or could reasonably be regarded as defamatory of any person, irrelevant or immaterial to the proceedings or which are detrimental to the interests of the company.

b. Minutes shall be written in clear, concise and plain language.

Minutes shall be written in third person and past tense. Resolutions shall however be written in present tense.

Minutes need not be an exact transcript of the proceedings at the Meeting.

In case any Director requires his views or opinion on a particular item to be recorded verbatim in the Minutes, the decision of the Chairman whether or not to do so shall be final.

c. Any document, report or notes placed before the Board and referred to in the Minutes shall be identified by initialling of such document, report or notes by the Company Secretary or the Chairman.

Wherever any approval of the Board is taken on the basis of certain papers laid before the Board, proper identification shall be made by initialling of such papers by the Company Secretary or the Chairman and a reference thereto shall be made in the Minutes.

d. Where any earlier Resolution(s) or decision is superseded or modified, Minutes shall contain a reference to such earlier Resolution(s) or decision.

e. Minutes of the preceding Meeting shall be noted at a Meeting of the Board held immediately following the date of entry of such Minutes in the Minutes Book.

Minutes of the Meetings of any Committee shall be noted at a Meeting of the Board held immediately following the date of entry of such Minutes in the Minutes Book.

11. Finalisation of Minutes

Within fifteen days from the date of the conclusion of the Meeting of the Board or the Committee, the draft Minutes thereof shall be circulated by hand or by speed post or by registered post or by courier or by e-mail or by any other recognised electronic means to all the members of the Board or the Committee for their comments.

Where a Director specifies a particular means of delivery of draft Minutes, these shall be sent to him by such means.

If the draft Minutes are sent by speed post or by registered post or by courier, an additional two days may be added for delivery of the draft Minutes.

Proof of sending draft Minutes and its delivery shall be maintained by the company.

The Directors, whether present at the Meeting or not, shall communicate their comments, if any, in writing on the draft Minutes within seven days from the date

of circulation thereof, so that the Minutes are finalised and entered in the Minutes Book within the specified time limit of thirty days.

If any Director communicates his comments after the expiry of the said period of seven days, the Chairman shall have the discretion to consider such comments.

In the event a Director does not comment on the draft Minutes, the draft Minutes shall be deemed to have been approved by such Director.

A Director, who ceases to be a Director after a Meeting of the Board is entitled to receive the draft Minutes of that particular Meeting and to offer comments thereon, irrespective of whether he attended such Meeting or not.

12. Signing and Dating of Minutes

Minutes of the Meeting of the Board shall be signed and dated by the Chairman of the Meeting or by the Chairman of the next Meeting.

The Chairman shall initial each page of the Minutes, sign the last page and append to such signature the date on which and the place where he has signed the Minutes.

Minutes, once signed by the Chairman, shall not be altered, save as mentioned in this Standard.

13. Who should certify the copy of the signed minutes before it is circulated to the directors?

A copy of the signed Minutes certified by the Company Secretary or where there is no Company Secretary, by any Director authorised by the Board shall be circulated to all Directors within fifteen days after these are signed.

18.11 Duties of company secretary with respect to Board Meetings

The secretary plays an important role in the holding of Board meetings. As the principal officer of the company, he must ensure that every Board meeting is properly convened and duly constituted and that the provisions of the Act, Articles and standing orders are complied with in the conduct of these meetings. The principal duties of the secretary relating to Board meetings may be outlined as follows :

18.11-1 Before the meeting

(1) If the date, time and place of the Board meeting has not been fixed by the preceding meeting, to fix the same in consultation with the Chairman of the Board.

(2) To prepare the agenda in consultation with the Chairman or as directed by the authority convening Board meeting. In the absence of such provision, to prepare and issue notice of the meeting as per directions of the chairman or the Board. Also to ensure that the length of the notice is as per Articles.

(3) To send notice of the meeting along with the agenda to all directors in India and to the usual address in India of all directors not in India.

(4) To receive resolutions from directors proposed to be discussed at the meeting and circulate them among other directors.

(5) To issue invitation letters to solicitors, auditors, etc., who are required to attend the meeting by special invitation.

(6) To prepare and keep in readiness statements and reports regarding the company's trading activities, documents including cheques, contracts, transfer instruments, etc., for sealing and signatures, and other materials likely to be required at the meeting.

(7) To keep ready the Bank pass book and certificate of balances, the Minutes Book of Board Meetings, indexed copies of Memorandum and Articles, the company's seal, etc.

(8) To arrange for the seating arrangement, stationery any other equipment necessary for holding the meeting.

18.11-2 During the meeting

(1) To obtain signatures of the directors present in the Directors' attendance Book.

(2) To help the Chairman by ascertaining whether quorum is present or not as per Articles.

(3) To read the notice of the meeting if required or if requested by the chairman.

(4) To read the Minutes of the last Board meeting if requested by the chairman and to obtain the signature of the Chairman to the minutes when it is approved by the meeting.

(5) To assist the Chairman in conducting the meeting including taking of votes.

(6) To supply necessary information and explanations to the directors when required.

(7) To take notes of the proceedings including exact terms of the resolutions passed.

18.11-3 After the meeting

(1) To prepare the minutes from his own and chairman's agenda notes and enter the same in the Minutes Book within 30 days of the meeting.

(2) To circulate the minutes amongst the directors.

(3) In case of a Board meeting held to approve the draft profit and loss account and balance sheet, appropriation suggested by the Board, etc., to allow inspection of the draft by the auditors.

(4) Where some agreement has been approved, to arrange for the sealing of the agreement with the Common Seal, after entering the same in the Seal Book.

(5) To carry out the instructions issued to him by the Board meeting and to carry out the statutory duties specifically imposed on him.

(6) To start collecting and preparing materials for the next Board meeting.

18.12 Chairman of Board Meetings

SS-1, in this regard, provides that every company should have a chairman who would be the chairman for meetings of the Board.

Further, it provides that it would be the duty of the Chairman to see that the meeting is duly convened and constituted in accordance with the Act or any other applicable guidelines, rules and regulations before it proceeds to transact business. The Chairman should then conduct the proceedings of the meeting and ensure that only those items of business as have been set out in the Agenda are transacted and generally in the order in which the items appear on the Agenda. The Chairman should encourage deliberations and debate and assess the sense of the meeting. The Chairman should ensure that the proceedings of the meeting are correctly recorded and, in doing so, he may include or exclude any matter as he deems fit.

In the case of a public company, if the Chairman himself is interested in any item of business, he should entrust the conduct of the proceedings in respect of such item to any other disinterested director and resume the chair after that time of business has been transacted.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. XYZ Company Limited calls a meeting of the Board of Directors without giving notice to directors as required under the Companies Act, 2013. The meeting is attended by all the directors. None of the directors of the company objected to the absence of notice. The proceedings of the meeting are ratified later by the Board of Directors at a regularly constituted meeting.

Decide giving reasons for your answer whether :

(*i*) the meeting and the proceedings are valid ?

(*ii*) the Board of Directors are competent to ratify at a later meeting the above proceedings?

2. What is the procedure to be followed, when a Board meeting is adjourned for want of quorum?

3. What do you understand by the passing of resolutions by circulation?

4. Advise the company with reference to the relevant provisions of the Companies Act about sending notice of board meetings to the following directors :

(*i*) Mr. Rohit, a director, states that he will not be able to attend the next board meeting.

(*ii*) Mr. Bipin Ram goes abroad for four months and an alternate director has been appointed in his place.

(*iii*) Mr. James is a director residing abroad representing the foreign collaborator and the Articles of Association of the company provides for sending notice to such directors.

5. The Board of directors of M/s. Infotech Consultants Limited, registered in Calcutta, proposes to hold the next Board meeting in the month of May, 2014.

They seek your advice in respect of the following matters :

(*i*) Can the Board meeting be held in Chennai, when all the directors of the company reside at Calcutta ?

(*ii*) Whether the Board meeting can be called on a public holiday and that too after business hours as the majority of the directors of the company have gone to Chennai on vacation ?

(*iii*) Is it necessary that the notice of the Board meeting should specify the nature of business to be transacted ?

Advice with reference to the relevant provisions of the Companies Act.

6. Write a note on the quorum at Board of Directors' meeting.

7. Comment on the following :

(*a*) Quorum need not be present throughout the Board meeting.

(*b*) The transaction at Board meeting, the notice of which was not sent to one of the directors.

8. Explain what is meant by 'Disinterested quorum'.

9. (*a*) State the provisions of the Companies Act, 2013 regarding the recording and signing of minutes of proceedings of Board meetings.

(*b*) What matters must be contained in the minutes of Board meetings?

(*c*) Can a director insist that his dissent be recorded in the minutes of Board meetings on a particular decision?

(*d*) What presumptions are to be drawn from the minutes of a Board meeting?

10. The auditor of a company wanted to see the minutes book of directors' meetings. The chairman of the company refused on the ground that matters of confidential nature were contained therein. Advice the auditors.

11. Can a member inspect the books of minutes for the Board meeting?

12. The Board meeting of P.Q. Ltd. which was adjourned due to lack of quorum falls on a national holiday. State the legal position.

Hints: Meeting to be held on the next succeeding day.

13. The Board of Directors of a company met three times in a year. The fourth meeting was adjourned twice for want of quorum. Does it not constitute a violation of the Act ?

14. In what frequency should Board meetings be held?

15. Can an item not included in the agenda of Board meeting be discussed?

PRACTICAL PROBLEMS

1. The Board of Directors of a public company met on three times in the previous year, the fourth meeting though called could not be held for want of quorum on two occasions successively. Discuss whether any provisions of the Companies Act has been contravened ?

Hints: See Para 18.8.

2. The Articles of Association of a company provide that the meeting of the Board of Directors of the company will be held on the last Friday of every month. The Secretary of the company as a result does not serve the notice to the individual directors of the company. Consequently, a meeting of the Board of Directors was held on 23rd February, 2014. The meeting was attended by all the directors with the exception of two directors out of a total of 10 directors and certain resolutions were passed. The two absentee directors object to the meeting and the proceedings of the meeting for want of notice. Referring to the provisions of the Companies Act, 2013, decide :

(*i*) Whether the objection raised by the two absentee directors is valid ?

(*ii*) Would your answer be the same in case the Secretary of the company, instead of sending notice on a usual format to the individual directors, sent a copy of the Articles of Association to each one of the directors ?

Hints : *Period and form of notice* - Section 173(*3*) requires that a meeting of the Board shall be called by giving not less than seven days' notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. However, a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting :

In case of absence of independent directors from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any.

Accordingly, the objection raised by the two absentee directors is valid. In the second situation, once again, the answer shall be the same.

3. The auditor of a company wanted to see the minutes book of directors' meetings. The chairman of the company refused on the ground that matters of confidential nature were contained therein. Advise the auditor.

Hints : Under section 143(1) of the Act, the auditor of a company has the right of access at all times to all books and information which he considers necessary for the proper performance of his duties, even though the information is of a confidential nature. He has, accordingly, a statutory right to inspect the directors' minutes book. In case, he is denied access to it, he should state that in his report along with the reasons therefor. The Board of directors are bound to give the fullest information and explanations in their report on the accounts of the company, on every reservation, qualification or adverse remark contained in the auditor's report.

4. In a Board meeting, a few Directors raise disagreements on the minutes of the earlier Board meeting alleging that the decisions were recorded wrongly. Advise the Chairman.

Hints : The minutes of a Board meeting once recorded cannot be changed. However at the current meeting, the disagreeing directors, with the permission of the Chairman, may move a motion for passing a resolution modifying the earlier resolutions recorded in the minutes which, they feel, have been wrongly recorded.

5. During the year 2013, A Ltd. held four meetings of the Board on 2nd Jan., 2013, 10th May, 2013, 16th Oct., 2013 and 31st Dec., 2013. Examine whether this was in accordance with the provisions of the Companies Act, 2013 ?

Hints : As per section 173 of the Companies Act, in case of every company, its Board of Directors shall hold at least four meetings every year in such a manner that the gap between two consecutive meetings is not more than 120 days. In the present case, the gap between the January and May meeting and likewise between May meeting and October meeting has been more than 120 days. Hence section 173 has been violated.

6. (*a*) The Articles of Association of a company fixed 3 as the quorum for a meeting of the Board. At a meeting of the Board, all the 5 directors were present. They allotted the shares of the company to 3 of the directors. Is it valid ?

(*b*) A meeting of the Board of directors of a company was convened to be held on 30th December, 2013, but the meeting could not be held for want of quorum. The last meeting of the Board of directors was held on 14th August, 2013. Advise.

(*c*) By an oversight, a notice of meeting of the Board was not sent to one of the directors who was in India. Is the meeting valid ?

(*d*) A member wants to inspect the minutes book of the meetings of the Board. Advise.

Hints : (*a*) The provisions in regard to quorum for a Board meeting are contained in section 174 of the Companies Act, 2013. It is provided therein that the quorum for a Board meeting shall be one-third of the total number of directors of a company (any fraction contained in that one-third shall be rounded off as one) or two directors whichever is higher. It is further provided that where at any time the number of interested directors exceeds or is equal to two-

thirds of the total strength, the number of disinterested directors present at the meeting being not less than two shall form the quorum. The company is, however, free to fix a higher quorum for the Board meeting.

Viewed in the context of the above provisions, the company has fixed the quorum for a Board meeting at 3. In this case, out of five directors present at the meeting, the number of interested directors is three. As such, the remaining two directors who are not interested do not constitute a quorum and hence the meeting cannot be validly convened. Therefore, the allotment of shares at the aforesaid meeting is not valid, (*Re : Sir Hormusji & Wadia* AIR 1921 Bom. 372).

The provision of section 174(3) cannot also be availed of as the interested directors, who are three, are not equal to or more than two-thirds of the total strength of directors. The figure representing two-thirds will be 4 by rounding off fraction, if any. Hence, it can be assumed that the allotment made at the Board meeting will not be valid.

(*b*) As per section 174(4) of the Companies Act, 2013, if a meeting of the Board could not be held for want of quorum, then unless the Articles provide otherwise, the meeting shall automatically stand adjourned to, the same day in the next week, at the same time and place or if that day is a national holiday till the next succeeding day which is not a national holiday. Thus, the provision of section 174 shall not be deemed to have been contravened merely by reason of the fact that a meeting of the Board which had been called in compliance with the terms of that section could not be held for want of a quorum.

(*c*) According to section 173 of the Companies Act, 2013, a meeting of the Board shall be called by giving at least 7 days notice in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means. As this is a compulsory requirement, failure to do so will make the meeting and the resolution passed at the meeting *null* and *void*. [*Kuldip Singh Dhillon* v. *Paragon Utility Financiers (P.) Ltd.* [1988] 60 Comp. Cas. 77 (P & H)].

(*d*) The Companies Act contains no provision either specifically permitting or prohibiting inspection by the shareholders of the minutes of the meeting of the Board. As per the letter issued by the Department of Company Affairs [now Ministry of Corporate Affairs], unless the Articles of Association provide to the contrary, a shareholder has no right of inspection or of taking copies of the minutes of the Board meetings.

7. Advise the company with reference to the relevant provisions of the Companies Act about sending notice of board meetings to the following directors :

(*i*) Mr. Rohit, a director, states that he will not be able to attend the next board meeting.

(*ii*) Mr. Bipin Ram goes abroad for four months from 4-1-2014 and an alternate director has been appointed in his place.

(*iii*) Mr. James is a director residing abroad representing the foreign collaborator and the Articles of Association of the company provide for sending notice to such directors.

Hints : According to section 173 of the Companies Act, 2013 notice in writing of every board meeting shall be given at least 7 days before the meeting to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means.

(*i*) Notice should be given even if Mr. Rohit expressed his inability to attend the next board meeting. Otherwise section 173(1) will be violated. [*In re : Portuguese Consolidated Copper Mines Ltd.* [1889] 42 Ch. D. 160 (CA)].

(*ii*) Although there is no legal precedent in this regard, it would be a prudent practice (under section 173) that notice should be served to both, the alternate director as well as the original director Mr. Bipin Ram, who is outside India, at the address supplied by him. The notice may be sent to him electronically also, if he has supplied his email id.

(*iii*) In the case of a company having foreign collaboration, once again the notice will be required to be served at the address supplied to the company including e-mail address.

8. Four out of ten Directors of a company have gone abroad. Out of the remaining directors in India, four have signed in favour and two have signed against a resolution sent by circulation. Discuss the validity of the circular resolution.

Hints : The resolution is *not* valid. *See Para 18.9.*

9. M/s. Hurybury Builders Limited is contemplating to enter into a joint venture agreement with another construction company for the development of landed properties located at Bangalore. Since it is not possible to convene the Board Meeting immediately, as the directors are at different places in connection with various works, the Managing Director seeks your advice on the following matters :

(*i*) Whether the resolution pertaining to the joint venture agreement is required to be passed at the Board meeting convened for this purpose or it can be passed by means of a circular resolution.

(*ii*) The steps that are required to be taken to pass the Board resolution by circulation. Advise.

Hints: Resolution for entering into a joint venture is not contemplated to be passed only at a meeting of the Board of Directors. Accordingly, it can be passed through circulation. For requirements of passing of resolution through circulation, *see Para 18.9.*

10. ABC Ltd. has 12 directors on its board and has the following clause in its Articles of Association :

"The question arising at any meeting of the Board of Directors or any Committee thereof shall be decided by a majority of votes, except in cases where the Companies Act, 2013 expressly provides otherwise."

In a meeting of the Board of Directors of ABC Ltd. 8 directors were present. After completion of discussion on a matter voting was done. 3 directors voted in favour of the motion, 2 directors voted against the motion while 3 directors abstained from voting.

You are required to state with reference to the provisions of the Companies Act, 2013 whether the motion was carried or not.

Hints: As per Regulation 20(*i*) of Table F, except where the Act requires a unanimous resolution, questions arising at a Board meeting shall be decided by a majority of votes. [Unanimous resolution is required, *inter alia*, for the following purposes: (*i*) appointment of a person as managing director or manager who is already a managing director or manager of another company (Section 203); (*ii*) to invest in any shares of any other body corporate or to make loan to any other body corporate].

It may be noted that the determination of majority, only those directors who are present in the meeting and vote are to be considered. Directors who abstain from voting are not considered.

Thus, in the given case, since three directors have voted in favour as against two directors who have voted against the motion, the motion shall be said to have been validly passed.

11. A meeting of the Board of Directors of R. Ltd. was called where out of total 10 directors, 8 directors attended the meeting. Out of these 8 directors, 2 directors were indirectly interested in certain matters and voted in favour of the related resolutions. These resolutions were passed as out of remaining 6 directors 3 voted in favour.

Examine whether the resolutions involving indirect interest of the 2 directors were validly passed.

Hints : No; interested directors are precluded from voting.

SPECIMEN OF NOTICE, AGENDA AND MINUTES

A. NOTICE OF THE BOARD MEETING

[Specimen]

ABC Ltd.

(Regd. Office.....)

To

(Director)

Dear Sir/Madam,

This is to inform you that the first meeting of the Board of directors will be held at the Registered Office of the company on 5th September ...at 3 p.m. to transact the business as per the enclosed agenda:

You are requested to please attend the meeting.

Yours faithfully,

Place.....

Date.....

Secretary

For and on behalf of the
Board of Directors

B. AGENDA OF THE FIRST BOARD MEETING

[Specimen]

Agenda

1. Election of the Chairman of the meeting.
2. To produce the Certificate of Incorporation, the Memorandum and the Articles of Association.
3. Election of the Chairman of the Company.
4. Appointment of Managing Director.
5. Appointment of Secretary.
6. Appointment of Solicitors.
7. Appointment of Auditors.
8. Appointment of Bankers.
9. Adoption of the company's seal.
10. Fixing a quorum for the Board's meeting.
11. Consideration and approval of the opening of a Bank account and its operation.
12. Approval of the statement of preliminary expenses by the promoters.
13. Authorising the Secretary to purchase books and registers as are necessary.
14. Consideration and approval of the draft of prospectus.
15. Consideration and adoption of the preliminary contracts and underwriting contracts.
16. Consideration of the application to the stock exchange for the listing of shares.
17. Any other business with the permission of the Chair.
18. Fixing the date of the next Board meeting.

C. AGENDA OF THE SUBSEQUENT BOARD MEETING

[Specimen]

Agenda

1. To read and approve the minutes of the last Board meeting.
2. To consider application for transfer of shares.
3. To consider letter of resignation of the Manager of Kanpur Branch.
4. To consider trading returns for the quarter ended....20....
5. To fix the date for the closure of Register of members.
6. To consider the annual accounts of the company for the year ended....
7. To consider appropriation of profit and recommendation of dividends.
8. To take note of directors liable to retire by rotation.
9. To authorize the Secretary to print the annual accounts and other documents and to issue notice of the annual general meeting.
10. To consider any other business with the permission of the Chair.

D. NOTICE CANCELLING BOARD MEETING

[Specimen]

ABC Ltd.

(Regd. Office.....)

To

.....

.....

.....

(Director)

Dear Sir/Madam,

Notice is hereby given that the meeting of the Board of directors of the company notified to be held at.....on.....at.....p.m. has been cancelled.

A further notice is hereby given that a meeting of the Board of directors of the company will be held at the Registered Office of the company on.....at.....p.m. You are requested to make it convenient to attend the meeting.

A fresh agenda of the business to be transacted at the meeting is enclosed herewith.

Yours faithfully,

Secretary

Place..... For and on behalf of

Date..... the Board of Directors

E. SPECIMEN BOARD RESOLUTION FOR APPOINTMENT OF MANAGING DIRECTOR

Specimen Board Resolution : *"Resolved that* Shri Sincere who fulfils the conditions specified in Parts I and II of Schedule V to the Companies Act, 2013 be and is hereby appointed as the Managing Director of the company for a period of 5 years effective from 1-2-2014 and that he may be paid remuneration of.... by way of salary, commission and perquisites and the same is within the ceilings of Part II of Schedule V of the Act.

Resolved Further that the Secretary of the company be and is hereby directed to file the necessary returns with the Registrar of Companies and to do all acts and things as may be necessary in this connection."

F. MINUTES OF THE FIRST BOARD MEETING

[Specimen]

Minutes of meeting of the Board of directors held at....on.....day.....of.....Ltd.

Present :

1. Chairman of the meeting

   Shri.....was unanimously elected Chairman of the meeting.

2. Certificate of Incorporation

   The Certificate of Incorporation dated.....and a copy each of the Memorandum and Articles of Association filed with the Registrar were placed before the meeting and duly noted.

3. Filing of Consent by Directors

   It was noted that all the Directors present (being persons named in the Articles of Association, as the first directors of the company) have signed the consent to act as Directors and the consent has been filed with the Registrar of Companies in the prescribed form.

4. **Appointment of the Chairman of the Board**

   Shri 'A' proposed the name of Shri 'X' for the post of Chairman of the company and Shri 'B' seconded it. It was unanimously resolved as follows:

   Resolved that Shri 'X' be and is hereby appointed Chairman of Board of directors of the company.

5. **Appointment of Secretary**

   The Board considered the proposal for appointment of Secretary and approved the appointment of Shri 'M' as Secretary of the company. The following resolution was passed:

   "Resolved that Shri 'M' who has the requisite qualifications prescribed under the Companies (Appointment and Qualifications of Secretary) Rules, 1988 be and is hereby appointed as Secretary of the company at a remuneration of Rs.....per month to perform all such duties as may be performed by a Secretary under the Companies Act, 2013 and any other ministerial or administrative duties that may be assigned by the Board of directors from time to time."

6. **Appointment of First Auditors**

   The Chairman placed before the meeting a letter dated ....20....received by the Company from M/s XYZ & Co., Chartered Accountants in response to the company's letter No....dated.....intimating their consent and stating that in case of their appointment as auditors of the company for the year ending....20.....the same would be in accordance with the limits specified in the Companies Act, 2013. The Board noted the same and it was then resolved as follows:

   "Resolved that M/s XYZ & Co., Chartered Accountants, be and are hereby appointed as the first auditors of the Company to hold office until the conclusion of the first Annual General Meeting of the Company at a remuneration of Rs....."

7. **Adoption of Common Seal**

   The Common Seal of the company was produced before the meeting and approved. The following resolution was passed:

"Resolved that the seal which has been submitted to and approved by this meeting and an impression of which has been affixed in the margin of these minutes be and the same is hereby adopted as the Common Seal of the Company and that the Seal be kept in safe custody of the Secretary who shall maintain a Seal Register in which details of all documents sealed shall be entered."

8. **Opening of a Bank Account**

   The Board approved the proposal for opening an account with State Bank of India in Karol Bagh, New Delhi Branch and passed the following resolution:

   "Resolved that a bank account of the Company be opened with the State Bank of India at 31 Arya Samaj Road, Karol Bagh, New Delhi Branch, and that the said Bank be and is hereby authorised to honour all cheques, bills of exchange, promissory notes and other orders for payment drawn, accepted, made or signed on behalf of the Company by any one Director, and the Chief Accountant of the Company and to act upon any instructions so given relating to the account whether the same be overdrawn or not, or relating to the transactions of the Company and the Secretary be instructed to deliver to the said Bank a copy of the Resolution signed by the Chairman, specimen signatures of the Directors and Chief Accountant and a copy of the Memorandum and Articles of Association of the Company."

9. **Financial year**

   It was resolved that the financial year of the Company will be from 1st April to 31st March and that the first accounting period of the Company shall be from the date of incorporation, *i.e.* ..... to 31st March.....

   "Resolved further that the blank forms and blocks, engravings, facsimiles, etc. relating to the printing of the Share Certificate Forms be kept in the custody of the Secretary of the Company."

10. **Approval of Statement of Preliminary Expenses incurred by Promoters**

    The statement of preliminary expenses placed before the Board was perused and approved. It was—

    "Resolved that the preliminary expenses amounting to Rs....incurred by the promoters in connection with incorporation of the company as per the statement submitted to the meeting be and are hereby approved and that the amount be reimbursed from the company's fund to Mr...."

11. Books and Registers

    The Secretary was authorised to purchase books, registers and stationery necessary for the Company's business as per the proposal placed at the meeting.

12. Vote of Thanks

    There being no other business the meeting terminated with a vote of thanks to the Chair.

Chairman

Dated.....20.....

19 Accounts and Audit

ACCOUNTS

19.1 Books of account required to be kept[1]

Section 128 of the Companies Act, 2013 requires every company to maintain at its registered office books of account and other relevant books and papers and financial statements for every financial year which give a true and fair view of the state of affair of the company including that of its branch office or offices. As per Section 2(13) the books of account includes records maintained with respect to:

(*a*) all sums of money received and expended by the company and the matters in respect of which receipts and expenditure take place;

(*b*) all sales and purchases of goods by the company;

(*c*) the assets and liabilities of the company; and

(*d*) the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section;

As noted in the preceding paragraph, Section 128 requires books of account to be kept at the registered office of the company. However, the proviso to Section 128(1) allows the company to keep its books of account or any of them at any other place in India as the Board of directors may decide. In such a case the company within seven days of the decision is required to file with the Registrar a notice in writing giving the full address of that other place. The rule 2A of the Companies (Accounts) Rule 2014 requires the notice regarding address at which books of account may be kept to be given in Form AOC-5. In respect of a branch office in India or outside India Section 128 (2) allows the books of account relating to the transactions effected at the branch office to be kept at that office. However proper summarized returns periodically are required to be sent by the branch office to the company at its registered office or the other place referred to in Section 128 (1).

The proviso to Section 128(1) also permits the company to maintain the books of account and other relevant papers in an electronic mode. If a company decides to maintain the books of account in the electronic mode as permitted by Section 128

1. For details see under 'Register and Returns'

(1), the Rule 3 of the Companies (Accounts) Rules, 2014 requires that such books of account and records to remain accessible in India for being usable subsequently. Such books and records must be maintained in the format in which they were originally generated, sent or received. Likewise the information received from the branch office need to be kept without alteration and must depict information originally received from the branches. The company needs to have proper system of storage, retrieval, display or printout as considered appropriate by the Audit Committee or the Board. Records maintained in an electronic mode can be disposed of or rendered unusable only if permitted by law. In respect of books and records maintained in the electronic form including at a place outside India, periodic back up shall be kept in servers physically located in India. If the company is using the services of a third party service provider for maintaining the books and records in the electronic format, the company shall intimate to the Registrar the name of the service provider, internet protocol address and location of the service provider. This information needs to be furnished annually at the time of filing of the financial statements.

Section 338(2) provides (taken in positive terms) that proper books of account constitute such books of account as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing sufficiently detailed entries of daily cash receipts and payments. Also, where the business of the company has involved dealings in goods, statements of the annual stock takings (except in the case of goods sold by way of ordinary retail trade) and of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable these goods and these buyers and sellers to be identified should also be maintained.

Though section 338 relates to a situation involving winding up of a company, it has the special effect of further amplifying the requirements as regards maintenance of books of account and should be taken as a general requirement from the standpoint of the company. In other words, its application should not be taken as confined to winding-up process only.

Other books and papers - There exists reference to "other books and papers" in the matter of right of inspection in section 128 (3). Section 2(12) of the Act has defined the terms "book and paper" and "book or paper" in an inclusive manner. It states that "book and paper" and "book or paper" shall include books of account, deeds, vouchers, writings, minutes and registers maintained on paper or in electronic form. It may be noted that the definition equates "book and paper" and "book or paper" and provides for a wide coverage which may not necessarily be related to the books of account and includes such records maintained in the electronic form. The High Court at Madras in *K. Kanakasabapathy* v. *T.M. Sanmughan* [1972] 42 Comp. Cas. 596 has held the view that nomination papers received by a company for election of directors is not open to inspection by a director basing on the principle of "*ejusdem generis*". In view of the definition in section 2(12) as given above, this decision may not be well accepted. However, the right of the directors to inspect the books of account and books and papers is certainly restricted to a *bona fide* use of the right.

Proper books of account - Section 2(13) and Section 128(1) read with section 338(2) of the Act provides for the maintenance of proper books of account and they obviously include the cost accounting records [section 2(13)(*d*)] and stock records [section 338(2)], apart from normal books of account. As per Section 148(1) of the

Act the Central Government may order that companies engaged in production of such goods or providing such services as may be prescribed to maintain detailed cost records including utilization of material or labour or other items of cost in the manner specified by the Central Government. The Central Government had ordered maintenance of Cost Records for different types of Industries.

Proper maintenance of stock records is also a necessity as in the absence of proper stock record the true and fairness of the annual statements of account cannot be properly understood. The Institute of Chartered Accountants of India (ICAI) had in the Compendium of Guidance Notes[2], casts the duty on the statutory auditor to examine the cost records maintained, as the cost records form a part of the "proper books of account" within the meaning of the Act.

19.2 Inspection of Books of Account[3]

Section 128(3) provides that books of account and other books and papers shall be open to inspection by any director during business hours. However inspection in respect of the subsidiary company is permitted only by a person duly authorized by the Board of Directors by passing a resolution in this regard.

Further, section 206(1) provides that the Registrar by a written notice may call on the company to produce the books of account, books, papers and explanations as may be required. Before serving any notice under Section 206, the Registrar shall record his reasons in writing for issuing such notice. Likewise, if the circumstances so warrant, the Central Government under section 206(5) of the Act may appoint an inspector for carrying out an inspection of books and papers of a company. If the Registrar or inspector so appointed by the Central Government calls for the books of account and other books and papers as aforesaid, the directors, officers and employees of the company are duty bound to produce all such documents and other statements, information and explanations as may be needed for the purpose of such inspection. The Registrar or inspector making the inspection under section 206, may make or cause to be made copies of books and account and other books and papers or place or cause to be placed any marks of identification on the books of account or other books and papers as token of inspection having been made.

Under section 45N of the Reserve Bank of India Act, books of account of non-banking companies may also be inspected by the Reserve Bank of India for the purpose of verifying the correctness or completeness of any statement, information or particulars furnished to the Bank or for the purpose of obtaining any information or particulars which the non-banking company has failed to furnish on being called upon to do so.

Penalty under section 207(4) - Sub-section (1) of section 207 casts a duty on every director or other officer or employee of the company to produce to the person making inspection all such books of account and other books and papers of the company in his custody/control and to furnish him with any statement, information or explanation as may be required by that person, within such time and at such place as he may specify. Also, it is the duty of every director, other officer or employee of the company to assist the person in the inspection as it may be reasonable to expect

2. Refer Compendium of Guidance Note, Vol 1, 2nd Edition, Page 18-1, Issued by the ICAI
3. For details see under 'Register and Returns'

from the company. Where default has been made in the above matter, every officer of the company, including a director who is in default, shall be punishable with fine which shall not be less than rupees twenty five thousand but which may extend to rupees one lakh and also with imprisonment for a term which may extend to one year. Further, the director or the officer, if convicted, shall, on and from the date of conviction, be deemed to have vacated his office as such and also shall be disqualified for holding such office in any company. In respect of directors, this vacation of office is in addition to the grounds mentioned in section 167 of the Act. This disqualification extends to private companies as well.

19.2-1 Directors' right of inspection

As noted above, a director is empowered under section 128(3) to inspect the books of account but must he exercise this right personally? Generally, a director should exercise right of inspection of books of account personally. However, in *N.V. Vakharia* v. *Supreme General Film Exchange Co. Ltd.* [1948] 18 Comp. Cas. 34, it was held that a director is entitled to make inspection of accounts personally or through an agent provided that there is no reasonable objection to the person chosen and the agent undertakes not to utilise the information obtained by him for any purpose other than the purpose of his principal. In the aforesaid case, inspection through an agent was allowed because of the physical inability of the director to inspect books of account personally.

As the right of inspection is a statutory right given under section 128, a director who is prevented from or is refused inspection, may enforce his right through Court. The right of inspection, however, is not an absolute right. Where on the facts and circumstances it is clear in any case that there is reason to believe that the inspection is sought for supplying information to a rival in business of the company or for any purpose which is prejudicial or injurious to the interest of the company, the inspection may justifiably be refused.

19.2-2 Right of a shareholder to inspect books of account

A shareholder has no statutory right of inspection of the books of account of the company - *Lalita Rajya Lakshmi* v. *Indian Motor Co. Ltd.* [1962] 32 Comp. Cas. 207. He can, however, inspect the books only if such right is given specifically through the articles, which is rare.

19.2-3 Investigation by the Serious Fraud Investigation Office (SFIO)

The Central Government is empowered under Section 212 of the Act to order an investigation of the affair of a company by the SFIO. Such an investigation may be initiated on the basis of the report of the Registrar or inspector under Section 208 or at the request of the company that has passed a special resolution for its affairs to be so investigated or in public interest or on request from any Department of the Central Government or State Government. Once such investigation is ordered, all officers and employees of the company are under obligation to produce such books and papers as may be required by the inspector.

19.3 Persons responsible for keeping proper books of account [vide sub-section (6) of section 128]

The managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person of a company who has been given the responsibility of keeping proper books of account and other matters enumerated under section 128 shall be responsible for keeping proper books of account. In case of contravention the person so responsible shall be punishable with imprisonment or fine or both. The fine which shall not be less than rupees fifty thousand and may extend to rupees five lakhs and imprisonment for a term which may extend to one year or both. There is no provision in the Act to prosecute the company concerned. Only the functionaries identified in these sections who alone can be charged and prosecuted - *Sanjay Suri* v. *State* [2010] 102 SCL 1 (Delhi).

Proper books of account in relation to the branch of a company - Section 128(2) states that where a company has a branch office, whether in or outside India, the company shall be deemed to have complied with the provisions of section 128(1), if proper books of account relating to the transactions effected at the branch office are kept at that office and proper summarised returns, made up to date, at intervals of not more than three months, are sent by the branch office to the registered office of the company or at such other address where the books of account are kept by fulfilling the requirements mentioned earlier. This requirement is specific that a foreign branch has also to maintain proper books of account as required by section 128(1) of the Act, irrespective of the requirement, if any, in the country where the branch is located.

Period for which books of account to be retained - Section 128(5) specifies that the books of account of every company relating to the period of not less than eight years immediately preceding the current year shall be preserved in good order along with the relevant vouchers. Where a company has not been in existence for eight years, the books of account and related vouchers should be preserved in good order right from the first accounting year of the company.

19.4 Financial Statements

The Section 129(1) of the Act requires every company to prepare its financial statements at the end of 'financial year' so as to give a true and fair view of the state of affairs of the company. Such statements prepared shall comply with the accounting standards notified under section 133 of the Act in the format prescribed in Schedule III. Section 2(40) of the Act has given an inclusive definition of the expression 'financial statements'. The financial statements accordingly include -

(*i*) a balance sheet as at the end of the financial year;

(*ii*) a profit and loss account;

(*iii*) cash flow statement for the financial year;

(*iv*) a statement of changes in equity, if applicable; and

(*v*) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (*i*) to sub-clause (*iv*):

In case of company not carrying on business for profit, it will prepare 'Income & Expenditure Account' instead of Profit and Loss account. With respect to One

Person Company, small company and dormant company, the cash flow statement need not be prepared.

The financial statement for the financial year are required to be presented by the Board of Directors before the annual general meeting (AGM) of members [Section 129(2)]. As the AGM is required to take place within six months of close of the financial year under Section 96(1), it means that the financial statements must be ready within six months of the close of the financial year.

The financial statements are required to be prepared for each financial year. Section 2 (41) of the Act defines the 'financial year' in relation to a company as the period ending on the 31st day of March every year. In case of a new company incorporated on or after 1st day of January of a year, the financial year will end on the 31st day of March of the following year. The Act provides for a uniform financial year ending on 31st day of March. The first financial year of a company may be shorter or longer than 12 months. The first financial year for a company incorporated between 1st January and 31st March would be longer than 12 months whereas for other companies it would be shorter than 12 months.

A company which is either a holding or a subsidiary or an associate* of a company incorporated outside India and which is required to follow a different financial year for consolidation of its accounts may follow a different period as financial year. For this purpose it needs to make an application to the Tribunal for approval.

Prior to the commencement of the Act, many companies were following accounting period different than that ending on 31st March. Such companies have been permitted a period of two years from the commencement of the Act to align their financial year as prescribed by the Act [proviso to Section 2(41)]. During this period of alignment such companies would have at least one financial year which is either longer or shorter than twelve months.

The Income-tax Act, 1961 already requires that all companies must submit their income-tax returns on the basis of 'Uniform Financial Year' closing on 31st March every year. A uniform financial year under the companies act would obviate the need for maintaining separate accounts for income-tax purposes.

19.4-1 Preparation and presentation of financial statements

Section 129 along with Schedule III to the Act deals with the preparation and presentation of balance-sheet and the statement of profit and loss of a company. This section requires that the financial statements shall give a true and fair view of the state of affairs of the company. The balance sheet should be in the form set out in Part I of Schedule III and the statement of profit and loss should be in form set out in Part II of Schedule III. Any reference to the financial statement under this section shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under this Act (Explanation to Section 129)

The balance sheet and the statement of profit and loss of a company shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by reason of the fact that they do not disclose—(*i*) in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act,

**Vide* Companies (Amendment) Act, 2017.

1938 or the Insurance Regulatory and Development Authority Act, 1999; (*ii*) in the case of a banking company, any matters which are not required to be disclosed by the Banking Companies Act, 1949; (*iii*) in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed under the Electricity Act, 2003; (*iv*) in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that special law. [proviso to Section 129(1)].

Schedule III of the Act prescribes the form in which the balance sheet, the statement of profit and loss and consolidated financial statements should be prepared. Schedule III have been divided into two parts. Division-I contains the formats of financial statements and general instructions for preparation of financial statements for companies which are required to comply with the existing accounting standards. Division-II prescribes the formats and general instructions for preparation of financial statements for companies which are required to comply with the revised Indian Accounting Standards (Ind AS) compliant with the International Financial Reporting Standards (see para 19.12-1).

The above provisions are not applicable to an insurance or banking company or any company engaged in the generation or supply of electricity or any other class of companies for which a form of financial statements has been specified in or under the special law concurrently governing such company.

Exemption from requirements of Schedule III - The Central Government may, by notification exempt in public interest, any class or classes of companies from compliance with any of the requirements of Section 129. Any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification [Section 129(6)]. Such an exemption may be given by the Central Government on its own or on an application made by a class or classes of companies.

Compliance with Accounting Standards: As per section 129(1) of the Act, items contained in the financial statements shall comply with the accounting standards notified under section 133. Where the financial statements of a company do not comply with the accounting standards, such company shall disclose in its financial statements the following :—(*a*) the deviation from the accounting standards; (*b*) the reasons for such deviation; and (*c*) the financial effect, if any, arising due to such deviation [Section 129(5)]. In respect of a Government company engaged in defence production, Accounting Standard 17 (Segment Reporting) will not apply.* Additionally the Directors' Responsibility Statement prepared under Section 134 of the Act shall state that the applicable accounting standards had been followed in the preparation of the financial statements giving proper explanation in case of material departures.

Until the accounting standards are notified by the Central Government under section 133 as aforesaid, the standards specified under the Companies Act, 1956 shall apply as the accounting standards.

Responsibility for compliance: The managing director, the whole-time director in charge of finance, the Chief Financial Officer or any other person charged by the

*Amended *vide* Notification No. F No. 1/2/2014-CL.V dated 5 June 2015.

Board with the duty of complying with the requirements of this section and in the absence of any of the officers mentioned above, all the directors are deemed to be responsible for the compliance with the provisions of Section 129. As per Section 129(7) in case of contravention, those responsible shall be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than rupees fifty thousand but which may extend to rupees five lakh, or with both.

Preparation of consolidated financial statements by the holding company *- Section 129 (3) of the Act requires that where there is one or more subsidiary or associate companies of a company (*i.e.*, the holding company), at the end of the financial year of the (holding) company, it shall prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies. The consolidated financial statements shall be presented in the same form and manner as that of its own. The consolidated financial statements are also required to be laid before the annual general meeting of the company.

In addition, a separate statement containing the salient features of the financial statement of the subsidiary or subsidiaries and associate companies shall also be presented in Form AOC-I prescribed by the Companies (Accounts) Rules, 2014.

It may also be noted that it is mandatory to prepare and present consolidated financial statements by companies having one or more subsidiaries or associate companies. Where at the end of the financial year of a company, there is no subsidiary company related to it, there is no necessity to attach the documents aforesaid even though that during the year there was a subsidiary or subsidiaries of the company.

The Companies (Accounts) Rules, 2014 provides that the consolidation shall be made in accordance with the provisions of Schedule III of the Act and the applicable accounting standards (Rule 6). However, proviso of rule 6 provides states that nothing in this rule shall apply in respect of preparation of consolidated financial statements to the following categories of companies:

(*a*) a wholly-owned or partially-owned subsidiary of another company provided that all its members, (including those not otherwise entitled to vote), have been intimated in writing and do not object to the company not presenting consolidated financial statements. The proof of delivery of such intimation must be available with the company;

(*b*) a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

(*c*) if the ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Default under section 129 - Whether a continuing offence? Offence under section 211(7) (now section 129) is not a continuing offence and thus, a complaint in respect of such an offence has to be filed within one year as per section 468(2)(*b*) of Code of Criminal Procedure, 1973 - *C.K. Ranganathan* v. *Registrar of Companies* [2003] 45 SCL 500 (Mad.).

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*Amended *vide* Companies (Amendment) Act, 2017.

Attachment of documents in relation to an overseas subsidiary company

Section 129 does not make any distinction between a local subsidiary company and an overseas subsidiary company. Under section 2(46), a holding company in relation to one or more other companies means a company of which such companies are subsidiary companies. Under section 2(20), the expression 'company' means a company incorporated under this Act or any previous company law. In view of the aforesaid position, the Indian holding company is legally bound to consolidate the financial statements of the overseas subsidiary as well. However, there may arise practical difficulty in consolidation in view of different accounting format or different audit requirements or different accounting period in regard to overseas subsidiary.

19.5 Authentication of Financial statements

According to section 134(1), the financial statements of a company, including the consolidated financial statements, shall be approved by the Board of Directors. They are required to be signed on behalf of the Board of directors by the chairperson of the company where he is authorized by the Board or by two directors out of which one shall be the managing director, if any, and the Chief Executive Officer. They are also required to be signed by the Chief Financial Officer and the company secretary of the company if appointed. In case of a banking company, the balance sheet and the profit and loss account shall be signed by the persons mentioned in clause (*a*) or clause (*b*) of section 29(2) of the Banking Regulation Act, 1949. In the case of One Person Company, they are required to be signed by only one director.

The financial statements of all companies shall be approved by the Board of directors before they are signed on behalf of the Board in accordance with the provisions of this section and before they are submitted to the auditors for their report thereon. Section 134(2) further provides that auditors' report shall be attached to every financial statements.

19.6 Can Approval of Annual Accounts be delegated?

*The DCA (*vide *its letter dated 27-10-1976)* had clarified that in the absence of any specific provision in section 215 of the Companies Act, 1956, (now Section 134) the power of the directors to approve the annual accounts cannot be delegated to a committee of directors or some of the directors. It, *inter alia,* states that the approval of annual accounts which are to be ultimately placed before the shareholders of the company is not to be treated as a routine or part of day-to-day work. Hence the Board of Directors must consider the annual accounts and approve them before the accounts are handed over to the statutory auditor of the company.

If the auditor signs the balance sheet on the same date on which the directors have approved it, it may not be inferred from this solitary circumstance that the auditor has not performed the audit efficiently (*Sl. No. 215, pp. 232-33, Ibid*).

There is no contravention of this section in a case where audit of final accounts is completed before the approval of the balance sheet by the Board of directors of the company (*Sl. No. 244, p. 254, Ibid.*).

19.7 Filling and publication of financial results - Requirements under SEBI (Listing Obligations and Disclosure) Regulations, 2015

The requirements relating to the filing and publication of financial results by the listed companies are contained in the regulations 29, 33, 47, 52 and Schedule IV and Schedule VIII of the listing regulations. The regulations *inter alia* provide for:

Advance notice of the Board Meeting - The listed entity is required to give prior intimation to stock exchange about the meeting of the board of directors at least five days in advance (excluding the date of the meeting and the date of intimation) in which financial results *viz.* quarterly, half yearly, or annual is due to be considered.

Accounting Policies - The financial results shall be prepared on the basis of accrual accounting policy and shall be in accordance with uniform accounting practices adopted for all the periods. The quarterly and year to date results shall be prepared in accordance with the recognition and measurement principles laid down in Accounting Standard 25 or Indian Accounting Standard 31 (AS 25/Ind AS 34 - Interim Financial Reporting), as applicable, specified in Section 133 of the Companies Act, 2013.

The audited financial results in respect of the last quarter shall be submitted alongwith the results for the entire financial year. It must be stated that the figures of last quarter are the balancing figures between audited figures in respect of the full financial year and the published year-to-date figures upto the third quarter of the current financial year. A statement of assets and liabilities as at the end of the half-year shall also be submitted as part of its standalone or consolidated financial results for the half year.

Audit - The quarterly and year-to-date financial results may be either audited or unaudited. In case unaudited financial results are submitted, they must be subject to limited review by the statutory auditors of the listed entity and shall be accompanied by the limited review report. However in case of public sector undertakings this limited review may be undertaken by any practicing Chartered Accountant. If audited financial results are submitted, they shall be accompanied by the audit report. It needs to be ensured that the limited review or audit reports submitted to the stock exchange(s) on a quarterly or annual basis are to be given only by an auditor who has subjected himself to the peer review process of Institute of Chartered Accountants of India and holds a valid certificate issued by the Peer Review Board of the Institute of Chartered Accountants of India.

Un-audited financial half yearly results shall be accompanied by limited review report prepared by the statutory auditors of the listed entity or in case of public sector undertakings, by any practising Chartered Accountant, in the format as specified by the Board. The company may intimate in advance to the stock exchange(s) that its intention to file annual audited results within sixty days from the end of the financial year. In such a case un-audited financial results for the last half year accompanied by limited review report by the auditors need not be submitted.

Time Limit - The quarterly and year-to-date standalone financial results are required to be submitted to the stock exchange within forty-five days of end of each

quarter, other than the last quarter. The audited standalone financial results for the financial year must be submitted within sixty days from the end of the financial year. If the listed entity has subsidiaries, it is also required to submit annual audited consolidated financial results along with the audit report.

Likewise un-audited or audited financial results on a half yearly basis are required to be submitted within forty five days from the end of the half year.

Approval and authentication - The quarterly financial results submitted shall be approved by the board of directors. The financial results are required to be certified by the chief executive officer and chief financial officer of the listed entity that they do not contain any false or misleading statement or figures and do not omit any material fact which may make the statements or figures contained therein misleading. The financial results shall be signed by the chairperson or managing director, or a whole time director or in the absence of all of them by any other director duly authorized by the board of directors. Similarly the annual audited financial results are required to be approved and signed by the board of directors.

Half-yearly results are required to be taken on record by the board of directors and signed by the managing director/executive director. If un-audited financial results for the last half year are accompanied by limited review report by the auditors, audited financial results for the entire financial year duly approved by the board of directors shall also be submitted as soon as they are approved.

Advertisement in Newspapers - The company shall publish the notice of the board meeting where the financial results shall be discussed in the newspaper simultaneously with the submission of the same to the stock exchange(s). The financial results are required to be published within 48 hours of conclusion of the meeting of board of directors at which the financial results were approved. The notice and results shall be published in at least one English language national daily newspaper circulating in the whole or substantially the whole of India and in one daily newspaper published in the language of the region, where the registered office of the listed entity is situated. Link to the website where further details are available shall also be given in the newspaper advertisement.

Additional Information - While submitting half yearly/annual financial results, the following additional information is also required to be given:

(*a*) credit rating and change in credit rating (if any);

(*b*) asset cover available, in case of non-convertible debt securities;

(*c*) debt-equity ratio;

(*d*) previous due date for the payment of interest/dividend for non-convertible redeemable preference shares/repayment of principal of non-convertible preference shares/non-convertible debt securities and whether the same has been paid or not; and,

(*e*) next due date for the payment of interest/dividend of non-convertible preference shares/principal along with the amount of interest/dividend of non-convertible preference shares payable and the redemption amount;

(*f*) debt service coverage ratio;

(*g*) interest service coverage ratio;

(*h*) outstanding redeemable preference shares (quantity and value);

(*i*) capital redemption reserve/debenture redemption reserve;

(*j*) net worth;

(*k*) net profit after tax;

(*l*) earnings per share:

19.8 Board's Report

Section 134(3) requires that there shall be attached to financial statements laid before a company in general meeting, a report by its Board of directors, with respect to the following:

(*a*) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;**

(*b*) number of meetings of the Board;

(*c*) Directors' Responsibility Statement;

(*ca*) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government.[4]

(*d*) a statement on declaration given by independent directors under sub-section (6) of section 149;

(*e*) in case of a company covered under sub-section (1) of section 178, company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;*

(*f*) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made—

(*i*) by the auditor in his report; and

(*ii*) by the company secretary in practice in his secretarial audit report;

(*g*) particulars of loans, guarantees or investments under section 186;

(*h*) particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;

(*i*) the state of the company's affairs;

(*j*) the amounts which it proposes to carry to any reserves;

(*k*) the amount which it recommends should be paid by way of dividend;

(*l*) material changes and commitments affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report;

(*m*) the conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as may be prescribed;

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4. Inserted *vide* the Companies (Amendment) Act, 2015. Also see Para 19.29-3.

*Sub-clause (*e*) above shall not apply to the Government companies. (Amended *vide* Notification No. F No. 1/2/2014-CL.V dated 5 June, 2015).

**Amended *vide* the Companies (Amendment) Act, 2017.

(*n*) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk which in the opinion of the Board may threaten the existence of the company;

(*o*) the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year;

(*p*) in case of a listed company and every other public company having such paid-up share capital as may be prescribed, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors has been made*

(*q*) such other matters as may be prescribed.

The Companies (Accounts) Rules, 2014 requires that the Board's Report shall be prepared using the financial statements of the company on a standalone basis [Rule 8(1)]. The performance and financial position of each of the subsidiaries, joint ventures companies and associates included in the consolidated financial statement shall be reported separately in the Board's Report.

If the disclosure as required under section 134(3) has been made elsewhere in the financial statements, it would be sufficient to refer to such disclosure rather than repeating the same in the Board's report. In case, the policies referred to in sub-clause (*e*) or (*o*) are available on the company's website, only salient features and changes in the policy need to be mentioned in the Board's report indicating the web-address where such policies are available. In case of One Person Company or small company, the Central Government may prescribe an abridged Boards' report '†

The expression "material changes and commitments, if any, affecting the financial position of the company. . ." occurring in clause (*l*) of sub-section (3) would include events such as the disposal of a substantial part of the undertaking, the profit or loss whether of a capital or revenue nature, changes in the capital structure, alteration in the wage structure arising out of trade union negotiations, purchases, construction, sale or any catastrophe befalling the fixed assets, incurring or a reduction of long term indebtedness, awards in litigations, entering into or cancellation of contracts and refund of taxes or completion of assessments - (*Clarification issued by the Deptt. of Company Affairs***, *Taxmann's Circulars and Clarifications*, 1992 edn. p. 234).

It may be noted that sub-section (3) of section 134 requires the report of the Board of directors to be 'attached to' the financial statements and not 'annexed to' such statements. Thus, the report of the Board of directors forms part of the 'Annual Report' of the company which is sent to every member; it is not a part of the financial statements.

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*Amended *vide* the Companies (Amendment) Act, 2017.

**Now Ministry of Corporate Affairs.

†Inserted *vide* the Companies (Amendment) Act, 2017.

19.8-1 Directors' Responsibility Statement

Clause (*c*) of Section 134(3) requires a Directors' Responsibility Statement to be furnished as a part of the Directors' Report. It reinforces the responsibility of the Board in laying down the internal controls, maintenance of accounting records and preparation of financial statements. The Directors' Responsibility Statement accordingly states:

(*a*) Applicable accounting standards have been followed in the preparation of financial statements. In case of a deviation, proper explanation has been provided.

(*b*) Accounting policies have been selected by the Board and judgments and estimates have been made that are reasonable and prudent. The policies chosen have been applied consistently. The financial statements give a true and fair view of the state of affairs of the company at the end of the financial year and the profit and loss of the company for that period.

(*c*) Proper and sufficient care has been taken for the maintenance of adequate accounting records to meet the requirements of the Act. The directors also take responsibility for safeguarding the assets of the company and for preventing and detecting frauds and other irregularities.

(*d*) The accounts have been prepared on a going concern basis.

(*e*) In the case of a listed company, adequate internal financial controls have been laid down and such controls are operating effectively.

(*f*) Proper systems have been laid down to ensure compliance with the provisions of all the applicable laws.

19.8-2 Disclosures with respect to employees' stock option scheme

As per SEBI guidelines with respect to employees' stock option scheme, Directors' report of a listed company must, *inter alia*, contain the following disclosures:

(*i*) the total number of shares covered by the ESOP as approved by the shareholders;

(*ii*) the pricing formula;

(*iii*) options granted, options vested, options exercised, options forfeited, extinction or modification of options, money realised by exercise of options, total number of options in force, employee-wise details of options granted to senior managerial personnel and to any other employee who receive a grant in any one year of options amounting to 5% or more of options granted during that year;

(*iv*) Fully diluted earnings per share (EPS) computed in accordance with Accounting Standard (AS- 20) on earning per share.

By far the most important element of disclosure in the Board's report is about the 'state of the company's affairs' enjoined by clause (*i*) of sub-section (3). Yet, because of the element of subjectivity inherent in this regard, there is no uniformity prevailing in the Board's reports of companies. While some companies prefer to include financial highlights in the Board's report as indicative of the state of the company's affairs, others give such financial highlights separate from and indepen-

dent of Board's report. While some companies give interesting details of operations and prospects including projects in hand, others make only cursory mention of these matters. Changes which have occurred during the financial year in the nature of the company's business, though material for the appreciation of the state of the company's affairs, may not be disclosed on the plea that disclosure of these changes may be harmful to the business of the company. Of course, wherever any non-disclosure is to be defended on the ground that the non-disclosure is about changes which have occurred and the disclosure thereof would be harmful to the business of the company, onus is strictly on the Board of directors to prove that this is really so if and when any of the directors are charged with the offence of non-compliance. The shareholders of the company may proceed against the directors for any deliberate mis-statement or negligent statement made in the report.

19.8-3 Reserves and Dividends

It may be noted that the recommendations of the Board of directors with regard to the amount of profits to be paid as dividend and the amount to be transferred to reserves do not lend finality to the matters in these regards. The shareholders are free to reject the recommendations of the directors as regards the amount to be declared as dividend. They cannot, however, increase the amount of dividend recommended by the directors. They can reduce the amount and even reduce it to nullity. Contrarily they can ask for a higher amount to be transferred to reserves, but they cannot reduce the amount to be carried to reserves against the wishes of the directors. Both clauses (*j*) and (*k*) of sub-section (3) contain only the statutory sanction of this prerogative which the directors enjoy. No doubt, clause (j) uses the word "proposes" while clause (k) uses the word "recommends". But, there is no real difference as between the two expressions. The idea of a proposal contemplates somebody else accepting or not accepting it, just as the very idea of recommendation contemplates somebody else accepting and acting upon it or not accepting it. Therefore, when the balance sheet shows a sum appropriated as the general reserve, it is no more than a proposal by the Board of directors made to the general body of the company for setting apart that amount as a general reserve - *Southern Roadways Ltd.* v. *CIT* [1981] 51 Comp. Cas. 513 (Mad.) (FB). The Board of directors is the ultimate authority for proposing and recommending but is not the final authority for approving what is proposed or recommended. This is so despite any provision to the contrary contained in the articles of the company - *Southern Roadways Ltd.* (*supra*).

Similarly, the Board of directors only recommends payment of final dividend and it is the general body of shareholders which accepts the recommendation and declares the dividend. Until such declaration is made, there is no debt owed by the company to its shareholders - *Kesoram Industries & Cotton Mills Ltd.* v. *CWT* 1370 (SC); *see* also *Tarajan Tea Co. Ltd.* v. *CIT* [1994] 13 CLA 75 (Gau.).

19.8-4 Conservation of energy, technology absorption, foreign exchange earnings and outgo

The Companies (Accounts) Rules 2014, Rule 8(3) specifies the details to be furnished under clause (*m*) of Section 134(3). The board report shall highlight the steps taken for conservation of energy and the impact thereof. The company needs to disclose the efforts made towards the use of alternate sources of energy as well as the capital

investment made on energy conservation equipments. With regards to the technology absorption, the board report shall highlight the efforts made by the company towards technology absorption and also the benefits derived from the same including product improvement, cost reduction, product development and import substitution. Expenditure incurred on research and development activities during the year need to be disclosed. In respect of technology imported during the last three years the details of technology imported with the year of import and the extent of technology absorption need to be disclosed. The report shall also give reasons if the technology absorption has not taken place.

The foreign exchange earned and outgo during the year in terms of actual inflows and outflows also need to be reported. However, government companies engaged in the production of defence equipments have been exempted from disclosure requirements under this clause*.

Non-banking Financial Companies - As per the RBI Directions, 1998, every report of the Board of directors has to include particulars on number of depositors who have not been paid back their deposits on maturity and the amount thereof.

Board's Response to Auditors' Report - The responses of the Board of directors on the auditors' report as well as secretarial audit report are to be given as a part of the board' report as per sub-section (3)(*f*) of this section. In case the auditors' remarks are not available to the Board at the time of its consideration and authentication of the balance sheet and statement of profit and loss account, the Board has to meet once again to consider the reservations/qualifications made in the auditors' report and give their explanations to the said remarks. It is expected that the auditors and the Board work in a harmonious manner - *Clarification issued by the Deptt. of Company Affairs***, *Taxmann's Circulars and Clarifications,* pp. 238-239, 1992 edn.

19.8-5 Contracts and arrangements with related parties

The required particulars of contracts and other arrangements between the company and related parties as defined under Section 188 of the Act shall be reported in the Board's report. The Companies (Accounts) Rules 2014 has prescribed the Form AOC-2 for reporting the same. The information is required to be shown separately for contracts, arrangements and transactions with the related parties not at arm's length basis and those at arm's length basis.

19.8-6 Policy on directors' appointment and remuneration

Clause (*e*) of Section 134(3) requires the board's report to disclose the company's policy on directors' appointment and remuneration. The report shall also include the criteria for determining qualifications, positive attributes and independence of a director. Rule 8(4) of the Companies (Accounts) Rules requires that every listed company and other public company with paid up share capital of rupees twenty five crores of more at the end of the financial year shall also report the manner in which the formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.

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*Vide Notification dated 4 September 2015 F No 1/19/2013-CL-V-Part.

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19.8-7 Disclosure about the number of meetings of the Board/Committees

Clause 3(*b*) of Section 134 requires the Board' report to disclose the number of meetings of the Board during the year. Secretarial Standard-1, issued by the Institute of Company Secretaries of India (ICSI), requires the Annual Report of a company to disclose the number of meetings of the Board and Committees held during the year indicating the number of meetings attended by each director.

19.8-8 Notes forming part of the accounts

The practice has developed over the years to give notes on accounts stating specifically that these notes form part of the accounts. At the same time, a mention is made in the Board's report stating that these notes on accounts are self-explanatory. It is obvious that in the absence of these notes explaining the accounts, the auditors would have made qualifying remarks or expressed their reservations. An auditor is to make report on the annual accounts of the company. If notes to accounts are given by the company as part of the annual accounts, this obviously helps the auditor to properly understand the nature of the transaction involved and based on his professional judgment, he may decide whether to qualify his report. If the notes contain clarification that satisfies the auditor, he may not make any observation in his report. However, in no case it should be assumed that inserting notes to accounts by the management relieves the auditor from making an adverse report, where his professional judgment directs so. If certain notes included Secretarial Standard. in the "Notes to Accounts" inserted by the management are showing an adverse feature, it is the bounden duty of the auditor to qualify his report either by reproducing the relevant part from the "Notes to Accounts" in his report or by putting the essence of the note in understandable manner in his report with qualificatory statement. In the opinion of the ICAI, an auditor should not bring qualification in his report merely by referring to the concerned note to accounts. Where he is not satisfied, he should put independent remark in his report by reproducing the note itself where it is self-explanatory or by referring to the note along with his observations.

19.8-9 Additional information under the Companies (Accounts) Rules 2014

Rule 8(5) requires some additional information to be reported in the Board' report as detailed below:

(*i*) the financial summary or highlights;

(*ii*) the change in the nature of business, if any;

(*iii*) the details of directors or key managerial personnel who were appointed or have resigned during the year;

(*iv*) the names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;

(*v*) the details relating to deposits accepted during the year, remained unpaid or unclaimed as at the end of the year. If there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved.

(*vi*) deposits which are not in compliance with the requirements of the Act need to be reported separately.

(*vii*) Any significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;

(*viii*) Adequacy of internal financial controls with reference to the Financial Statements;

(*ix*) a disclosure, as to whether maintenance of cost records as specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013, is required by the Company and accordingly such accounts and records are made and maintained;

(*x*) a statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 [14 of 2013]*.

19.8-9A Board Report for One Person Company and Small Company

The Board's Report of One Person Company and Small Company is required to be prepared based on the standalone financial statement of the company, which shall be in abridged form and contain the following:—

(*a*) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;

(*b*) number of meetings of the Board;

(*c*) Directors' Responsibility Statement as referred to in sub-section (5) of section 134;

(*d*) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;

(*e*) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report;

(*f*) the state of the company's affairs;

(*g*) the financial summary or highlights;

(*h*) material changes from the date of closure of the financial year in the nature of business and their effect on the financial position of the company;

(*i*) the details of directors who were appointed or have resigned during the year;

(*j*) the details or significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future.

The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2**.

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*Amended *vide* Notification G.S.R 725(E) dated 31st July 2018

**Rule 8A Companies (Accounts) Amendment Rules, 2018, inserted *vide* Notification G.S.R 725(E) dated 31st July, 2018

19.8-10 Corporate Social Responsibility Report

Section 135 of the Act requires certain companies to constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors with at-least one independent director. However, if a company is not required to appoint an independent director under section 149(4), the CSR committee shall have two or more directors.* The companies specified for this purpose are those having net worth of rupees five hundred crores or more, or turnover of rupees one thousand crores or more or a net profit of rupees five crore or more. The composition of the committee formed under Section 135 needs to be disclosed in the Board's report. Clause (*o*) of Section 134(3) requires disclosure of company's policy and initiatives taken during the year. The Companies (Social Responsibility Policy) Rules, 2014 states that Board' report shall include an annual report on CSR containing particulars specified in the Annexure to the rules.

19.8-11 Composition of Audit Committee

Every listed public company and other class or classes of companies as may be specified are required to constitute an Audit Committee as per the requirements of Section 177(1). The Audit Committee so constituted has power to give recommendation to the Board on matters relating to appointment of auditors, internal financial controls etc. The Board's report needs to disclose the composition of Audit Committee. If any of the recommendation of the Audit committee had not been accepted by the Board, the same also shall be disclosed in the Board's Report [Section 177(8)].

19.8-12 Other disclosures in the Board's Report

The requirements of other provisions of the Act relating to disclosure in the Board's Report are summarized below:

(*i*) Section 43 - Details regarding issue of equity shares with differential rights [Para 9.4].

(*ii*) Section 62 – Details regarding Employees Stock Option Scheme [Para 9.7].

(*iii*) Section 131 – Reasons for voluntary revision of financial statements or Board' Report [Para 19.11-2].

(*iv*) Section 135 – Composition of CSR Committee, CSR Policy of the company and reasons for not spending the prescribed amount on CSR activities [Para 19.8-10].

(*v*) Section 149 – Details regarding reappointment of independent director by special resolution [Para 14.9-9].

(*vi*) Section 177 –Details regarding establishment of Vigil Mechanism (Para 19.35-1].

(*vii*) Section 178 – Policy relating to remuneration of directors, key managerial personnel and other employees

(*viii*) Section 188 – Contracts or arrangements with related parties [Para 14.23].

(*ix*) Section 204 – Secretarial Audit Report to be annexed to the Board's Report [Para 19.37-8].

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* Inserted *vide* the Companies (Amendment) Act, 2017.

19.8.13 Management Discussion and Analysis Report

Regulation 34 of SEBI (Listing Obligations and Disclosure Requirement) Regulations requires a Management Discussion and Analysis report to be incorporated in the annual report of the company. This report may be made a part of the Board's report or as an addition thereto. As contents of the MDA report are overlapping with the Board's report, many of the companies are incorporating the same in the Board's report itself. The following are the matters to be reported:

(*i*) Industry structure and developments.

(*ii*) Opportunities and Threats.

(*iii*) Segment–wise or product-wise performance.

(*iv*) Outlook

(*v*) Risks and concerns.

(*vi*) Internal control systems and their adequacy.

(*vii*) Discussion on financial performance with respect to operational performance.

(*viii*) Material developments in Human Resources/Industrial Relations front, including number of people employed

The extent of disclosure here would be guided by company's competitive position.

19.8-14 Corporate Governance Report

Regulation 34 of SEBI (Listing Obligations and Disclosure Requirement) Regulations also requires a separate corporate governance report in the Annual Report of the company. The report would have details relating to the company's philosophy on corporate governance, composition of the Board of directors including committees of the board and attendance of the board members, prescribed details regarding the audit committee, remuneration committee and shareholders, committee.

19.8-15 Disclosure under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013

The company needs to confirm that it has established an Anti Sexual Harassment Policy to redress complaints received regarding sexual harassment covering all employees (permanent, contractual, temporary, trainees). In addition a summary of sexual harassment complaints received and disposed off during the year needs to be given.

19.8-16 Report to be signed by the Chairman of the Board

The Board's report and any annexures thereto shall be signed by the chairperson of the company if he is authorised in that behalf by the Board; and where he is not so authorised, the report shall be signed by at least two directors one of whom shall be a managing director or by the director where there is one director [Section 134(6)].

Any contravention to the provisions of Section 134 makes both the company and officers of the company at default liable to punishment. The company shall be

punishable with fine which shall not be less than rupees fifty thousand but which may extend to rupees twenty-five lakh and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than rupees fifty thousand but which may extend to rupees five lakh, or with both. [Section 134 (8)]

Liability for mis-statement - If any mis-statement appears in the Board's Report, then the directors remain liable in tort to individual members who acted placing reliance on such statement and suffered loss - *W.B. Anderson & Sons Ltd.* v. *Rhodes (Liverpool) Ltd.* [1967] 2 All (R-450).

Draft Secretarial Standard on Report of Board of Directors by ICSI - The ICSI has issued draft standard on Report of Board of Directors in pursuant of the Companies Act, 2013. Extract from the draft standard are given in Annexure 19.1.

Annual Report - The expression Annual Report represents a composite concept comprised of the Board's Report, Chairman's Message, if any, Annual Accounts, Audit Report and Report on Corporate Social Responsibility. It contains non-financial statements and disclosures apart from financial information in the form of balance sheet and profit and loss account along with related further financial information like cash flow statement. Traditionally financial information enjoyed the prominence vis-à-vis non-financial information in the Annual Report. However, with gradual expansion of corporate stakeholders' information needs and increased societal concerns with corporate functioning, the importance of non-financial information in the Annual Report is gaining prominence as financial information alone cannot satisfy the users of Annual Report including the government. The Corporate Social Responsibility statement has opened a new focused window to the users and others to understand whether the corporate functioning is in tandem with societal expectations from the corporate entities and whether such entities are socially responsive. In the context of growing importance of non-financial information, the ICSI issued a Guidance Note on Non-Financial Disclosures. By making meaningful, transparent and comprehensive disclosure of non-financial information, not only corporates would add more meaning to financial information, the disclosures will create a platform for stakeholders' interaction with the prevailing corporate world and when positive, will in turn create a sustainable value of the corporate to the society at large. Transparency on non-financial directors would form a fundamental component in effective stakeholder's relations, investment decisions and market relations.

19.9 Circulation of Financial Statements

Section 134(7) requires that a signed copy of every financial statements including consolidated financial statements shall be issued , circulated or published with a copy of any notes annexed to or forming part of such financial statements, the auditor's report and the Board's report.

A copy of the financial statements including consolidated financial statements, auditor's report and every other document required by law to be annexed or attached to the financial statements which are to be laid before the annual general meeting of the company shall be sent, not less than 21 days before the meeting, to every member of the company. Besides, a copy each must be sent to every trustee

for the debenture holders of the company and to all other persons so entitled [Section 136(1)]. In respect of a section 8 company, the documents are required to be sent 14 days before the meeting instead of 21 days.* Under section 146 of the Act, the auditor, is entitled to receive all notices and communications relating to any general meeting.

If copies of documents are sent less that twenty-one days before as required, they may be deemed to be duly sent if agreed to by the requisite number of members. In case of a company having share capital, majority of the member entitled to vote and representing not less than ninety-five per cent of the paid-up share capital shall agree. If the company has no share capital, it must be agreed by members having not less than ninety-five per cent of the total voting power exercisable at the meeting.**

In case of a listed company the above requirements are deemed to be met if the copies of the documents as aforesaid are made available for inspection at its registered office during working hours for a period of twenty one days before the date of the meeting. In such a case a statement containing the salient features of such statements is sent not less than twenty one day before the date of the meeting [proviso 1 to Section 136(1)]. The statement containing the salient features of financial statements shall be in Form AOC-3† of the Companies (Accounts) Rules 2014. However if any shareholder asks for full financial statements, the same shall be provided.

For a Nidhi company, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in the face value or more than one per cent of the total paid-up share capital whichever is lower, only an intimation is required to be sent by public notice in newspaper circulated in the district where the Registered Office of the company is situated. The notice need to state the date, time and venue of the AGM and that the financial statements can be inspected at the registered office of the company. The financial statements with enclosures are also required to be affixed in the notice board of the company and a member is entitled to vote either in person or through proxy.‡

The listed companies also need to place the financial statements and all other documents required to be annexed or attached thereto on its website including the separate audited accounts of each of its subsidiary companies. A copy of the separate audited financial statements of subsidiary companies shall also be furnished to the shareholders on demand [proviso 3 and 4 to Section 136(1)].

In case a listed company has a subsidiary incorporated outside India (foreign subsidiary) and the foreign subsidiary is statutorily required to prepare consolidated financial statement under any law of the country of its incorporation, it would be sufficient if consolidated financial statement of such foreign subsidiary is placed on the website of the listed company. Where such foreign subsidiary is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, it would be

*Amended *vide* Notification No. F No. 1/2/2014-CL.I dated 5 June, 2015.

** Inserted *vide* the Companies (Amendment) Act, 2017.

†Form AOC 3A for companies required to follow IND AS has been inserted *vide* Companies (Accounts) Amendment Rules, 2018 dated 27 February 2018.

‡Amended *vide* Notification No. F No. 2/11/2014-CL/V dated 5 June, 2015.

sufficient for the Indian holding to place such unaudited financial statement on its website and where such financial statement is in a language other than English, a translated copy of the financial statement in English is also required to be placed on the website.*

However if the foreign subsidiary is not required to get its accounts audited as per the local regulations, unaudited accounts may be placed or filed. If the accounts are in a language other than English the same need to be translated in English. Furthermore the format of the accounts of the subsidiary companies needs to meet the requirements of the Companies Act, 2013 to the extent possible. In case of deviation the reasons for the same also need to be placed with such accounts**.

In case of listed companies with net worth of rupees one crore and turnover of more than rupee ten crores, the financial statements may be sent electronically. The Rule 11 of the Companies (Accounts) Rules 2014 provides that financial statements may be sent electronically to those who are holding shares in dematerialized form and whose email ids are registered with depository for communication purposes. Likewise other members who have positively consented to receive the financial statements in electronic form, the financial statements may be sent electronically. Physical copies need to be sent to all other members.

Section 136(2) also requires that a company shall allow its members and debenture trustees to inspect the financial statements and other documents mentioned under sub-section (1). Such an inspection can be done at the registered office of the company during the business hours.

Section 136 attempts to strike a balance between the need of the shareholders to receive the financial statements and at the same time keeping the cost of printing and dispatch low. Wherever feasible and permitted financial statements can be sent in electronic mode.

Any default in compliance of Section 136 attracts a penalty of rupees twenty-five thousand for the company and rupees five thousand for every officer who is in default.

19.10 Adoption and filing of Financial Statements

One of the businesses to be transacted at an A.G.M. is consideration and adoption of the financial statements and the reports of the Board of Directors and auditors including the balance sheet and the profit and loss account [Section 102(2)]. Every A.G.M., other than the first A.G.M., is required to be held within six months of the close of the financial year [Section 96(1)].

It may be noted that the financial statements are required to be placed only at an A.G.M. and not at any other general meeting. The combined reading of Section 96(1) and Section 102(2) indicates that the financial statements shall be ready for placing before the A.G.M. within six months of the close of the financial year. In case the financial statements are not ready for laying at the appropriate annual general meeting, the company may adjourn the said annual general meeting to a subsequent date when the annual accounts are expected to be ready for laying. This may

*Inserted *vide* the Companies (Amendment) Act, 2017.

**Vide General Circular No 11/2015 dated 21 July 2015.

be done by adopting a suitable resolution adjourning the said annual general meeting to a specified date, or to a date to be specified later on. Section 116 of the Act however states that a resolution passed at an adjourned meeting shall be treated as having been passed on the date on which it has been passed. It follows that the adjourned A.G.M. should be held within the time frame laid down in Sections 96(1) and 102(2).

19.10-1 Filing of financial statements with the Registrar

Within thirty days of the date of the A.G.M. a duly adopted copy of the financial statements, including consolidated financial statement along with all the documents required to be annexed or attached to such financial statements, is required to be filed with the Registrar together with Form AOC-4* prescribed by Rule 12 of the Companies (Accounts) Rules, 2014. If the financial statements are not adopted at the A.G.M. or the adjourned A.G.M., the company shall file the un-adopted financial statements and the same are taken on record as provisional till the adopted financial statements are filed [Section 137(1) and proviso].

What happens if the A.G.M. for any year is not held within the time frame prescribed? In such a case the financial statements along with the necessary annexures and documents shall be filed with the Registrar within 30 days of the last date on which such A.G.M. should have been held. A statement explaining the facts and reasons for not holding the A.G.M. is also required to be submitted [Proviso to Section 137(1)]. In case of One Person Company, the financial statements shall be filed within one hundred and eighty days of the closure of the financial year.

A company having one or more subsidiaries which have been incorporated outside India and have not established a place of business in India is also required to file the accounts of its subsidiary or subsidiaries [proviso to Section 137(1)].

In case of a subsidiary incorporated outside India (foreign subsidiary) which is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, it would be sufficient for the Indian holding to file such unaudited financial statement alongwith a declaration to that effect and where such financial statement is in a language other than English, a translated copy of the financial statement in English is also required to be filed.**

If the financial statements along with all the necessary documents are not filed with the Registrar within thirty days of the A.G.M. or within thirty days of the last date before which the A.G.M. should have been held, the same may be filed within a period of two hundred and seventy days thereafter with additional fees as may be prescribed. Any failure to file the financial statements as aforesaid within three hundred days (thirty plus two hundred seventy days) is considered a continuing default and both the company and officers in default are liable to punishment. The company shall be liable to a penalty of rupee one thousand for every day during which the failure continues within a maximum of rupee ten lakh. The managing director and the Chief Financial Officer, if any or in absence of the managing

*Form AOC 4 has been amended *vide* Companies (Accounts) Amendment Rules, 2017 dated 7 November 2017 Notification No. G.S.R. 1371(E).

**Inserted *vide* the Companies (Amendment) Act, 2017.

director and the chief financial officer, any other director charged by the Board with responsibility under this section and in the absence of any such director, all the directors of the company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with a further penalty of one hundred rupees for every day after the first during which such failure continues subject to maximum of five lakh rupees [Section 137(3)].*

Even after retirement, a director would come under the definition of an 'officer in default' provided the offence has occurred during his stay in the office. Delhi High Court in *Anita Chadha* v. *Registrar of Companies* [1998] 18 SCL 304 has held that if it is not so held, then any managing director, director, manager or secretary would escape the provisions of sections 159 and 220 [now Sections 92 and 137] by simply tendering his resignation as the office bearer now of the company. The Gujarat High Court in *Rameshchandra Manilal Kotla* v. *State of Gujarat* [1998] 30 CLA 313 has held that if in a complaint, the accused were not shown as 'officer in default', they could not be held responsible merely because they were directors at the relevant time of occurrence of the offence.

Where petitioner, who was honorary secretary in accused company, had tendered his resignation 11 to 15 years prior to alleged violation and same had been accepted by company and ROC, he could not be convicted for alleged offence under section 162 read with section 220(2) [Corresponding to sections 92 and 137 of the Act] - *B.N. Kaushik v. ROC* [2009] 92 SCL 127/150 Comp. Cas. 97 (Delhi).

19.10-2 Filing of financial statements in XBRL format

The Central Government may by notification require a certain class of companies to file their financial statements in Extensible Business Reporting Language (XBRL) format. The manner and filing may also be prescribed by the Central Government. XBRL is a standardized language to express, report or file information in an electronic form [Rule 12(2) of the Companies (Accounts) Rules, 2014]. The Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 require the following class of companies to file their financial statement and other documents under section 137 of the Act using the XBRL taxonomy:

i. companies listed with any Stock Exchange(s) in India including their Indian subsidiaries;

ii. companies having paid up capital of rupees five crore or above;

iii. companies having turnover of rupees hundred crore or above; or

iv. Companies which were hitherto covered under the Companies (Filing of documents and forms in Extensible Business Reporting Language) Rules, 2011.

v. All companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

vi. The companies which have filed their financial statements either under these rules or under the erstwhile rules, namely the Companies (Filing of

**Substituted vide Companies (Amendment) Act, 2019.*

Documents and Forms in Extensible Business Reporting Language) Rules, 2011.*

However, banking companies, insurance companies, power sector companies non-banking financial companies and housing finance companies are exempted from XBRL filing.

19.11 Reporting on revised annual statements of accounts

A need may arise for a company to reopen and revise its accounts even after their adoption in the annual general meeting. For example it may arise in order to meet the technical requirements of taxation laws or to meet the directions of the Insurance Regulatory and Development Authority by the insurance companies. The erstwhile Department of Company Affairs clarified that a company could reopen its accounts even after their adoption in the annual general meeting and filing with the Registrar of Companies in order to comply with the technical requirements of any other law to achieve the object of exhibiting true and fair view. The revised annual accounts would be required to be adopted either in the extraordinary general meeting or in the subsequent annual general meeting and filed with the Registrar of Companies - 'General Circular No. 1 of 2003, dated 13th January 2003'.

19.11-1 Re-opening of accounts on Court's or Tribunal's orders

The Act allows the reopening of accounts and recasting the financial statements at the order of a court or the Tribunal. The application to the court or the Tribunal may be made by the Central Government, the Income Tax authorities, the Securities and Exchange Board of India or any other statutory regulatory body or any other person concerned. The Court or the Tribunal, if of the opinion that the relevant accounts were prepared in a fraudulent manner or the affairs of the company were being mismanaged during the relevant time questioning the reliability of the financial statements, may order the accounts to be revised or re-casted [Section 130(1)]. However, no order for re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year can be made. If the Central Government under Section 128(5) has ordered books of account to be kept for more than eight years, the books of account may be ordered to be re-opened with in such longer period**. The accounts so revised or re-casted shall be final.

The application is required to be made in Form Number NCLT 9 prescribed under National Company Law Tribunal Rules, 2016. The applications need to be accompanied with the requisite fees and prescribed documents.†

*Amended *vide* Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Amendment Rules, 2018, Notification G.S.R. 213(E), dated 8 March 2018.

**Inserted *vide* the Companies (Amendment) Act, 2017.

† Inserted *vide* National Company Law Tribunal (Amendment) Rules, 2016, Notification No G.S.R. 1159(E) dated 20 December 2016.

19.11-2 Voluntary revision of Financial Statements or Board's Report

Section 131 of the Act permits the company to voluntarily revise its financial statements or Board's report in respect of any of the three preceding financial years. If in the opinion of the directors the financial statements or Board's report are not meeting the requirements of Section 129 or Section 134 respectively, the company may apply to the Tribunal for an approval to revise the financial statements or the Board's report. The application is required to be made in Form No NCLT-1 within fourteen days of the decision taken by the board. In case the majority of the directors of company or the auditor of the company has been changed immediately before the decision is taken to apply under section 131, the company shall disclose such facts in the application. Rule 77 of National Company Law Tribunal Rules, 2016 lays down the documents to be submitted with the application and procedure to be followed by the Tribunal in such case. The Tribunal after giving notice to the Central Government and the Income Tax authorities may by order permit such revision. Such revised statement or report shall not be prepared or filed more than once in a financial year. The company is also required to furnish the reasons for such a revision in the Board's report of the financial year in which such revision is being made. [proviso to Section 131(1)].

A company applied under section 131 for voluntary rectification of the Report of Board pertaining to procedural documents attached with financial statement or disclosures. ROC found that there would be no financial effect if revision was made in Report of Board and further, company undertook to pay tax dues and there was no pending complaint and inspection/investigation. The NCLT upheld the application to grant the approval. [*Clues Network (P.) Ltd.* v. *Registrar of Companies, NCT of Delhi and Haryana,* [2018] 100 taxmann.com 171 (NCLT-Chd.)]

The provisions relating to re-opening and revision of financial statements and board's report either voluntarily or on Court's orders or Tribunal's orders have been introduced for the first time by the Act. There were no corresponding provisions in the earlier law.

19.12 Accounting Standards

Under Section 129(1) the financial statements shall comply with the accounting standards notified under Section 133 of the Act. The Directors Responsibility Statement prepared under clause (*c*) of Section 134(3) shall state that in the preparation of the annual accounts, the applicable accounting standards have been followed. Any material departures need to be explained. The Central Government may under Section 133 prescribe the standards of accounting or any addendum thereto as recommended by the Institute of Chartered Accountants of India. The recommendations of the ICAI need to be examined by the National Financial Reporting Authority. A combined reading of Section 129(1), Section 133 and 134(3) makes it amply clear that the accounting standards notified by the Central Government are mandatory to be followed. Till the time accounting standards are specified by the Central Government as aforesaid, the standards specified under the Companies Act, 1956 shall be treated as the accounting standards [Rule 7 of the Companies (Accounts) Rules 2014].

The Ministry of Company Affairs[5], Govt. of India, by Notification No. GSR 739(E), dated 7-12-2006 issued the Companies (Accounting Standards) Rules, 2006 in pursuant of the Companies Act, 1956. Under these rules, the accounting standards notified therein apply in preparation of 'General Purpose Financial Statements', which include balance sheet, statement of profit & loss, cash flow statement (wherever applicable), and other statements and explanatory notes which form part thereof. The rules enjoin on every company and its auditors to comply with the accounting standards annexed to the rules. In complying with the rules, only material items are intended to be under the purview of the rules. The accounting standards annexed to the rules are intended to be in conformity with provisions of applicable laws. If subsequently, due to change in law, any requirement of the standards does not meet the corresponding requirement of the applicable law, then the applicable law as changed will prevail upon the standard. The rules have defined 'Small and Medium Sized Company' (SMC) which has been accorded some exemption or relaxation in complying with the rules and have stated that an existing company which was not an SMC but has become SMC will not be allowed exemptions/relaxation available to SMCs until the company remains an SMC for two consecutive accounting periods. These rules apply to the accounting periods commencing on or after the publication of these rules in the official gazette.

The List of Accounting Standards (AS) specified under the Companies Act, 1956 is as under:

1. Disclosure of Accounting Policies (AS 1).
2. Valuation of Inventories (AS 2).
3. Cash Flow Statements (AS 3).
4. Contingencies and Events occurring after the Balance Sheet Date (AS 4).
5. Net Profit or Loss for the period, Prior Period Items and Changes in Accounting Policies (AS 5).
6. Depreciation Accounting (AS 6).
7. Construction Contracts (AS 7).
8. Revenue Recognition (AS 9).
9. Accounting for Fixed Assets (AS 10).
10. The Effects of changes in Foreign Exchange Rates (Revised) (AS-11)[6].
11. Accounting for Government Grants (AS 12).
12. Accounting for Investments (AS 13).
13. Accounting for Amalgamations (AS 14).
14. Employee Benefits (AS 15).
15. Borrowing costs (AS 16).
16. Segment Reporting (AS 17).

5. Now Ministry of Corporate Affairs.
6. Vide Notification F. No. 17/133/2008-CLV dated 29.12.2011, the MCA has extended certain relaxations in application of the Standard for Accounting Statements ending upto 31.3.2020.

17. Related Party Disclosures (AS 18).
18. Leases - (AS 19).
19. Earnings per share (AS 20).
20. Consolidated Financial Statements (AS 21).
21. Accounting for Taxes on Income (AS 22).
22. Accounting for Investments in Associates in Consolidated Financial Statements (AS 23)
23. Discontinuing operations (AS 24).
24. Interim financial reporting (AS 25).
25. Intangible Assets (AS 26).
26. Financial Reporting of interests in Joint Ventures-(AS-27).
27. Impairment of assets (AS-28).
28. Provisions, Contingent Liabilities and Contingent Assets - (AS-29).
29. Financial Instruments : Recognition and Measurement (AS 30).
30. Financial Instruments : Presentation (AS 31).
31. Financial Instruments Disclosures (AS 32).

19.12-1 Convergence of Accounting Standards in India with International Financial Reporting System (IFRS)

In view of a high degree of globalization of Indian businesses and to smoothen the two-way flow of investments, the ICAI at the behest of the MCA, took on hand the process of integration of Accounting Standards with International Financial Reporting Standards (IFRS) so as to require large sized Indian companies to follow the IFRS Converged Accounting Standards. These converged accounting standards have been titled as Indian Accounting Standards (Indian ASs). The list of such standards finalized and notified by MCA on 16-2-2015 is as under:

Indian Accounting Standards (Ind AS) 1 - 'Presentation of Financial Statements'

Indian Accounting Standards (Ind AS) 2 - 'Inventories'

Indian Accounting Standards (Ind AS) 7 - 'Statement of Cash Flows'

Indian Accounting Standards (Ind AS) 8 - 'Accounting Policies, Changes in Accounting Estimates and Errors'

Indian Accounting Standards (Ind AS) 10 - 'Events after the Reporting Period'

Indian Accounting Standards (Ind AS) 12 - 'Income Taxes'

Indian Accounting Standards (Ind AS) 16 - 'Property, Plant and Equipment'

Indian Accounting Standards (Ind AS) 17 - 'Leases'

Indian Accounting Standards (Ind AS) 19 - 'Employee Benefits'

Indian Accounting Standards (Ind AS) 20 - 'Accounting for Government Grants and Disclosure of Government Assistance'

Indian Accounting Standards (Ind AS) 21 - 'The Effects of Changes in Foreign Exchange Rates'

Indian Accounting Standards (Ind AS) 23 - 'Borrowing Costs'

Indian Accounting Standards (Ind AS) 24 - 'Related Party Disclosures'

Indian Accounting Standards (Ind AS) 27 - 'Consolidated and Separate Financial Statements'

Indian Accounting Standards (Ind AS) 28 - 'Investments in Associates'

Indian Accounting Standards (Ind AS) 29 - 'Financial Reporting in Hyperinflationary Economies'

Indian Accounting Standards (Ind AS) 32 - 'Financial Instruments : Presentation'

Indian Accounting Standards (Ind AS) 33 - 'Earnings per Share'

Indian Accounting Standards (Ind AS) 34 - 'Interim Financial Reporting'

Indian Accounting Standards (Ind AS) 36 - 'Impairment of Assets'

Indian Accounting Standards (Ind AS) 37 - 'Provisions, Contingent Liabilities and Contingent Assets'

Indian Accounting Standards (Ind AS) 38 - 'Intangible Assets'

Indian Accounting Standards (Ind AS) 40 - 'Investment Property'

Indian Accounting Standards (Ind AS) 41 – Agriculture

Indian Accounting Standards (Ind AS) 101 - 'First-time Adoption of Indian Accounting Standards'

Indian Accounting Standards (Ind AS) 102 - 'Share-based Payment'

Indian Accounting Standards (Ind AS) 103 - 'Business Combinations'

Indian Accounting Standards (Ind AS) 104 - 'Insurance Contracts'

Indian Accounting Standards (Ind AS) 105 - 'Non-current Assets Held for Sale and Discontinued Operations'

Indian Accounting Standards (Ind AS) 106 - 'Exploration for and Evaluation of Mineral Resources'

Indian Accounting Standards (Ind AS) 107 - 'Financial Instruments : Disclosures'

Indian Accounting Standards (Ind AS) 108 - 'Operating Segments'

Indian Accounting Standards (Ind AS) 109 - Financial Instruments

Indian Accounting Standards (Ind AS) 110 - Consolidated Financial Statements

Indian Accounting Standards (Ind AS) 111 - Joint Arrangements

Indian Accounting Standards (Ind AS) 112 - Disclosure of Interests in Other Entities

Indian Accounting Standards (Ind AS) 113 - Fair Value Measurement

Indian Accounting Standards (Ind AS) 114 - Regulatory Deferral Accounts

Indian Accounting Standards (Ind AS) 115 - Revenue from Contracts with Customers

The MCA has notified a phased road map for the transition to Ind AS commencing from 1st April, 2016. It would be compulsory for the listed companies and certain other class of companies to follows Ind AS with effect from 1st April 2016 whereas other companies would be required to transit to Ind AS for the accounting periods

beginning on or after 1st April, 2017. The Companies (Accounts) Rules 2014 has accordingly been amended. The financial statements need to be prepared in accordance with the requirements and definitions specified in the Accounting Standards or the Indian Accounting Standards as may be applicable*.

In respect of insurance companies, banking companies and NBFCs, the transition to Ind AS would begin for the accounting period beginning from 1 April 2018.

Voluntary Adoption

Companies may voluntarily prepare financial statements using Ind AS for accounting periods beginning on or after 1 April, 2015, with the comparatives for the periods ending 31 March, 2015 or thereafter.

Mandatory Adoption

In the first phase it would be mandatory for the companies specified below to follow Ind AS for the accounting periods beginning on or after 1 April, 2016, with comparatives for the periods ending 31 March, 2016.

(*i*) Companies whose equity and/or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth of Rs. 500 Crore or more.

(*ii*) Companies other than those covered above, having net worth of Rs. 500 Crore or more.

(*iii*) Holding, subsidiary, joint venture or associate companies of companies covered above.

In the second phase Ind AS would be mandatory for specified companies for the accounting periods beginning on or after 1 April, 2017, with comparatives for the periods ending 31 March, 2017 or thereafter. The companies specified for the second phase are:

(*i*) Companies whose equity and/or debt securities are listed or are in the process of being listed on any stock exchange in India or outside India and having net worth of less than Rs. 500 Crore.

(*ii*) Unlisted companies having net worth of Rs. 250 crore or more but less than Rs. 500 Crore.

(*iii*) Holding, subsidiary, joint venture or associate companies of companies covered above.

In respect of insurance companies, banking companies and NBFCs, the following companies are required to follow Ind AS for the accounting period beginning from 1 April 2018 with comparatives for the period ending on 31 March 2018.

(*i*) Insurance companies, scheduled commercial banks (excluding regional rural banks) and all-India term lending institutions

(*ii*) The holding, subsidiary, joint venture or associate companies of scheduled commercial banks (excluding RRBs)

(*iii*) NBFCs having net worth of rupees 500 crores of more

*Vide notification dated 4th September 2015 (F No. 1/19/2013-CL-V-Part).

(*iv*) The holding, subsidiary, joint venture or associate companies of the above mentioned NBFCs

In the second phase, the following type of NBFCs are mandated to prepare Ind AS based financial statements from accounting period beginning on 1 April 2019 with comparatives for the accounting period ending 31 March 2019.

(*i*) NBFCs whose equity or debt securities are listed or are in the process of listing on any stock exchange in India or outside India and having net worth less than rupees 500 crores

(*ii*) Unlisted NBFCs having net worth of more than rupees 250 crores but less than rupees 500 crores

(*iii*) The holding, subsidiary, joint venture or associate companies of NBFCs covered as aforesaid.

Once a company starts to follow Ind AS, voluntarily or mandatorily, it shall be required to follow the same for all the subsequent financial statements. Companies listed or getting listed on the Small and Medium Enterprises (SME) exchanges are exempted from adoption of Ind AS. Companies not covered by the revised road map could continue to apply the existing accounting standards.

19.12-2 National Financial Reporting Authority

The Central Government under Section 132(1) is empowered to constitute a National Financial Reporting Authority (NFRA) for matters relating to accounting and auditing standards. The accounting standards as recommended by the Institute of Chartered Accountants of India are prescribed by the Central Government after considering the recommendations of the NFRA under Section 133. The Government has laid down the rules relating to the functioning, powers, functions and duties of the National Financial Reporting Authority and processes for monitoring and enforcing compliance with accounting standards by the Authority.*

19.13 Internal Audit

Section 138 read with Rule 13 of the Companies (Accounts) Rules, 2014 requires the following class of companies to mandatorily appoint an internal auditor or a firm of internal auditors:

(*a*) every listed company;

(*b*) every unlisted public company having -

a. paid up share capital of rupees fifty crores or more during the preceding financial year; or

b. turnover of rupees two hundred crores or more during the preceding financial year; or

c. outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more at any point of time during the preceding financial year; or

*National Financial Reporting Authority Rules, 2018. *Vide* Notification No G.S.R 1111(E), dated 13, November 2018.

d. outstanding deposits of rupees twenty five crores or more at any point of time during the preceding financial year.

(*c*) every private company having –

a. turnover of rupees two hundred crores or more during the preceding financial year; or

b. outstanding loans or borrowings from banks or public financial institutions exceeding rupees one hundred crore or more at any point of time during the preceding financial year.

It is not compulsory that the internal audit shall be conducted by an outside firm; it may be conducted by the employees of the company as well. The internal audit shall be conducted by a chartered accountant or a cost accountant or any other professional as may be prescribed. The companies specified in this section appear to be those dealing with public money (listed companies or companies with large loans or borrowing or deposits or companies with large turnover). The scope, periodicity, functioning and methodology for conducting the internal audit shall be finalized by the Audit Committee in consultation with the Internal Auditor.

AUDIT

19.14 Need for audit/Objective of audit

A company carries on business with capital provided by persons who are not in control of the use of the money supplied by them. They would, therefore, like to see that their investments are safe, are being used for intended purpose(s) and the annual accounts of the company present a true and fair view of the state of affairs of the company. For this purpose, the accounts of the company must be checked and audited by a duly qualified and independent person who is neither employed in the company nor is in any way indebted or otherwise obliged to the company.

Originally, the audit function was primarily a public function. Its objective was to detect fraud and error. Dicksee in his text book on auditing[7] outlines the objectives of an audit as:—

1. The detection of fraud
2. The detection of technical errors
3. The detection of errors of principle.

The means for achievement of such an objective was a detailed analysis of transactions. Dicksee mentioned the concept of internal check and pointed out that when a good system of internal checks exists, a detailed audit is frequently not necessary in its entirety.

With the passage of time and the growth of enterprises to the size that made significantly improved internal system of control economical, a detailed audit of transactions became impractical and the objectives of the audit function changed significantly. The auditor's report on financial statements became an end-product rather than merely an evidence of absence of fraud.

7. I.R. Dicksee. *Auditing - A Practical Manual for Auditors,* p. 7.

The Committee on Auditing Procedure of the AICPA dealt with this subject as follows ".....the ordinary examination directed to the expression of an opinion on financial statements is not primarily or specifically designed and cannot be relied upon, to disclose defalcation and other similar irregularities, although their discovery may result".

The ICAI, in its "Statement on Objective and Scope of the Audit of Financial Statements"[8] enumerates the following as the objectives of auditing the financial statements:

1. The objective of an audit of financial statements, prepared within a framework of recognised accounting policies and practices and relevant statutory requirements, if any, is to enable an auditor to express an opinion on such financial statements.
2. The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise. The user, however, should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.

Thus, the main objective of auditing today is the evaluation of financial statements to see whether they truly and fairly represent the actual financial position. Detection of frauds and errors is only an incidental objective. The auditor recognises that any fraud, if sufficiently material, may affect his opinion as to whether the accounts show a true and fair view and he takes this into account in conducting an audit. The Research Committee of the ICAI in its publication 'Statement on Auditing Practices'[9] had stated "While an audit under the Companies Act is not intended and cannot be relied upon to disclose all defalcations and other irregularities, their discovery may be incidental to such an audit. *Similarly,* although the discovery of deliberate misrepresentations by management is usually more closely associated with the objectives of an audit, an audit cannot be relied upon to ensure such discovery. The responsibility of the auditor for failure to detect fraud (which responsibility may differ as to clients and others) arises only when such failure is clearly due to his not exercising reasonable care and skill." *Further,* the Research Committee observed that if an audit is to be conducted with the objective of discovering all frauds, in the first place, it would take a considerable amount of time and it would not be possible to complete the audit within the time limit prescribed by law for the presentation of accounts to shareholders. *Further,* such an audit would have to involve a detailed and minute examination of all the books, records and other documents of the company, the cost of doing which would be recovered from the shareholders. *Finally,* it must be recognised that even if such an examination were to be conducted, there would be no assurance that all types of frauds (of omission or commission, forgery, illegal receipts of commission, etc.) would be discovered.

Nevertheless, the auditor is often in a position to discover frauds. Where, during the course of his audit, he comes across circumstances which arouse his suspicion, he

8. Issued in April 1985.
9. 1978 edition p.4. The ICAI has since issued AAS-4 on Fraud and Error embodying the same thought.

should decide whether a fraud, in fact, does exist, and if so, whether it would be sufficiently material to affect his opinion on the accounts he is auditing.

If after the auditor has completed his audit a fraud is discovered pertaining to that period, it does not necessarily mean that the auditor has been negligent or that he has not performed his duties competently. The auditor does not guarantee that once he has signed the report on the accounts, no fraud exists. If he has conducted his audit by applying due care and skill in consonance with the professional standards expected, the auditor would not be held responsible for not having discovered that fraud.

19.15 Who can be appointed as an Auditor (Qualifications)

Section 141(1) of the Act prescribes the qualifications and disqualifications for being appointed as a company auditor. An auditor of a company possessing the qualifications prescribed in section 141 of the Act is generally known as the statutory auditor of the company as he derives his duties, power and authority from the statute *i.e.*, the Companies Act. According to section 141(1) "a person shall be eligible for appointment as auditor of a company only if he is a chartered accountant". Section 2(17) defines a chartered accountant as a chartered accountant who holds a valid certificate of practice under sub-section (1) of section 6 of the Chartered Accountants Act, 1949.

Accordingly only a chartered accountant holding a certificate of practice is eligible to be appointed as an auditor of a company. It is further provided that a firm, including a limited liability partnership, whereof majority of the partners practising in India are qualified for appointment as auditor, may be appointed by its firm name to be the auditor of a company. In this regard, it may be noted that under the Chartered Accountants Act, 1949, only a chartered accountant holding a certificate of practice can be engaged in the public practice of accountancy. However the Chartered Accountants Act, 1949 also permits the chartered accountants to enter into partnership with other professionals. In such a case the Section 141(2) of the Act states that if a firm (including a limited liability partnership) is appointed as an auditor, only those partners who are chartered accountants are authorized to sign on behalf of the firm.

Thus, it is only a practising chartered accountant who can be appointed as an auditor of a company. Further, such a chartered accountant is also subject to the requirements of ethical conduct as contained in the Chartered Accountants Act. The High Court of Delhi in the case of the *Council of the Institute of Chartered Accountants of India* v. *B. Ram Goel* [2001] 29 SCL 257 has held the chartered accountant concerned as guilty for writing a letter to the shareholders of a company where he rendered professional service, for sale of their shares in that company (originally, the Council of the Institute held the chartered accountant as guilty).

In another case *Institute of Chartered Accountants of India* v. *S.K. Jain* [2001] 29 SCL 265, the same High Court held the chartered accountant concerned as guilty of gross negligence in certifying a statement of export of leather goods, without verifying facts from relevant books/documents of the concerned company.

19.16 Who cannot be appointed as an Auditor (Disqualifications)

The following entities or persons have been disqualified under section 141(3) of the Act from being appointed as an auditor of a company—

(*a*) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(*b*) an officer or employee of the company;

(*c*) a person who is a partner, or who is in the employment, of an officer or employee of the company;

(*d*) a person who, or his relative or partner—

(*i*) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However the relative may hold security or interest in the company of face value not exceeding one thousand rupees or such sum as may be prescribed;

(*ii*) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of such amount as may be prescribed; or

(*iii*) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, for such amount as may be prescribed;

(*e*) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed;

(*f*) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel;

(*g*) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

(*h*) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;

(*i*) a person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.*

The disqualifications as aforesaid are largely to ensure the independence of the auditors and for avoiding any conflict of interest while performing his duties as an auditor because of any pecuniary interest in the company whose accounts are being audited. The Companies (Audit and Auditors) Rules 2014 sets out the threshold limits for the purposes of Section 141. According to Rule 10(1) a relative of an auditor may hold securities in the company of face value not exceeding rupees

* Amended *vide* the Companies (Amendment) Act, 2017.

one lakh for the purpose of sub clause (*i*) of clause (*d*) of Section 141(3). Likewise for the purposes of sub clauses (*ii*) and (*iii*) of clause (*d*) limits of rupees five lakhs and rupees one lakh respectively have been prescribed. The proviso of Rule 10(1) states that if a relative acquire security or interest in the company, the auditor shall take the corrective action to maintain the limits within a period of sixty days of such acquisition.

The expression 'business relationship' as envisaged under clause (*e*) of Section 141(3) as aforesaid excludes professional services rendered by an auditor or firm which are permitted by the Act and the Chartered Accountants Act, 1949. Similarly commercial transactions entered into the ordinary course of business of the company and at arm's length price would not attract disqualification [Rule 10(4)(*i*) & (*ii*)]. For example sale of products or services by the company to the auditor by companies engaged in telecommunications, airlines, hotels etc.

Disqualification may come to an auditor if he ceases to be a member of the ICAI or is adjudged as having unsound mind or is an un-discharged insolvent (*vide* sections 8 and 20 of the Chartered Accountants Act, 1949). Further, in a clarification issued by the Central Government, Department of Company Affairs, it has been stated that if a person is appointed as statutory auditor, he cannot simultaneously be appointed internal auditor of the company for the same period.

If after his appointment an auditor becomes subject to any of the disqualifications listed above, he shall be deemed to have vacated his office forthwith. Thus, after appointment as auditor of banking company, if the auditor takes loan from the bank (including any branch of the bank) exceeding the limit prescribed, he becomes disqualified and has to vacate the office of the auditor in the banking company. The council of the ICAI has decided that no auditor/audit firm who/which does not have the Peer Review Certificate issued by the Peer Review Board can carry on audit of listed companies in respect of accounting periods commencing from April 1, 2009.

Also such auditor/audit firm is debarred from attesting the financial statements in respect of IPOs of companies - Source - The Hindu Business Line (N. Delhi Edition) of April 20, 2009.

The erstwhile Deptt. of Company Affairs had issued the Circular No. 14/51/62-PR; it reads as under:

"It is the view of the Department that it would not be desirable practice for a practising Chartered Accountant X who is connected with the managing director of company, A or where X acts as auditor of company A, to be on the Board of Company B or to act or be employed as tax or financial advisor to company B, where companies A and B are in the same group, because he may find it difficult to exercise an independent judgment." It may be noted that the circular does not possess the legal force. It roots on subjective proposition of desirability.

19.16-1 Disqualification due to fraudulent acts

Under Section 140(5) of the Act the Tribunal may by order remove an auditor if it is satisfied that the auditor of a company has acted in a fraudulent manner or has abetted or colluded in any fraud by or in relation to the company or its directors or officers. An auditor against whom a final order has been passed by the Tribunal

shall not be eligible for appointment as an auditor of any company for a period of five years from the date of passing of the order [Proviso to Section 140(5)].

19.16-2 Disqualification due to professional misconduct

In case of professional or other misconduct, the National Financial Reporting Authority (NFRA) has the power to debar the member or the firm form being appointed as an auditor or internal auditor of undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate or performing any valuation as provided under section 247. The debarment would be for a minimum period of six months but may extend to ten years. [Section 132(4)(c)(B)]†.

19.16-3 Ceiling on Audit

According to sub-clause (*g*) of Section 141(3) a person cannot be auditor of more than twenty companies at a time. For the purpose of counting twenty companies as aforesaid, only public companies and private companies having paid up capital of rupees one hundred crore or more are to be considered. One person companies, dormant companies, small companies and private companies having paid up capital of less than rupees one hundred crore are excluded for this purpose.*

19.17 Auditor not to render certain services

It is important to ensure that the auditor's independence and objectivity is not compromised because of the fees earned by him by rendering other services to the company for which he is acting as an auditor. To achieve this objective Section 144 of the Act prohibit the auditor to render certain prescribed services, directly or indirectly, to the company or its holding company or subsidiary company. The services specified are:

(*a*) accounting and book keeping services;
(*b*) internal audit;
(*c*) design and implementation of any financial information system;
(*d*) actuarial services;
(*e*) investment advisory services;
(*f*) investment banking services;
(*g*) rendering of outsourced financial services;
(*h*) management services; and
(*i*) any other kind of services as may be prescribed:

An auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall cease to provide such service before the closure of the first financial year after the date of such commencement.

The Audit Committee or the board of directors is empowered to define the scope of services to be rendered by the auditor excluding the services mentioned above. The restriction applies to rendering of such services by the individual auditor, his relatives or any other person connected or associated with the individual or any

†Amended *vide* the Companies (Amendment) Act, 2019.

*Amended *vide* Notification No. F No. 1/2/2014-CL.V dated 5 June 2015.

other entity over which the individual has significant influence or control. In case the auditor is a firm the restriction applies to the partners, parent, subsidiary or associate entity or an entity in which the firm or partner has significant influence or control. If the auditor, individual or firm, is using name, trade mark or brand of another entity, the restriction applies to that other entity as well.

19.18 Appointment of First Auditors

Section 139(6) lays down that the first auditor or auditors of a company shall be appointed by the Board of directors within thirty days of the date of registration of the company. The auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the Board of directors fails to exercise its power, it shall inform the members of the company. In such a case the first auditors are appointed by the members in an extraordinary general meeting within ninety days.

Sometimes, the first auditors of a company are named in the Articles of Association. Such appointment of auditors cannot be held valid since the Act grants it no recognition. The first auditors would be validly appointed only by a resolution of the Board of directors or that of the company in the general meeting.

In case of a Government company or a company owned or controlled by the Central Government, State Government or Governments or partly by the Central Government and partly by one or more State Governments, the first auditors shall be appointed by the Comptroller and Auditor-General of India (CAG) within sixty days from the date of registration of the company. If the CAG fails to exercise his power, the Board is authorized to appoint the first auditors within the next thirty days. In case of a failure by the Board, the members must be informed who shall appoint the first auditor in an extraordinary general meeting within sixty days [Section 139(7)].

The first auditors so appointed hold office till the conclusion of the first annual general meeting.

19.19 Appointment of subsequent Auditors

Section 139(1) provides that "every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting". The matter relating to such appointment shall be placed for ratification by members at every annual general meeting. The subsequent auditor or auditors are appointed by the members in annual general meeting by passing an ordinary resolution.

Where a company is required to constitute an Audit Committee under Section 177 of the Act, all appointments of auditors shall be made based upon the recommendation of the Audit Committee [Section 139(11)] To give effect to the requirements of Section 139(11), the Companies (Audit and Auditors) Rules 2014 lay down the manner and procedure of selection and appointment of auditors (Rule 3). Accordingly the Audit Committee (in case of companies where it is required to be constituted) after considering the qualification and experience of the proposed auditors and the size and requirements of the company recommend the name of the auditor to the Board. If the Board agrees with the recommendations of the Audit Committee, it shall further recommend the name proposed to the members to be

appointed in the annual general meeting. Alternatively in case of a disagreement, the Board may refer back to the Audit Committee for reconsideration. In case the audit committee is not required to be constituted, the Board needs to consider qualification, experience etc before recommending the name of proposed auditor or auditors to the members. The auditors so appointed in the annual general meeting shall hold office till the conclusion of the sixth annual general meeting. For this purpose the meeting where the appointment has been made is treated as the first meeting.

Before any such appointment is made, the written consent of the auditor proposed to be appointed shall be obtained along with a certificate [proviso to Section 139 (1)]. The Companies (Audit and Auditors) Rules 2014 require the auditor to certify that:

(*a*) he is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

(*b*) the proposed appointment is as per the term provided under the Act;

(*c*) the proposed appointment is within the limit laid down by under the authority of the Act;

(*d*) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate is true and correct. (Rule 4)

Within fifteen days of the meeting in which the auditor is appointed, the company shall inform the auditor concerned and also file a notice of such appointment with the Registrar. [proviso to Section 139(1)]. The notice to Registrar about appointment of auditor is required to be given in Form ADT-1 of the Companies (Audit and Auditors) Rules, 2014 as amended *vide* Notification F.No. 1/33/2013-CL-V dated 16 February 2018

Where the auditor appointed by the members does not accept the appointment, can the vacancy so caused be treated as a casual vacancy and the Board of directors be authorised by the shareholders to appoint new auditors? The matter was referred to the *Research Committee of the Institute of Chartered Accountants of India* which opined as follows:

'The provisions of section 224 of the Companies Act, 1956 (now Section 139) do not envisage changing the normal law of contract. Hence no appointment or reappointment is complete and effective if the auditor declines the same. Such a case is neither a vacancy caused by resignation nor a casual vacancy.'

It further opined that the Companies Act clearly envisages that the appointment of the auditor should, as a general rule, rest with the shareholders. The shareholders have to exercise this power in all cases, except in the case of filling casual vacancy or appointing the first auditors. This power cannot be delegated to the Board of directors. As such, another general meeting has to be convened to appoint a new auditor.

19.19-1 Appointment of subsequent auditor for a Government company

The Comptroller and Auditor-General of India (CAG) has been empowered to appoint the auditor in respect of a Government company. Section 139(5) states that in case of a Government company or a company owned or controlled, directly or indirectly, by the Central Government or by any State Government or Governments

or partly by the Central Government and partly by one or more State Governments, the auditor shall be appointed by the CAG for each financial year. The auditor so appointed shall meet the qualification criteria laid down by the Act. The auditor shall be appointed within one hundred and eighty days of the commencement of the financial year and shall hold office till the conclusion of the annual general meeting.

19.20 Tenure of appointment

Section 139(1) provides that an auditor is appointed from the conclusion of one annual general meeting until the conclusion of the sixth annual general meeting. The meeting wherein such appointment has been made shall be counted as the first meeting. But, if the annual general meeting is not held within the period prescribed by section 96, should the office of the auditor fall vacant by the date general meeting ought to have been held. Unlike the case of directors, the answer seems to be in the negative— the auditor is expected to continue in office till the annual general meeting is actually held and concluded. Thus, if an annual general meeting is adjourned, his tenure will extend till the conclusion of the adjourned meeting. Similarly if at an annual general meeting no auditor is appointed or reappointed, the existing auditor shall continue to be the auditor of the company [Section139(10)].

The company has a right to remove the auditor before the tenure is over. Similarly an auditor may resign from his office before his term is over.

19.21 Compulsory rotation of auditors

Section 139(2) of the Act provides for compulsory rotation of the auditors for the listed companies and certain class or classes of companies. The companies that are required to compulsorily rotate their auditors include all unlisted public companies having paid up capital of rupee ten crore or more and all private limited companies with paid up share capital of rupees fifty* crores or more. Companies having public borrowings from financial institutions, banks or public deposits of rupees fifty crores of more are also covered even if their paid up capital be lower than the threshold prescribed [Rule 5 of the Companies (Audit and Auditors) Rules, 2014].

One person companies and small companies are however, exempted from the requirement.

19.21-1 Period for rotation

Under Section 139(2) a listed company or a class of company prescribed shall not appoint an individual as auditor for more than one term of five consecutive years whereas an audit firm shall not be appointed for more than two terms of five consecutive years. After the expiry of the period as aforesaid the auditors are required to be rotated. For the purpose of calculating the period of five consecutive years or ten consecutive years as prescribed, the period for which the auditor has held office prior to the commencement of the act shall also be taken into account. [Rule 6(3)(*i*)]. The proviso to section 139(2) allows a company to comply with the requirements by the date of the first annual general meeting of the company held within the period specified under section 96(1), after three years from the date of commencement of the Act.**

*Companies (Removal of Difficulties) Third Order 2016, S.O. 2264(E) dated 30 June 2016.

**Amended vide companies (Audit and Auditors) (Second Amendment) Rules, 2017 dated 22 June, 2017

To illustrate if an individual auditor has been functioning as an auditor of a company for a consecutive period of five years till the first AGM held after the commencement of the Act, he shall be allowed another three years to comply with the requirements. Effectively he shall be allowed to act as auditor for eight years. However if the auditor has just completed one year, he can continue as the auditor for another four years. The illustration given the Rule 6(3) in the Companies (Audit and Auditors) Rules, 2014 is reproduced below:

Number of consecutive years for which an individual auditor has been functioning as auditor in the same company (in the first AGM held after the commencement of provisions of section 139(2)	Maximum number of consecutive years for which he may be appointed in the same company (including transition period)	Aggregate period which the auditor would complete in the same company in view of Column I and II
I	II	III
5 years (or more than 5 years)	3 years	8 years or more
4 years	3 years	7 years
3 years	3 years	6 years
2 years	3 years	5 years
1 year	4 years	5 years

Similarly the audit firm would also be entitled to a transition period of three years.

19.21-2 Cooling off period

An individual auditor or audit firm that has completed the prescribed tenure of five or ten consecutive years respectively shall have a cooling off period of five years during which it shall not be eligible for reappointment as auditor in the same company. [proviso to Section 139(2)]. The Act has prescribed a compulsory break of five year before the auditor or the firm becomes eligible for reappointment as auditor in the same company. The cooling off requirement even applies to an audit firm that which has one or more common partners with the audit firm that is being rotated. The Companies (Audit and Auditors) Rules 2014 also provides that an incoming auditor or audit firm shall not be eligible for appointment if such auditor or firm is associated with the outgoing auditor or audit firm under the same network of audit firms *i.e.* the firms operating or functioning under the same brand name, trade name or common control.

The objective of the compulsory auditor rotation is to ensure auditor independence and objectivity by breaking any kind of nexus that may develop between the company and auditor.

19.21-3 Joint Audit

A company may resolve to appoint more than one auditor to audit its accounts. In such a case the company may follow the rotation of auditors in such a manner that both or all of the joint auditors do not complete their term in the same year [Rule 6(4) of the Companies (Audit and Auditors) Rules, 2014].

19.22 Reappointment of retiring auditor

In accordance with the provisions of section 139(9) of the Act, a retiring auditor may be re-appointed at an annual general meeting if -

1. he is not disqualified for reappointment.
2. he has not given the company notice in writing of his unwillingness to be reappointed.
3. a special resolution has not been passed at that meeting appointing somebody else instead of him or providing expressly that he shall not be reappointed.

The reappointment will not be automatic. It may also be noted that non-reappointment of the retiring auditor in the AGM is not removal of the auditor as contemplated in section 140(1) of the Act. It is simple retirement.

19.23 Rights of retiring auditor [Section 140(4)]

The rights given to retiring auditor, which follow the principles of natural justice and ensure that shareholders get all the relevant information before deciding upon the resolution that the retiring auditor shall not be reappointed or that a person other than the retiring auditor be appointed as auditors are as follows:

(1) right to receive notice of the resolution.

The Karnataka High Court in *Ajit Kumar Iddya* v. *Institute of Chartered Accountants of India* [1994] 80 Comp. Cas. 197: [1994] 3 Comp. LJ 564 : [1994] 13 Corpt. LA 445 (Kar.) has held that the mode of serving the retiring auditor with a copy of the resolution appointing a new auditor is not prescribed by the Companies Act. The law does not compel the company to send such a notice by registered post. Institute has no control over companies and, therefore, cannot prescribe the mode of service. The guidelines of the Institute have no binding effect upon companies.[10]

(2) right to make a written representation to the company and request its notification to members of the company.

(3) right to get his representation circulated among the members. (The fact that the representation has been received must be mentioned in any notice of the resolution given to members). In such a case a copy of the representation shall be filed with the Registrar.

(4) right to get his representation read out at the meeting, if it has not been sent to the members because of delay in receiving or default on the part of the company.

The company or any other aggrieved person may make an application to the Tribunal alleging that by his written representation, the auditor is abusing the rights conferred by this section. The Tribunal may, on such an application, direct that the representation need not be circulated or read out at the meeting.

10. Vide para 9.9(D) if Code of Ethics published by the ICAI in 2001. It appears that the decision of the Hon'ble High Court is based on pure technicality.

No special notice as aforesaid is required if the auditor has completed a consecutive tenure of five years or as the case may be ten years under Section 139(2).

A professional duty has been casted upon the incoming auditor to communicate with the outgoing auditor.

The Guidance Note[11] issued by the ICAI in this regard, *inter alia*, suggests as follows:

1. It would not be sufficient for the incoming auditor to accept a certificate from the management of the company that the applicable provisions of the Companies Act have been complied with. It is necessary for him to verify relevant records of the company to ascertain whether in fact applicable provisions have been complied with. Where the company is unwilling to allow the incoming auditor to verify the relevant records, the incoming auditor should not accept the audit assignment.
2. The incoming auditor should verify the following :
   (*i*) Whether a member of the company has given special notice of the resolution as required under section 225(1) [now Section 140(4)(*i*)] at least 14 days before the date of the general meeting. A true copy of this notice should be obtained.
   (*ii*) Whether this special notice has been sent to the members of the company as required under section 190(2) [now Section 115].
   (*iii*) Whether this special notice has been sent to the retiring auditor forthwith as required under section 225(3) [now Section 140(4)(*ii*)].
   (*iv*) Whether representation received from the retiring auditor, if any, has been sent to the members of the company as required under section 225(3) [now Section 140(4)(*iii*)].
   (*v*) Whether the representation received from the retiring auditor has been considered at the general meeting and the resolution proposed by the special notice has been properly passed at the general meeting. A copy of the relevant minutes of the general meeting, duly certified by the Chairman of the meeting, should also be obtained by the incoming auditor for his record.
3. The incoming auditor should also communicate with the outgoing auditor in writing before accepting the audit assignment to inquire whether any professional reason exists for him not to accept the audit. This emanates from the provisions of the Chartered Accountants Act, 1949.

19.24 Casual vacancy

If there arises a casual vacancy by any reason other than resignation by the auditor, section 139(8) empowers the Board of directors to fill the same within thirty days. Till the vacancy, so caused, is filled, the remaining auditor or auditors, if any, may act. However, this power of the Board is subject to one limitation and, that is, where the casual vacancy is caused by the resignation of an auditor, it can only be filled

11. Guidance Note No. LVI : Clause 9 of the First Schedule to the Chartered Accountants Act, 1949 (as it stood before 2006 amendment), *The Chartered Accountant*, March 1981, reproduced in 'Code of Conduct' published by the ICAI in 1988.

by the company in general meeting to be convened within three months of the recommendation of the Board.

In case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, the power to fill any casual vacancy is vested with the CAG. In case of a failure by the CAG to fill the casual vacancy within a period of thirty days, the Board of Directors is required to fill the same within the next thirty days.

The auditor appointed in a casual vacancy shall hold office until conclusion of the next annual general meeting.

19.25 Removal and resignation of an auditor

Proviso to Section 139(2) establishes a right of the company to remove an auditor and right of the auditor to resign from such office of the company. However in order to make the removal of independent and conscientious auditors difficult, the Act has laid down specific procedure in this regard. Likewise obligation has been casted on the resigning auditor to clearly state the reasons thereof. The procedure contains many safeguards to ensure the independence of auditors.

19.25-1 Removal before expiry of the term

An auditor may be removed, at any time before the expiry of his term by passing a special resolution of the company after obtaining the prior approval of the Central Government and giving the auditor a reasonable opportunity of being heard [Section 140(1)]. The matter of the removal is first considered at the Board meeting and necessary board's resolution passed. The auditor proposed to be removed need to be given an opportunity of being heard. Within thirty days of the Board's resolution an application shall be made to the Central Government in form ADT-2 (as amended *vide* Notification F. No. 1/33/2013-CL-V dated 16 February 2018) prescribed under the Companies (Audit and Auditors) Rules, 2014. The form contains details of the grounds for removal, opportunity given to the auditor of being heard, pendency of audit etc. Within sixty days of the Central Government's approval, the general meeting of the members shall be held for passing the special resolution [Rule (7) of the Companies (Audit and Auditors) Rules, 2014].

For removal of auditors before the expiry of the term, besides passing a special resolution, prior permission of the Central Government must be obtained. Thus, it is difficult to remove an auditor before the expiry of his term since adequate grounds must exist to prove that such auditor is unsuitable for continuing as the auditor.

In *Basant Ram & Sons* v. *Union of India* the Delhi High Court upheld the removal of the auditors before expiry of the term as such removal had the approval of shareholders, and prior approval of the Govt. of India. Besides, there existed a chequered history of litigation between the petitioners and the company and the Petitioners' objections to certain transactions were raised only when they had fallen foul with the management and to resist their removal [2001] 29 SCL 119. In a more recent case, the same High Court upheld the removal when illegality of removal procedure was contended by the petitioner, as according to him the decision was already taken by the Board and only subsequently approvals of the Central Government and of the general meeting were obtained. The Court was of the view

that legally laid down procedure has been followed. The earlier decision of the Board does not matter - *Devinder K. Jain* v. *Union of India* [2007] 78 SCL 268. The Delhi High Court declined to uphold removal of the statutory auditor in *M.S. Kabli* v. *Union of India* [2011] 109 SCL 557 as it found that all the grounds concerning the job performance cited by the company in its application to the Regional Director (R.D.) seeking approval of removal of the statutory auditor were rejected by the R.D., who surprisingly accepted the remaining ground that the company has lost its confidence on the statutory auditor. The court held that the R.D. will have to be satisfied that reasons for removal are genuine, keeping in view the best interest of the company and consistent with the need to ensure professional autonomy to the auditor.

The prior approval of the Central Government may be taken even after passing the Board resolution to remove but it must be before the general meeting decision and actual act of removal. It may even be permissible for the general meeting to pass a resolution to remove an auditor, subject to approval taken from the Central Government, before actually issuing the removal communication.

19.25-2 Resignation of Auditor

If an auditor resigns from his office before the expiry of his term, he needs to file a statement with the Registrar within thirty days of the date of resignation [Section 140(2)]. The statement stating the reasons and other facts relevant to resignation shall be filed in the Form ADT-3 prescribed in the Companies (Audit and Auditor) Rules, 2014. A failure by the auditor to file the statement would make the auditor liable to a penalty of fifty thousand rupees or an amount equal to the remuneration of the auditor, whichever is less. In case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues. However, the penalty cannot exceed five lakh rupees.* [Section 140(3)].

19.25-3 Removal by the Tribunal

In certain circumstances the Tribunal may direct the company to remove the auditors. If the Tribunal is satisfied that the auditor of a company has acted in a fraudulent manner or has abetted or colluded in any fraud by or in relation to the company or its directors or officers, it may direct the company to change its auditors. The tribunal may take such an action either *suo motu* or on an application made to it by the Central Government or by any person concerned [Section 140(5)].

If an application under Section 140(5) as aforesaid is made by the Central Government and the Tribunal is satisfied that the change of the auditor is required, it shall within fifteen days of receipt of such application by order stop the auditor to function as such and the Central Government may appoint another auditor in his place. An auditor against whom a final order has been passed by the Tribunal shall not be eligible for appointment as an auditor of any company for a period of five years from the date of passing of the order [Proviso to Section 140(5)]. In case of firm both the firm and every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud shall be held liable.

**Substituted vide Companies (Amendment) Act, 2019*

The Mumbai Bench of NCLT in the case of *Union of India, Ministry of Corporate Affairs* v. *Mukesh Maneklal Choksi* [2019] 101 taxmann.com 98 (NCLT - Mum.) upheld the petition filed by the MCA for the removal of statutory auditors on the grounds that the family members of statutory auditor were shareholders of respondent company and statutory auditor had issued audit certificate without examining books of account of company, leading to the violation of the provisions of section 143(3)(*d*).

19.26 Remuneration of auditors

As per Section 142(1) of the Act the remuneration of the auditor is fixed by the general meeting or in a manner as may be determined in the general meeting. Notice that, it is not necessary that the amount of remuneration be specified by the company in its general meeting. It would be enough if the manner in which the remuneration is to be fixed is laid down in the general meeting. It is also not essential that the remuneration be fixed in the same general meeting in which the auditor is appointed. The Board of Directors may fix remuneration of the first auditors appointed by it.

The expression 'remuneration' includes any sums paid by the company in respect of the auditor's expenses in carrying out his duties including the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him. However, an auditor may receive separate remuneration for services rendered other than the audit work, *e.g.*, for advising on taxation matters etc. Such remuneration does not ordinarily require the sanction of the general meeting. However, a separate disclosure of all amounts paid to the auditor in different capacities is required to be made in the Statement of Profit and Loss under Part II of Schedule III, classified as below:

1. As auditor.
2. For—
   (*a*) taxation matters;
   (*b*) company law matters;
   (*c*) management services;
   (*d*) other services;
   (*e*) reimbursement of expenses.

19.27 Status of the auditor

As an agent of the members - An auditor is an agent of the shareholders. He is expected to safeguard their interests. In *Spackman* v. *Evans* 3 H.L. 236, Lord Cranworth said, "The auditors may be agents of the shareholders, so far as relates to the audit of the accounts. For the purposes of the audit, the auditors will bind the shareholders".

As to how far is an auditor agent of the shareholders, Lord Chelmsford in *Spackman* v. *Evans* expressed the view that although auditors may be the agents of the shareholders, the latter could not be deemed to be precluded from objecting to any

actions of the directors or others merely on the ground that the auditors were aware of such actions.

Thus, although an auditor is an agent of the shareholders and according to the law of agency 'the knowledge of the agent is the knowledge of the principal', the shareholders are not bound for any information which the auditor might have acquired during the course of audit if he had not communicated it to the shareholders.

Turner, L.J., *In re, Royal British Bank*[12] expressed his views with regard to the position of an auditor as to false and fraudulent representations made by the director in the following words:

> "These were auditors of the company appointed by the shareholders. These auditors were within the scope of their duty, at least as much the agent of the shareholders as the directors were, and the false and fraudulent representations were discoverable by them."

Again, if the auditor had given any information to the directors, it will not amount to giving the information to shareholders. If they have to communicate anything to the shareholders, they must do so through their report to them. Nevertheless, it is to be noted that an auditor is not an agent of individual shareholders and no shareholder can demand any information from the auditor. The auditor is accountable to the general body of the shareholders and accordingly he is required to attend general meetings.

19.27-1 As an officer of the company

In *London and General Bank*[13] case, an auditor was held to be an officer of the company. Lord Lindley said:

> "It seems impossible to deny that for some purpose, and to some extent, an auditor is an officer of the company. He is appointed by the company and his position is described in the section as that of an officer of the company. He is not a servant of the directors. On the contrary, he is appointed by the company to check the directors and for some purposes and to some extent, it seems to me quite impossible to say that he is not an officer of the company."

Similarly, in *Kingston Cotton Mill Co. Ltd.* [1896] 2 Ch. 279, it was decided that the auditors are officers of the company.

In India, in *Connell* v. *Himalaya Bank Ltd.* [1895], it was held that auditors, if appointed at a general meeting of the company and if also paid by the company, were officers of the company.

However, this position has changed with the Companies (Amendment) Act, 2000 coming into force. The definition of the term "officer" in section 2(*30*) of the Companies Act, 1956 has not included auditor for any of the provisions of the Act. It may be remembered that before the aforesaid amendment came into force, the definition of 'officer' in section 2(30) included 'auditor' for certain provisions of the Companies Act, 1956. The definition of the term 'officer' given in section 2(*59*) of the Companies Act, 2013 also does not include auditor.

12. [1856] 6 E & B 327.
13. [1895] 2 Ch. 682.

19.28 Rights of the company auditor

To enable the auditor to discharge his duties effectively, the Act gives him certain rights. They are:

19.28-1 Right of access to books and account, etc.

As per section 143(1), every auditor of company has a right of access at all times to the books, accounts and vouchers of the company, wherever kept. The term 'vouchers' includes all documents, correspondence, agreements, etc., which support any of the transactions or data disclosed in the financial statements, directly or indirectly. Similarly, the term 'books' includes the financial, statutory, and statistical books. The phrase 'all times', however, implies only to the normal business hours. In case of a holding company the auditor also is entitled to access to records of all its subsidiaries and associates insofar it relates to the consolidation of its financial statements with that of its subsidiaries and associates [proviso to Section 143(1)].

19.28-2 Right to obtain Information or Explanation

Section 143(1) also entitles the auditor of a company "to require from the officers of the company such information and explanations as the auditor may think necessary for the performance of his duties as auditor". Notwithstanding the generality of this right to obtain information, the auditor has a right to specifically enquire about the following matters:

(*a*) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

(*b*) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;

(*c*) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;

(*d*) whether loans and advances made by the company have been shown as deposits;

(*e*) whether personal expenses have been charged to revenue account;

(*f*) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

This may be viewed both as a right and an obligation.

19.28-3 Rights with respect to Branch Accounts

As per Section 2(14) of the Act 'branch office' in relation to a company means any establishment described as such by the company. The definition implies that the

company has discretion to describe its office as a branch office or not and only an office that is described as such by the company shall be treated as a branch office. Section 143(8) provides that the accounts of the branch office, if any, of the company are required to be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139. In case the branch office is situated outside India, the accounts of the branch office are required to be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of the country where the branch office is located.

Where the accounts of any branch office are audited by a person other than the company's auditor, the branch auditor shall submit a report to the company's auditor. The company's auditor is therefore entitled to receive a report from the branch auditor and deal with such report as he may deem necessary in his report [proviso to Section 143(8)]. The company's auditor shall have same power with reference to the audit of branch as prescribed under sub sections (1) to (4) of Section 143 [Rule 12 of the Companies (Audit and Accounts) Rules, 2014]. Thus the company's auditor shall be entitled to visit the branch office, if he deems it necessary to do so for the performance of his duties as auditor. He shall also have access at all times to the books and accounts and vouchers of the company maintained at the branch office.

However, in case of a banking company having a branch office outside India, it shall be sufficient, if the auditor is allowed access to such copies of, and extracts from, the books and account of the branch as have been transmitted to the principal office of the company in India.

19.28-4 Right to sign the report

Only the person appointed as an auditor has the right to sign the auditor's report or sign or certify any other document of the company [Section 145]. Where a firm of limited liability partnership is appointed as the auditor, only those partners that are chartered accountants are authorized to act and sign on behalf of the firm [Section 141(20)]. Accordingly if a firm or LLP has partners who are not chartered accountants, they are not authorized to sign the auditor's report.

19.28-5 Right to receive notices, etc.

Section 146 provides that all notices of and other communications relating to any general meeting of a company, which any member of the company is entitled to have sent to him, shall also be forwarded to the auditor of the company.

19.28-6 Right to attend general meeting

Under section 146 the auditor has the right to attend any general meeting and be heard, at any general meeting which he attends, on any part of the business which concerns him as auditor. The auditor may make any statement or explanation with regard to the accounts as he may deem fit. The auditor also has right to send his authorized representative to attend the meeting instead of attending the meeting himself personally. In such a case the authorized representative shall be a person who is qualified to be an auditor.

Section 145 makes it obligatory that any qualifications, observations or comments on the financial transactions or matters which have any adverse effect on the function of the company mentioned in the auditor's report be read at the general meeting and also shall be open to inspection by any member of the company. The entire auditor's report need not be read but only that portions that have any adverse effect on the functioning of the company as aforesaid need to be read in the general meeting.

19.28-7 Right to remuneration

An auditor is entitled to his remuneration on the completion of his work.

The above-mentioned rights of an auditor are his statutory rights and cannot be limited or abridged either by the Articles or resolution of the members. Any provision of this nature is *ultra vires* and hence void - *Newton* v. *Birmingham Small Arms Co.* [1906] 2 Ch. 378.

19.28-8 Auditors' lien

In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents. The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

(*i*) Documents retained must belong to the client who owes the money.

(*ii*) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of directors.

(*iii*) The auditor can retain the documents only if he has done work on the documents assigned to him.

(*iv*) Such of the documents can be retained which are connected with the work on which fees have not been paid.

Under section 128 of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. However, under the Act, further provisions are thereunder which books of account could be kept at a different place, pursuant to a Board's resolution of which notice must be given to ROC. If in a company, Board passes such a resolution and hands over the books of account to the auditor and makes the necessary notification to the ROC, the auditor may in such circumstances, exercise the right of lien for non-payment of fees. However, as per section 128 he must provide reasonable facility for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien on them does not arise.

Statement on Standard Auditing & Assurance Practices-3 (SSAP-3) issued by the ICAI on Documentation also states that, "working papers are the property of the auditor. The auditor may at his discretion make portions of or extracts from his working papers available to his clients. The auditor should also adopt reasonable procedures for custody and confidentiality of his working papers and should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention".

19.29 Duties of Company Auditor

The company auditor is under an obligation to make a report on the financial statements audited by him and has a general duty to satisfy himself that the financial statements give a true and fair view of the state of affairs of the company as at the end of the year and the profit and loss and cash flow for the year. In addition to this generally duty, the Act also cast some specific duties on the auditor.

19.29-1 Duty to make a report under section 143

Sub-sections (2) and (3) of section 143 provide that it is the duty of the auditor to report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting also that the report shall confirm the position, envisaged in the under-mentioned manner in which the requirements are to be met.

Sub-section (2) specifically requires that the auditor should report whether to the best of his information and knowledge the said accounts and financial statements give a true and fair view of the state of company's affairs at the end of financial year and the profit and loss and cash flows for the financial year.

Sub-section (3) requires that the auditor shall report on the following matters:

(*a*) *Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for audit* - The significance of such a requirement is that the auditor must obtain due satisfaction about the scope of work carried out by him and affirm that in the discharge of his duties he has maintained professional standards of diligence and care. If the answer to this question is negative, he needs to provide details thereof and also report the effects of such information on the financial statements.

Justice Lindley in his famous judgment, in the *London and General Bank* case, propounded his view. The relevant passage from the judgment is quoted below:

> "An auditor, however, is not bound to do more than exercise reasonable care and skill in making enquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not guarantee that his balance sheet is accurate according to the books of the company, if he did, he would be responsible for an error on his part, even if he were himself deceived without any want of reasonable care on his part say, by the fraudulent concealment of a book from him."

Lopes L.J. held in his judgment in the case of *Kingston Cotton Mills* that auditors must not be made liable for not tracking out ingeniously and carefully laid scheme of fraud when there is nothing to arouse their suspicion and when those frauds have

been perpetrated by the trusted servants of the company and have been undetected for years by the directors.

Thus, for the collection of information, the auditor is entitled to rely upon trusted servants of the company; he can accept representations made by them either orally or in writing, provided reasonable care was taken to ensure that the data or information furnished are true and could be trusted to have been prepared in the course of the working of the company. If, however, there are any circumstances that should arouse suspicion, it would be the auditor's duty to probe it to the bottom. So long as there is no such suspicion, he is only expected to exercise normal caution and care.

(*b*) *Whether in his opinion, proper books of account as required by law have been kept by the company, so far as appears from his examination of those books and proper returns adequate for the purpose of his audit have been received from branches not visited by him* - The term 'proper books of account' is defined indirectly under sub-section (1) of section 128 wherein it is stated that a company shall prepare and keep books of account and other relevant papers and financial statements which give a true and fair view of the state of affairs of the company including its branch office or branch offices, as the case may be. Further Section 129(1) requires that the financial statements shall comply with the notified accounting standards. As such the books of account not meeting these requirements shall not be considered 'proper'.

Further, in section 338(2), it is provided that a company that is being wound up shall be deemed not to have maintained proper books of account if it had not kept:

(*i*) such books of account as are necessary to exhibit and explain the transactions and financial position of the business of the company including books containing entries made from day to day in sufficient detail of all cash received and all cash paid; and

(*ii*) where the business of the company has involved dealing in goods, statement of annual stock-taking and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing particulars of goods and those of buyers and sellers in sufficient detail to enable those goods and those buyers and sellers to be identified.

In the circumstances, proper books of account as required by law are those which contain a record of all the transactions specified both in section 128 and section 338(2) in a manner that they present a true and fair view of the state of affairs of the financial position and profitability of the company.

The *cost records* prescribed under section 148(1) also form part of books of account required to be maintained under law.

(*c*) *Whether the report on the accounts of any branch office audited under section 143(8) by a person other than the company's auditor has been sent to him and how he has dealt with the same in preparing the auditor's report* - The Research Committee of the ICAI had obtained the views of a senior Counsel on this matter and an extract therefrom is given below:

> "Having regard to the scheme of sub-section 228(2) [now Section 143(8)], it is clear that though the company in general meeting appoints a branch auditor, the company's

auditor still has a certain measure of responsibility in respect of the accounts and papers of the branch. This is shown by the fact that he has a right to visit the branch and has access to the papers and documents of the branch. He must discharge this responsibility by looking into the branch auditor's report and satisfying himself that, having regard to the report and what he has seen of the branch and documents of the branch, affairs of the branch are in order."

(*d*) *Whether the company's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns* - The work of an auditor culminates in the verification of statements of account. It is apparent that the duty, in this regard, would not be properly discharged if he fails to verify them on making a reference to the books of account before proceeding to make a report thereon. When the auditor reports that proper books of account have been kept and the accounts are in agreement therewith, he confirms that he has discharged the specific duty in this regard imposed on him by the law. If proper books of account have not been kept and if there is a discrepancy in the statements of account and the entries as they appear in the books, he should refer to such a position in his report.

(*e*) *Whether, in his opinion, the profit and loss account and balance sheet have complied with the accounting standards* - As mentioned before Section 129(1) requires that the financial statements shall comply with the accounting standards notified under Section 133. The auditor is required to confirm that the financial statements are in compliance with the accounting standards.

(*f*) *The observations and comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company* - The language of clause (*e*) is unfortunate. The same was earlier introduced in the Companies Act, 1956 vide the Companies (Amendment) Act, 2000. It requires the auditor to state observations and comments of the auditors "which have any adverse effect on the functioning of the company". Auditors' comments or observations by themselves are never intended to create an adverse effect on the company's functioning. It should refer to the comments and observations of the auditor on aspects of adverse or wrong functioning of the company. Further, it leads to the question of whether clause (*f*) is an independent addition to the various clauses appearing in sub-sections (2) and (3) of section 143 or it is merely to put added emphasis on the auditor's such statements on facts and opinion otherwise required to be reported in sub-sections (2) and (3) which are adverse in nature. If clause (*f*) is independent of other clauses, then the observations or comments are in addition to those already contained in sub-sections (2) and (3) and then they may travel beyond the accounting matters to reach the quality of functioning or management of the company, which in a normal financial audit is never intended. The auditor is to report on the accounts after due verification. He is not required to go to management functioning. In fact, the performance of a company gets reflected in its financial statements. If the performance (for whatsoever may be the reason) is below par, it may have been caused by one or more factors, which may not necessarily include bad management. Auditing of management functioning, therefore, constitutes a distinct and different stream of auditing involving operations and management. Thus, we may reasonably conclude that clause (f) requires the auditor to report those matters which bear adverse finding/opinion. *For*

example, if proper books of account were not maintained, it amounts to a serious lapse in the accounting records keeping and may be reported under this clause. In effect, this requirement is, perhaps motivated by the anxiety to draw specific attention of users of the financial statements, on highly adverse matters in auditor's report. Also to be noted that this clause does not have the word "whether" to start with. So, it is not an independent clause.

(*g*) *Whether any director is disqualified from being appointed as director under section 164(2) of the Act* - The auditor of a company will have to report whether any director of the company under audit is disqualified from being appointed as a director of that company because of section 164(2). Under Section 164(2) of the Act "no person who is or has been a director of a company which—

a. has not filed financial statements or annual returns for any continuous period of three financial years; or

b. has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.".

The objective of making it a reporting requirement by the auditor is somewhat unclear. The auditor may be able to report whether the company under audit has made these default(s) as stated above. The auditor has no role to play on directors' appointment. In case it is the intention to know whether any of the existing directors of the company under audit is already a director of a public company which has committed the stated defaults, it is doubtful whether the auditor will have any objective or tangible basis for report except a declaration taken from all the directors of the company under audit at the time of audit. Then comes the question whether the inquiry of the auditor in this matter is restricted to the accounting period under audit or even up to the point of signing the audit report. Natural response to this, it appears, is the accounting period under audit. However, in terms of section 134 of the Act, the financial statements need to be approved by the Board of directors and signed by at least two directors. These will necessarily be done only after the accounting period under audit is over. At that point of time disqualification as per aforesaid clause may attach some or all the directors. The situation of "all the directors" may arise if the stipulation of three years/one year cushion has expired covering number of public companies where such directors are directors in the period intervening the end of the period of accounts under audit and the time of approval or signature as above. Then what happens to the Board's approval or signing by the directors? Though the extreme situation is improbable, these issues need clarification from authoritative quarter lest a state of total confusion emerges.

In this context, the Register of Directors required to be maintained by the company under section 170 of the Act may provide a basic document to the auditor to find whether disqualification in terms of section 164(2) has occurred in respect of any director. Since section 170 of the Act provides for a period of thirty days for filing of the Return with the Registrar as regards appointment of directors and any change in their particulars, the auditor is well advised to see by reference to minutes

books the appointment of directors and ascertain whether each director has given a declaration that as on the date of his appointment, he has not become ineligible for such appointment because of section 164(2) and that during the period for which he has been appointed as a director no such disqualification is expected to attach him. This is, perhaps, the only practical basis for the auditor to make his report on the matter. This necessarily requires that each company, while appointing any director must take a declaration/representation from the incumbent that he is not disqualified under section 164(2) on the day of appointment nor will he be so disqualified during the tenure as director. It is advisable that the auditor takes a declaration from the company management that none of the directors is disqualified under section 164(2) of the Act through the letter of representation. The auditor has necessary rights to seek explanation/information from officers of the company. Therefore, apart from management representation, he can ask for further information/explanation from officers of the company, in case he is in need of it.

The Calcutta High Court in *Pawan Jain* v. *Hindusthan Club Ltd.* [2005] 62 SCL 610, has ruled that the auditor should not remain restricted to the representation of the company in ascertaining whether a director is hit by section 274(1)(*g*) [now Section 164(2)]. He should make independent inquiry about collected materials from other sources. It seems that the Hon'ble Court was not adequately briefed about auditor's duty of making the report and the manner of drawing his conclusion. An auditor is not expected to make roving inquiries. His role is not that of a detective. He can put reliance on evidence available to him unless, the same provokes him for more information. In other words, in the absence of suspicious circumstances he can place reliance on available evidence, be that be, a management representation. Ordinarily, a person may be a director in a number of public companies. It is not possible for the auditor to seek and collect information in all such cases. It is not desirable also as it involves standing of an individual. On appeal before Division Bench of the High Court, the above judgment was upheld - *Hindusthan Club Ltd.* v. *Pawan Kumar Jain* [2005] 64 SCL 65.

(*h*) *Any qualification, reservation or adverse remarks regarding maintenance of accounts and other matters connected therewith* – Any reservation or adverse remarks on maintenance of accounts and related matters need to be reported.

(*i*) *Whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls* – The auditor is required to comment upon the presence and effectiveness of internal financial controls as far as they relate to financial statements. Maintaining such controls is the primary responsibility of the management. Any weakness observed by the auditors, during the course of the audit shall be mentioned in the auditor's report.

(*j*) *Such other matters as may be prescribed* – Rule 11 of the Companies (Audit and Auditors) Rules, 2014 has prescribed the following additional reporting requirements in the auditor's report:

(*a*) Whether the company has disclosed the impact of pending litigations on its financial position in its financial statement;

(*b*) Whether the company has made provisions, as required under any law or accounting standards, for material foreseeable losses on long term contracts including derivative contracts;

(*c*) Whether there has been any delay in transferring amounts required to be transferred to the Investor Education and Protection fund by the company.

The logic for prescribing the above additional comments and views by auditor is not very clear as they are required to comment upon these matters in the normal course of the audit. The intention appears to be draw specific attention of the auditor to these matters. Where any of the matters mentioned in Section 143(3) is answered in negative or with qualification, the auditor's report shall state the reasons therefor.

Disclaimer in the audit report - In terms of a news item in the Economic Times of 12th March, 2002, the President of ICAI has stated that henceforth the auditors have to include a disclaimer in their reports to the effect that the auditor's opinion does not amount to an assurance regarding future viability of the enterprise or efficiency or effectiveness with which the management has run the business. The President has further emphasised that the primary responsibility of preparing and presenting financial statement lies with the management. In all probability the present statement of the President of the ICAI is a fallout of Enron Corporation Disaster in the U.S.A. While he has stated a well-known fact, the significance of the statement lies in requiring the auditors to explicitly clarify the imports of their report to remove public misapprehension. The statement notwithstanding, the matter requires serious national debate by knowledgeable persons regarding the desired role of the auditor in the economic sphere and more particularly in the corporate affairs.

Reporting on matters under Section 143(1) – Under Section 143(1) the auditor is specifically required to inquire into the matters specified therein. What follows is that after making the inquiries as prescribed, the auditor is required to give his comments in the audit report. It is not clear however whether the auditor needs to report only if the answer to any of the queries is negative or even affirmations need to be reported.

Special requirements in regard to banking, insurance and electricity supply companies - The auditor of a banking company is required by section 30(3) of the Banking Regulation Act also to state the following additional matters *viz.*, (*a*) whether or not the information and explanations required by him have been found to be satisfactory; (*b*) whether or not transactions of the company fall within the powers of a banking company; (*c*) whether or not the returns received from the branch offices of the company have been found adequate for the purposes of his audit; (*d*) whether the profit and loss account shows a true balance of profit and loss for the period covered by such account; and (*e*) any other matter which he considers should be brought home to the shareholders of the company.

Likewise, there are special provisions contained in the Insurance Act, 1938 and the Electricity (Supply) Act, 1948 specifying matters on which the auditor should make a report. Similar provisions also are contained in certain other Acts, *e.g.,* Societies Registration Act, 1860. On a consideration of sub-sections (3), (4) and (5) of section 129, a banking, insurance, electricity supply and other companies governed by the special Acts as well as those which have been specially exempted by the Central Government from making a disclosure of certain matters or from complying with certain requirements with regard to the balance sheet and profit and loss account, are exempt from drawing up their financial statements in the forms contained in Schedule III.

The statements of account of the company cannot be deemed to have been improperly drawn up or as not disclosing a true and fair view of the state of affairs of the company merely because they only disclose matters which require disclosure under the special Acts under which they are drawn up or they do not disclose any matter which does not require disclosure by virtue of provisions contained in Schedule III to Act. It is thus clear that in the statement of account of a company drawn up under the special Acts, only the information requiring disclosure thereunder needs to be disclosed.

19.29-2 Companies (Auditors' Report) Order, 2016[14]

In addition to a report under section 143(3) as aforesaid, the auditors are also required to specifically report on certain matters under Companies (Auditor's Report) Order, 2016 (CARO)[15]. These requirements are applicable to every company including a foreign company. However banking company, insurance company, section 8 company, one-person company and small company are exempted from this requirement. A private limited company which is not a subsidiary or holding company of a public company is also exempt provided its paid up capital and free reserves on the balance sheet do not exceed rupees one crore, the total borrowings from any bank or institution do not exceed rupees one crore any time during the year and total revenue during the financial year does not exceed rupees ten crore.

The matters to be included in the Auditors' Report are:

(*i*) Maintenance of record relating to fixed assets

a. Showing full particulars including quantitative details and situation of fixed assets

b. Physical verification of fixed assets by the management at reasonable intervals, material discrepancies observed on verification and the manner in which discrepancies have been dealt in the books of account.

c. If the title deeds of the immovable properties are not held in the name of the company, details to be provided.

(*ii*) **Maintenance of record relating to inventories**

a. Physical verification of inventory by management at reasonable interval.

b. Any material discrepancies observed on verification and the manner in which discrepancies have been dealt in the books of account.

(*iii*) Loans and advances to related parties - Any loans and advances, secured or unsecured, granted to companies, firms or other parties covered in the register maintained under section 189 of the Companies Act

a. Terms and conditions of the loans are not prejudicial to the interest of the company.

b. Regular receipt of the principal amount and interest as per the stipulated schedule of repayment.

14. *Vide* Order No. F.No. 17/45/2015-CL-V dated 29 March 2016
15. File No. 17/45/2015-CL-V dated 10th April 2015

c. Amount overdue for more than ninety days and steps taken by the company to recover principal and interest

(*iv*) **Compliance with Sections 185 and 186 -** In respect of loans, investments, guarantees and security, if the provisions of Section 185 and Section 186 have not been complied with, details to be provided.

(*v*) **Acceptance of deposits -** Compliance with the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules framed thereunder. Any contravention to be reported. Likewise compliance or otherwise with an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other Tribunal to be reported.

(*vi*) **Cost Records -** If cost records have been specified under section 148 by the Central Government, whether such records have been maintained.

(*vii*) **Payment of Statutory Dues** -

a. Regular payment of undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, wealth tax, service tax, duty of customs, duty of excise, value added tax or cess and any other statutory dues. The extent of arrears as at the last day of the financial year concerned for a period of more than six months from the date they became payable shall be reported.

b. In case dues of income tax or sales tax or wealth tax or service tax or duty of customs or duty of excise or value added tax or cess have not been deposited on account of any dispute, then the amount involved and the forum where dispute is pending shall be mentioned. It may be noted that a mere representation to the concerned Department shall not constitute a dispute.

c. The amount required to be transferred to investor education and protection fund in accordance with the relevant provisions of the Companies Act, 1956 (1 of 1956) and rules made thereunder.

(*viii*) **Default to financial institutions or banks** - Any default in repayment of dues to a financial institution or bank, Government or debenture holders indicating the period and amount of default. The information to be provided lender wise.

(*ix*) **Utilization of Funds Raised -** Utilization of moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans for the purposes for which those are raised. Details of delays or default and subsequent rectification to be reported.

(*x*) **Frauds** - Whether any fraud by the company or on the company by its officers or employee has been noticed or reported during the year indicating the nature and the amount involved.

(*xi*) **Managerial Remuneration** - Approval for managerial remuneration obtained or not as per section 197; If not, state the amount involved and steps taken for securing refund of the same;

(*xii*) **Nidhi Companies -** Compliance with requirements relating to Net Owned Funds to Deposits in the ratio of 1:20 and maintaining ten per cent unencumbered term deposits to meet out the liability;

(*xiii*) **Related Party Transactions -** Compliance of related party transactions with sections 177 and 188 of the Act and disclosure in the Financial Statements etc., as required by the applicable accounting standards;

(*xiv*) **Preferential allotment and Private Placement -** Any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and compliance with section 42 of the Act and the amount raised have been used for the purposes for which the funds were raised. If not, the details in respect of the amount involved and nature of non-compliance

(*xv*) **Non cash transactions** - Any non-cash transactions entered by the company with directors or persons connected with him and compliance with section 192 of the Act

(*xvi*) **RBI Registration -** In case the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934, whether the registration has been obtained.

It may be noted that the auditors are required to specifically report on the above matters even if there is no adverse or negative remark. If the auditor has any adverse or negative remark or he is not able to form an opinion on any of the matter he must state the reasons thereof.

19.29-3 Compliance with auditing standards

Section 141(9) requires the auditor to comply with the auditing standards as may be prescribed for the performance of the audit. For this purpose the Central Government may prescribe auditing standards as recommended by the Institute of Chartered Accountants in consultation with the National Financial Reporting Authority. Till such auditing standards are notified, the standards already specified by the ICAI shall be followed [Section 141(10) and proviso]. The ICAI has issued various standards as auditing, review and other standards. Till auditing standards are notified under the Act, these standards shall be deemed to the standards of audit.

19.29-4 Duty to report fraud

Section 143(12) of the Act imposes a duty on the auditor to report to the Central Government if in the course of the performance of his duties as auditor, he has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company involving an amount of rupees one crore or more. The auditor first needs to forward his report immediately (not later than two days) to the audit committee or the Board seeking their reply within forty five days. On receipt of reply from the Board or the audit committee, the auditor is required to forward his report, reply or observations of the Board or the audit committee and his comments upon such reply or observations to the Central Government within fifteen days of receipt of such reply or observations. The report on the letter-head of the auditor is required to be sent to the

Secretary, Ministry of Corporate Affairs in a sealed envelope by registered post with acknowledgement due or by speed post followed by an email as a conformation [Rule 13 of the Companies (Audit and Auditors) Rules, 2014*]. In case of fraud involving lesser amount, it would be sufficient for the auditor to report the same to the audit committee of the board constituted under section 177 or to the Board, immediately (not later than two days) stating clearly the nature of fraud, amount and parties involved. The incidence of frauds so reported to the board or audit committee are required to be disclosed in the Board's Report under section 134(3) clearly stating the nature of fraud, amount involved, parties involved and remedial action taken.

It may be noted here that the duty on the auditor under section 143(12) is to report any fraudulent activities that he observed in the performance of his duties as auditor. He is not under an obligation to start with the suspicion that a fraud is being committed. If the auditor fails to comply with section 143(12), he shall be punishable with fine which shall be not less than rupees one lakh but may extend to rupees twenty-five lakh.

19.29-5 Duty to attend general meeting

Under section 146 the auditor has a duty to attend the general meeting either by himself or through his authorized representative unless exempted by the company. The authorized representative shall be person who is qualified to be an auditor.

Scope of duties of an auditor - The statutory duties of the auditor cannot be limited in any way either by the Articles or by the directors or members but a company may extend them by passing a resolution at the general meeting or making a provision in the articles [*Newton* v. *Birmingham Small Arms Co. Ltd.* (1875)].

19.29-6 Duty to make statement in Prospectus

Under sub-clause (*iii*) of section 26(1)(*b*) an auditor is required to make a report to be included in the prospectus of a company. Such a report should be made out on—

(*a*) the profits and losses of the business of the company for each of the five financial years immediately preceding the issue; and

(*b*) assets and liabilities of its business on the last date to which the accounts of the business were made up (not more than one hundred and eighty days before the issue of the prospectus).

In case of a new company for which five years since incorporation has not lapsed, the report on the profit and losses should cover the period from the date of incorporation.

19.30 Duty to produce documents and evidence

Duty to produce documents and evidence - For the purposes of section 217 of the Act auditor may be classified as an agent of the company and thereby is duty bound for preserving and producing to an inspector or any person authorised by him in this

*Amended *vide* Companies (Audit and Auditors) Amendment Rules, 2015, notification number GSR 972(E) dated 14 December 2015.

behalf with the previous approval of the Central Government, all books and papers of, or relating to the company. Moreover he is under a duty to give to the inspector all assistance in connection with the investigation which he is reasonably able to give.

19.31 Duty to acquaint themselves with their duties

Auditors are bound to acquaint themselves with their duties under the Companies Act - *Re. Bolivia Exploration Syndicate* [1913] 3 TLR 146. They are also bound to see what additional duties, if any, are cast upon them by the Articles of the company whose accounts they are called upon to audit. Ignorance of the Articles and of additional duties imposed by them would not afford any legal justification for not observing them - *Leeds Estate Building Investment Co.* v. *Shepherd* [1887] 36 Ch. D 787.

19.32 Limitation of Auditor's duties

No limitation can be placed upon rights or duties of the auditor under section 143 either by the Articles of the company or by any resolution of the members. Thus, where the Articles of the company provided :

(*a*) that the directors shall have power to form an internal reserve fund which was not to be disclosed in the balance sheet and which should be utilised in whatever way the directors thought fit;

(*b*) that the auditors shall have access to accounts relating to such reserve fund and that it was applied to the purposes of the company as specified in the special articles, but that they should not disclose any information with regard thereto to the shareholders or otherwise; such provisions in the Articles were held to be invalid as being a limitation of the statutory duties of the auditors.[16]

Buckley, J. said, "Any regulations which precluded the auditors from availing themselves of all the information to which under the Act they are entitled, as material for the report which under the Act they are to make as to the 'true and correct'[17] state of company's affairs, are, I think inconsistent with the Act".

Above position will stand even in case of a private company in which almost the entire share capital is held by one or two individuals.

The reason is that audited financial statements are relied upon not only by the members exclusively but also by the debenture holders and the other creditors.

An auditor is expected to determine the scope of his duties on a consideration of the nature of business carried on by the concern, provisions of the law that govern the organisation and the system of internal control in operation. However, on taking into account the legal decisions in the cases which so far have been taken to courts, his duties and responsibilities can be summarised as follows:

16. *Newton* vs. *Birmingham Small Arms Co.* [1906] 2 Ch. 378.
17. Now the 'true and correct' phrase has been substituted by 'true and fair'.

(*i*) *To verify that the statements of account are drawn up on the basis of the books of the business* - The auditor is not responsible for failure to disclose the affairs of the company kept out of the books and concealed from him which could not be known in the ordinary course of exercise of reasonable care and diligence. However, it is his duty to check the books for finding out that the position, as shown by the books of account, is true and substantially correct.

(*ii*) *To verify that the statements of account drawn up on the basis of the books exhibit a true and fair state of affairs of the business* - The duty of the auditor is not limited to mere verification of the arithmetical accuracy of the statements of account. He must find out that these are substantially correct, having regard to provisions in the Articles and the statute governing the business of the organisation under which it is being carried on.

(*iii*) *To confirm that the management has not exceeded the financial administrative powers* vested in it by the Articles or by any specific resolution of the shareholders recorded at a general meeting.

(*iv*) *To investigate matters in regard to which his suspicion is aroused as to the result of a certain action on the part of the servants of the company* - He is, however, not required to start an audit with a suspicion or to proceed in the manner of trying to detect a fraud or an irregularity unless some information has reached him which excites his suspicion or should arouse suspicion in a professional man of reasonable competence. This is because his duty is verification and not primarily detection of fraud.

(*v*) *To perform his duties by exercising reasonable skill and care* - For the verification of matters which are not capable of direct verification, he can rely on what he believes to be honest statements of the management. He must, however, review the verification of assets by the company and not rely merely on the statement made by the persons appointed by the company.

Payment of managerial remuneration in excess of the limits under Schedule XIII [now Schedule V] without necessary approval - By a press release dated 10-11-2000 the DCA informed that the auditors of companies have been asked to ensure that managerial remuneration in excess of the limits given in Sch. XIII [now Schedule V] without necessary approval is not paid. It is not understood how the auditor will ensure that payment is not made in excess. Payment is made by the company and not by the auditor. Auditor examines the accounts on year-ending. At best, the auditors could have been asked to specifically report on excess payment if made without proper approval.

Reporting on matters contained in the Directors' Report - The duty of any auditor for making a report on the statement of account also extends to matters reported upon by the directors to the shareholders insofar as information which is required to be given by the Act in the statements of account or can be given in a statement annexed to the accounts, are contained in the report of directors. *For instance*, the opinion of the Board of Directors as regards current assets, loans and advances, when contained in the director's report, must be considered by the auditor.

19.33 Special provisions relating to audit of Government Companies

The provisions relating to conduct of the audit of the Government companies are summarized below. It may be observed that the Comptroller and Auditor-General of India (CAG) plays a crucial role in the manner in which the audit is conducted for a Government company and other companies owned or controlled by the Central and/or State Governments. The expression Government company has been defined by section 2(45) as any company in which not less than fifty one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

19.33-1 Appointment of Auditors

In case of a Government company or a company, directly or indirectly owned or controlled by the Central Government, State Government or Governments or partly by the Central Government and partly by one or more State Governments, the first auditors shall be appointed by the Comptroller and Auditor-General of India (CAG) within sixty days from the date of registration of the company. If the CAG fails to exercise his power, the Board is authorized to appoint the first auditors within the next thirty days. In case of a failure by the Board, the members must be informed who shall appoint the first auditor in an extraordinary general meeting with in the sixty days [Section 139(7)].

The subsequent auditor for a company covered under section 139(7) shall also be appointed by the CAG for each financial year. The auditor so appointed shall meet the qualification criteria laid down by the Act. The auditor shall be appointed within one hundred and eighty days of the commencement of the financial year and shall hold office till the conclusion of the annual general meeting. The power to fill any casual vacancy in such a company is vested with the CAG. In case of a failure by the CAG to fill the casual vacancy within a period of thirty days, the Board of Directors is required to fill the same within the next thirty days.

The expression 'directly or indirectly' used in section 139 above read with the definition of control in section 2(27) have been interpreted to include companies where ownership or control lies with two or more Government companies or corporations within the scope of audit by CAG[18].

It will primarily be the responsibility of the company concerned to intimate about incorporation of a company subject to audit by an auditor to be appointed by the CAG along with name, location of registered office, capital structure of such a company immediately on its incorporation. The company is also required to share such intimation to the relevant Government so that such Government may also send a suitable request to the CAG[19].

19.33-2 Audit of Government Companies

Section 143(5) and (6) of the Act lay down special provisions regarding the conduct of the audit of Government companies. The sections provides that the Comptroller

18. General Circular No. 334, dated 31st July 2014, Ministry of Corporate Affairs.
19. *Ibid* 18.

and Auditor-General of India (CAG) has power to direct the manner in which the company's accounts shall be audited and to give instructions to him in regard to any matter relating to the performance of his functions as such. He may also conduct a supplementary or test audit of such company's accounts by persons authorised by him in this behalf. For the purposes of such audit he has the power to require information or additional information to be furnished to the persons so authorised, on such matters and in such form, as he may direct.

The auditor must submit a copy of his audit report to the CAG who has the right to comment upon or supplement the audit report in such manner as he may think fit and the same should be sent to by the company to every person entitled to copies of the audited financial statements under section 136(1) and also be placed in the annual general meeting at the same time and in the same manner as the audit report.

Section 143(7) of the Act provides that in case of company covered under sub-section (5) or sub-section (7) of section 139, the CAG may order a test audit to be conducted on the accounts of such a company. If such a test audit is ordered, the provisions of section 19A of the Comptroller and Auditor-General of India (Duties, Powers and Conditions of Service) Act, 1971 shall apply to the report of such test audit. Accordingly such report of test audit will be submitted by the CAG to the Government or Governments concerned and will be placed before the House of Parliament or State legislature by the Central Government or the State Government as the case may be.

A person should keep these provisions in mind while accepting an appointment as the auditor of a company. It would be necessary on the part of the auditors appointed/ re-appointed to ensure, before accepting the appointment/re-appointment that the company concerned is in fact outside the ambit of section 139(5) to 139(7) of the Act. If the company is covered by these sections, any appointment or re-appointment of auditors by the company concerned would be *ab initio void*.

19.34 Punishment for Contravention

Section 147 lays down the punishment for the company, officers in default and auditors for contravention of sections 139 to 146.

19.34-1 Penalty on the company and officers in default

Any contravention with the provisions from sections 139 to 146 makes the company liable to fine which shall not be less than rupees twenty-five thousand but which may extend to rupees five lakh. Every officer in default is punishable with fine between rupees ten thousand and rupee one lakhs or imprisonment extending up to one year or both [Section 147(1)].

19.34-2 Penalty on the auditor

Any contravention by the auditor of section 139 (appointment), section 143 (power and duties), section 144 (prohibited services) or section 145 (signing of audit report) shall be punishable with fine of rupees twenty-five thousand to rupees five lakhs or four times the remuneration of auditor, whichever is less [Section 147(2)]. If the auditor is found to have contravened such provisions knowingly or willingly with

the intention to deceive the company or its shareholders or creditors or tax authorities, the fine shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less and imprisonment which may extend to one year.

The auditor if convicted as aforesaid shall also be liable to refund the remuneration received from the company and for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report [Section 147(3)]. In case of a firm, the partner or partners concerned shall be jointly and severally liable. If an audit firm is held criminal liable, for liability other than fine, only the partner or partners concerned, who acted in a fraudulent manner or abetted or colluded in any fraud shall only be liable*

19.35 Audit Committee

This concept came in the wake of celebrated American case of *McKesson* v. *Robbins Inc.*, involving auditor's liability. The Securities and Exchange Commission of USA recommended setting up of audit committee in the early forties of the last century. However, it was Canada, which first made the constitution of audit committee mandatory for public companies. In our country, thoughts have gone into audit committee as a means to attain better financial discipline in corporate sector by enhancing audit independence and assuring proper functioning of the internal control system. The Sachar Committee set up in 1977 to recommend reforms in the Companies Act and the MRTP Act had before it the suggestion of incorporating the requirement of setting up Audit Committee by companies of certain size in the Companies Act. The growing concern for good corporate governance led to insertion of section 292A in the Companies Act, 1956 by the Companies (Amendment) Act, 2000. The public sector banks and financial institutions in our country had already taken the lead by setting up Audit Committee in their respective organisations during the last several years. Besides, listing agreement with stock exchanges and guidelines issued by public financial institutions provide for audit committee.

Section 177(1) of the Act requires every listed company and such other class or classes of companies as may be prescribed to constitute an Audit Committee as a committee of the Board of Directors. This Committee shall consist of such number of directors as its members, as may be determined by the Board. However, the number shall not be less than three out of which majority shall be independent directors. Proviso to section 177(1) requires that the majority of the members of the Audit Committee including the chairperson shall have the ability to read and understand the financial statements.

Members of the audit committee shall elect a chairman from amongst themselves. Therefore, the position of the Chairman is not an *ex officio* position and it is open to any member to be elected as the Chairman. However, as a measure of objectivity, neither the managing director nor any whole-time director should be the Chairman.

* Amended *vide* the Companies (Amendment) Act, 2017.

Sub-section (4) of section 177 mandates that the audit committee shall act in accordance with terms of reference to be specified in writing by the Board of directors. The terms of reference shall *inter alia* include:

(*i*) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;

(*ii*) measures to review and monitor the auditor's independence and performance, and effectiveness of audit process;

(*iii*) examination of the financial statement and the auditors' report thereon;

(*iv*) approval or any subsequent modification of transactions of the company with related parties;

(*v*) scrutiny of inter-corporate loans and investments;

(*vi*) valuation of undertakings or assets of the company, wherever it is necessary;

(*vii*) process for evaluation of internal financial controls and risk management systems;

(*viii*) monitoring the end use of funds raised through public offers and related matters.

It may be noted that the exact terms of reference of the Audit committee is required to be specified by the Board however the minimum requirements have been set out by section 177(4) as aforesaid. The following observations may be made from the above:

(1) Being a committee of the Board of directors, the duties of the audit committee shall be determined by the Board. However, the duties that would be assigned have to include the matters specified in sub-section (4). It is a moot question whether the Board of directors can assign a task to the committee that is incongruous with the word audit. For example, can the Audit Committee be given a task to consider and decide upon the tenders received by the company? Probably not, notwithstanding the unqualified power given to the Board of directors to issue terms of reference to the Committee.

(2) The terms of reference given to the Committee must be specified in writing by the Board. A mere recording of the decision on terms of reference in the Board's minutes book will not be enough. Terms of reference that are decided to be given and recorded in the minutes book will have to be incorporated in a written communication addressed to the Chairman of the Audit Committee or to the Audit Committee if it has the benefit of a Secretary.

(3) The Audit Committee may call for the comments of the auditors on the internal control systems, the scope of audit and observations of the auditors and review of financial statements before their submission to the Board. It seems that no corresponding duty has been cast on the auditors to oblige them to discuss abovesaid matters with the Committee. However, auditors' cooperation in this regard can be expected. The provision in sub-section (4) has not specified whether the word "auditors" cover statutory auditors, cost auditors, tax auditors and company secretary in practice to certify compliance with the provisions of the Companies Act and internal auditors. However, having regard to the generally understood sense of the term "auditor", it may be presumed to be the statutory auditor. But this will leave out the other auditors from the scope of discussion on

matters specified in the sub-section. For example, discussion on internal control systems may not be meaningful without participation of internal auditor, as they are expected to examine working of the internal control systems on a continuous basis. So far as scope of audit work is concerned, there is nothing to be discussed with the statutory auditors as the scope of their work has been laid down by the Act itself. If the terms of appointment of the statutory auditors have some more duties to be performed beyond the statutorily laid down duties (which is often not the case), then there can be some meaning in discussion of the scope. We may, however, reckon that the scope of duties assigned to the internal auditors is often a matter of concern. The duties of the internal auditors are determined by the management of the company and the level of management may not be the highest in the company. Quite often matters involving higher level of management are not included in the duties of an internal auditor. It is often the practice to require the internal auditors to carry out routine verification of the books of account and make periodic reports thereon. Therefore the discussion of the scope of audit is more relevant from the view point of the internal auditors. Taking a practical view of the matter and to be meaningful "auditors" used in sub-section (4) should cover all the auditors of the company.

Further, the use of the word "including" to connect up 'scope' and 'observations of the auditors' is confusing. The scope of work and observation made on working are two different things and one does not include the other. This type of drafting confusion should not have found place in a legislation.

According to sub-section (7) of this section, the auditors and the key managerial personnel shall have a right to be heard in the meeting of the Audit committee when it considers the auditor's report. However, none of these persons shall have the right to vote in the meeting. As discussed above the expression 'auditors' should be construed to include statutory auditors, cost auditors, tax auditors and company secretary in practice to certify compliance with the provisions of the Act and internal auditors. The expression 'key managerial personnel' includes the Chief Executive Officer or the managing director or the manager, the company secretary, the whole-time director, the Chief Financial Officer and other officers as may be prescribed. By specifically denying the key managerial personnel of the company voting rights, though allowed to attend the meetings of the Committee and participate in the discussions, the legislative intent appears to suggest that such persons cannot be made member of the Committee because right to vote moves along with membership.

This might have been done for good reasons as the audit committee will mostly be considering matters directly flowing from the financial records and financial statements of the company. However, it is not clear from the language of the law whether the Board of directors is precluded from including the key managerial personnel in the Audit Committee.

Participation of cost auditor in the meetings of audit committee to be constituted under section 292A of the Companies Act, 1956 (now section 177) - Clarification reg. [General Circular No. 2 of 2003, dated 9th January, 2003]

1. The Department has examined whether the cost auditor appointed under section 233B of the Companies Act, 1956 (now Section 148), could or should be invited to

the audit committee constituted in compliance with section 292A [now Section 177]. It was clarified *vide* Circular No. 6 of 2001, dated 20th August, 2001, that the cost auditor, wherever appointed, shall also attend and participate at the meetings of the audit committee, but shall not have the right to vote.

2. It has been mentioned in the circular that the presence of cost auditor in such committees will ensure overall cost management besides proper pricing of inter-unit/inter-company transfer and valuation of inventories. The intent of the Department was to impress upon the need for the presence of "cost auditor" in audit committee meetings, as an auditor, but not as a member.

3. Sub-section (5) of section 292A [now Section 177] provides that the auditors, internal auditors, if any, and the director, in charge of finance, shall attend and participate at the meetings of audit committees without voting rights. The intention of providing for attending the meetings by auditors and internal auditors is to give an opportunity to the audit committee to hear their views.

4. However, it has come to the notice of the Department that an interpretation is being made that cost auditor can be a member of the audit committee. It is reiterated that the cost auditor cannot become a member of the audit committee and wherever appointed, can only attend and participate in the meeting without voting rights. Any other interpretation will be outside the purview of section 292A [now Section 177] and incorrect.

Other areas like cost-records and cost-statements and internal controls over costing (*e.g.* using standard costing method) and specific compliance with the provisions of the Companies Act have not been excluded from the purview of the audit committee.

In fact, in most situations of companies having manufacturing activity, not much of deeply buried information involving costs and expenses of the company would be known by excluding cost records and cost statements, where they are maintained, irrespective of whether it is mandatory for them to have those records and statements.

Similarly, there could be areas of vital importance involving compliance with the provisions of the Act like fixation of managerial remuneration, recording of minutes of the Board and general meetings, issues of shares and debentures and filing of annual returns. If the company secretary charged with the responsibility of verifying compliance with the provisions of the Act is not available to the Committee, it may pose a serious handicap in the working of the Committee. Sub-section (6) of this section has covered the position to some extent by equipping the Committee with the power to investigate into any matter in relation to the items specified in sub-section (4) of this section (already discussed) or referred to it by the Board of directors. The Committee has been allowed full access to information contained in the records of the company and to external professional advice. The word "records" has been used in this sub-section not with any restricted meaning and as such any record of the company involving any area of operation of the company is open to the Committee. Consequently, the persons responsible for maintenance of various records are undoubtedly answerable to the Committee.

The provisions on audit committee incorporate a significant provision binding the Board of directors to the recommendations of the audit committee in the matters

of financial management and the audit report. This naturally suggests that the audit committee will make its report, containing its recommendations to the Board of directors. It should be so, though not specifically provided, as this committee is a committee of the Board of directors. While binding the Board, as stated above, the provisions have created an incompatible situation by providing room to the Board to disagree with the recommendations of the Committee [sub-section (8)]. As per the provision, if the Board of directors does not accept the recommendations of the Committee, it will record the reasons therefor and communicate such reasons to the shareholders through Board's Report. This undoubtedly allows Board to reject the recommendations and explain to the shareholders the reasons for such rejection. As the audit committee is a committee of the Board, it is proper that the committee should make its report to the Board for its "consideration" and should not have been described as "binding" as in effect the recommendations of the committee does not bind the Board, which has been simultaneously given the power of not accepting the recommendation. This blatant contradictory position should not have found its place in the legislation.

So far auditor's report is concerned, the Committee may make recommendations on accepting or non-accepting any comment or observation or reservation in the audit report. Section 134(3) makes it a duty of the Board to provide fullest information and explanation on every reservation, qualification or adverse remark contained in the auditor's report. Take a situation that the auditors have made a clean report and the audit committee does not agree with that. The audit committee will make a recommendation in its report to the Board to reject the audit opinion. Further, consider that the Board disagrees with the recommendation of the audit committee in this regard. This will give rise to an anomalous position as the Board has accepted the audit opinion, it is not required to give any explanation in terms of section 134(3) of the Act. But, as it disagreed with the recommendations of the audit committee, it is obliged to explain the reason for non-acceptance of the audit committee recommendations. This will have a confusing effect on the users of the financial statement and the auditor's report thereon. Also, it will have the effect of undermining the importance of the audit committee.

It should be noted that section 177 is silent as regards:

(*i*) quorum for the meetings of audit committee;

(*ii*) frequency of meetings of audit committee;

(*iii*) criteria for chairmanship of the committee.

Further, the provisions of this section should have laid down criteria for membership of the committee instead of leaving it entirety to the discretion of the Board. The membership should have been restricted to persons having financial and accounting background to be of any real effect. A member with just general or administrative background cannot reasonably be expected to have even basic exposure to implications of accounting policy or accounting presentation or the present day function expected of internal auditor. Specific but vital requirement of various statutes having impact on the preparation and presentation of the financial statements are also mostly beyond the knowledge of the general stream of directors. As far as frequency of the Audit Committee meeting or its quorum are concerned it seems that the Board's terms of reference would contain them. The

regulation 18 and Schedule II (Part C) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 prescribe the role of audit committee and review of information by Audit Committee as applicable to the listed companies.

19.35-1 Establishment of vigil mechanism

Clause (9) of section 177 requires every listed company or such class or classes of companies as may be prescribed to establish a vigil mechanism for directors and employee. The vigil mechanism is to be used by the employees and directors to report genuine concerns in such manner as may be prescribed. The vigil mechanism must have provisions to safeguard the person using the mechanism from victimization and for providing direct access to the chairperson of the Audit Committee in appropriate or exceptional cases. The details of the vigil mechanism so established shall be made available on the website of the company and disclosed in the Board's report as well. Similar requirements for establishing a vigil mechanism and safeguard against victimization has been incorporated in the regulation 22 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

It appears that the vigil mechanism as described in clause (9) is aiming to have an internal whistle blower policy whereby the employees and directors can raise concerns about the unethical, illegal, immoral or illegitimate activities being carried out in the company. The section imposes a duty of the prescribed companies to establish such a mechanism and made it available on the website for ease of access to the employees and directors. However the section fails to clearly establish the essential requirements for an effective whistle-blowing policy.

19.36 Joint audit

The practice of appointing chartered accountants as joint auditors has become widespread, specially in big companies and corporations. With a view to providing a clear idea of the professional responsibility undertaken by the joint auditors, the ICAI had issued a Statement on Standard Auditing & Assurance Practices on the Responsibility of Joint Auditors (AAS-12).

According to the statement it would not be correct to hold an auditor responsible for the work of another and each joint auditor will be responsible only for the work allotted to him. In coming to these conclusions, the Council considered that the extent of work to be carried out is a matter of professional judgment and that no two firms, whatever be their standing and competence, will necessarily exercise their judgment in an identical manner so as to perform the same volume of work in the same manner. Where joint auditors are appointed, they should divide the work of audit between them by mutual discussion. Such division of work would usually be in terms of identifiable operating units or specified areas of work and, in such a case, it is good practice to communicate to the client, wherever possible, the actual division of the work. Where auditors have been allotted the work of separate unit or branch it would be desirable for each auditor to prepare a separate report on the financial statement of the branch or the unit for which he is responsible. When a natural division of work is not possible, the statement suggests that some division of work, by classification of assets or liabilities or income or expenditure

or periods of time, should be made. It is the responsibility of each joint auditor to determine the extent of audit test to be applied in relation to the area of audit allocated to him and the manner in which it is to be performed. Consequently, it is the separate and specific responsibility of each joint auditor to enquire into and review the prevailing system of internal control relating to the work allocated to him.

Notwithstanding allocation of the job between the joint auditors on some agreed basis, it is possible that certain areas and matters may continue to be of common concern. Each auditor should bring to the attention of his co-auditors matters which require discussion, the disclosure or application of judgment, by the submission of a report or a note prior to the finalisation of audit. Each joint auditor is entitled to assume that his co-auditor(s) have carried out the audit in accordance with the normal standards laid down by the Institute and in accordance with the generally accepted auditing standards. It is not necessary for a joint auditor to review the work performed by his co-auditor or to perform any tests in order to ascertain whether the work has actually been performed. Each auditor is entitled to assume that his co-auditors will bring to his notice any departure from the generally accepted accounting principles or any material error noticed in course of the audit unless corrective action has already been taken before the accounts are finalised. Where separate financial statement of a branch or unit is reported upon by one of the joint auditors, each joint auditor is entitled to assume that such financial statement complies with all the legal and professional requirements regarding the disclosures to be made and also present a true and fair view of the state of affairs of the unit audited. As regards the report, the Council of the Institute is of the view that where joint auditors are in disagreement with regard to the report, each one of them would be justified in expressing his own opinion through a separate report. Even where more than two joint auditors are appointed, there is no question of minority with regard to audit report.

General advantages of a joint audit - Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This by itself is a great advantage. In specific terms the advantages that flow may be the following:

(*i*) Sharing of expertise.

(*ii*) Advantage of mutual consultation.

(*iii*) Lower workload.

(*iv*) Better quality of performance.

(*v*) Improved service to the client.

(*vi*) Displacement of the auditor of the company taken over in a take-over is often obviated.

(*vii*) In respect of multinational companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.

(*viii*) Lower staff development costs.

(*ix*) Lower costs to carry out the work.

(*x*) A sense of healthy competition towards a better performance.

The general *disadvantages* may be the following :

(*i*) The fees being shared.

(*ii*) Psychological problem where firms of different standing are associated in the joint audit.

(*iii*) General superiority complex of some auditors. However, professional expertise may differ amongst the Jt. auditors. The auditor with higher level of expertise has the responsibility to smoothen the relationship.

(*iv*) Problems of co-ordination of the work.

(*v*) Areas of work of common concern being neglected.

(*vi*) Uncertainty about the liability for the work done.

19.37 Cost Audit [section 148]

It is an audit process for verifying the costs of manufacture or production of an article on the basis of accounts as regards utilisation of material or labour or other items of costs maintained by the company. Under the provisions of section 148(3) of the Act, such an audit shall be conducted by a Cost Accountant in practice within the meaning of the Cost Accountants Act, 1959. The expression Cost Accountant means a cost accountant as defined in clause (*b*) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act. [Section 2(28)]

As per sub-clause (*iv*) of section 2(*13*), the books of account includes records maintained in respect of the items of cost as may be prescribed under section 148(1) in the case of a company which belongs to any class of companies specified under that section. The Central Government may by order direct any class or classes of companies to maintain particulars relating to the utilization of material, or labour or to other items of cost as may be prescribed. The order shall apply to such class or classes of companies which are engage in the production of specified goods or provision of specified services. A class or classes of companies which are required to maintain cost records under sub-section (1) may also be subjected to the cost audit under clause (2). The Companies (Cost Record and Audit) Rules, 2014 prescribe the manner in which the cost record are to be maintained, the class or classes of companies that are required to maintain cost records and also the class or classes of companies that are subject to cost audit.

The cost audit is in addition to audit conducted under section 143. The cost auditor is subject to the same qualifications, disqualification, rights, duties and obligations as prescribed under section 143 of the Act for the auditors appointed under section 139. An auditor appointed under section 139, cannot be appointed for conducting the audit of cost records under this section [proviso to section 148(3)].

19.37-1 Maintenance of cost records

In pursuant of section 143(1), the Companies (Cost Record and Audit) Rules, 2014 have prescribed the detailed cost records to be included in the books of account by the class of companies specified in Rule 3 of the said rules. The following class of companies, including foreign companies, has been specified:

A. Companies engaged in the production of specified goods in strategic sectors;
B. Companies engaged in an industry regulated by a Sectoral Regulator or Ministry or Department of Central Government;
C. Companies operating in areas involving public interest; and
D. Companies engaged in production, import and supply of specified medical devices.

The Rule also specifies the threshold limits for these companies to maintain cost records. The detailed list of products and services covered by these Rules and threshold specified are given in Annexure 19.2 to this chapter.

The cost records are required to be maintained in Form CRA-1 as amended *vide* the Companies (Cost Record and Audit) Amendment Rules, 2017 dated 7 December 2017, F.No. 1/40/2013-CL-V.

19.37-2 Appointment and remuneration of cost auditor

Section 143(3) read with Rule (14) of the Companies (Audit and Auditors) Rules, 2014 prescribe the manner of appointment and remuneration of the cost auditor. The cost auditor shall be appointed by the Board of directors of the company which is required to include in books of account, the particulars referred to therein, if the Central Government so directs. The remuneration of the cost auditor shall be determined by the members.

In the case of companies which are required to constitute an Audit committee the procedure for the appointments as laid down in Rule 14 as aforesaid is set out below:

(*i*) Audit committee to consider the appointment of a cost auditor and recommend the same to the Board. The remuneration to be paid shall also be recommended by the Audit Committee.

(*ii*) The Board shall appoint the cost auditor who is a cost accountant in practice or a firm of cost accountants in practice as recommended by the Audit committee. The remuneration needs to be ratified by the shareholders subsequently.

If the company is not required to constitute an Audit committee, the cost auditor is appointed by the board and the remuneration fixed which is subsequently ratified by the shareholders.

Before appointing a cost auditor, the company need to obtain the written consent of the cost auditor to such appointment and a certificate stating that the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment. The certificate shall also state that the individual or the firm satisfies the criteria provided in section 141 that the proposed appointment is within the limits laid down by or under the authority of the Act.*

From the above provisions it appears that the Audit committee's recommendation regarding the cost auditor and his remuneration is binding upon the Board. The Rule 14 is silent upon a situation where the Board is not in agreement with the recommendation of the Audit committee about the individual or firm to be appointed as the cost auditor or the remuneration thereof. Rule 3, which deals with

*Companies (Cost Records and Audit) Amendment Rules, 2016; G.S.R. 695E dated 14 July 2016.

the manner of appointment of auditors under section 139 specifically states that in case of disagreement with the recommendation of the Audit committee the Board has a right to refer back to the committee for reconsideration. That seems to be a more practical procedure. Further only the remuneration of the cost auditor requires ratification from the shareholders.

Rule 6 of the Companies (Cost Record and Audit) Rules, 2014 requires that if applicable, cost auditor shall be appointed within one hundred and eighty days of the commencement of every financial year. The auditor so appointed shall be informed about his appointment within thirty days of the Board meeting or within one hundred and eighty days of the commencement of the financial year whichever is earlier. The appointment shall also be notified to the Central Government within the same time frame. The notice to the Central Government is required to be given in Form CRA-2, the Companies (Cost Record and Audit) Rules, 2014. The appointment of the cost auditor so appointed shall continue till the expiry of one hundred and eighty days from the closure of the financial year or till the submission of the cost audit report for the financial year, whichever is earlier.

A cost auditor may resign from his office before the expiry of his term and may also be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard and recording the reasons for such removal in writing.*

19.37-3 Report of Cost Auditor

The cost auditor is required to submit its report on the audit of cost records to the Board of Directors in form CRA-3 (as amended *vide* the Companies (Cost Record and Audit) Amendment Rules, 2017 dated 7 December 2017, F.No. 1/40/2013-CL-V.) within a period of one hundred and eighty days from the close of the financial year [proviso to section 148(5) and Rule 6(5) of the Rules]. The cost audit report and other documents are also required to be filed using the Extensible Business Reporting Language (XBRL) Taxonomy. The Board is required to furnish a copy of the cost audit report to the Central Government within thirty days of receipt of the same. The Board is also required to give full information and explanation to every reservation and qualification in the report. The Central Government after considering the report with information and explanation provided by the Board may seek further information and explanation as it may deem necessary. The company is under an obligation to furnish the same within the time frame as may be specified.

The cost statements, including other statements to be annexed to the cost audit report are required to be approved and signed on behalf of the Board by any of the director authorised by the Board, before submission to the cost auditor to report thereon.*

The cost auditor shall comply with the cost auditing standards [proviso to section 148(3)]. The cost auditing standards are issued by the Institute of Cost Accountants of India with the approval of the Central Government.

*Companies (Cost Records and Audit) Amendment Rules, 2016; G.S.R. 695E dated 14 July 2016

19.37-4 Cost Audit to be in addition to financial audit

Cost audit requirement under section 148 is in addition to the audit conducted by an auditor appointed under section 143 of the Act. The requirements for the conduct of the cost audit for different classes of companies have been prescribed by the Rule 4 of the Companies (Cost Record and Audit) Rules, 2014. The threshold limits for the conduct of cost audit by different class of companies are given in Annexure 19.2 to this chapter.

Cost audit report for a financial year contains corresponding data for previous year. In case first cost audit of a company, the previous year's figures shall be taken as provided by the management and the cost audit report should bear a statement to that effect (by way of a note).

19.37-5 Appointment of a firm of cost accountants as cost auditors

A firm of cost accountants can also be appointed as cost auditors if all the partners of the firm are practising cost accountants and the firm itself has been constituted with the previous approval of the Central Government as required under Regulation 113 under the Cost and Works Accountants Act, 1959. In such a case, the cost audit report may be signed by any one of the partners of the firm for and on behalf of the firm. The audit report cannot however be signed merely by affixing the firm's name.

The MCA has clarified that Cost audit report shall be signed by any of the eligible partners of the firm who has conducted the cost audit, in his own hand along with his Membership Number for and on behalf of the firm. By a General Circular Number 43/2012 dated 26.12.2012, the MCA allowed the cost auditors and companies under cost audit to file cost audit reports and Compliance reports by using XBRL taxonomy.

19.37-6 Cost Auditor cannot be internal auditor

The DCA earlier has clarified that since the cost auditor is required to comment on the scope and performance of internal audit as per the provisions of the Cost (Audit Report) Rules, it would tend to militate against proper and dispassionate discharge of the duties of the cost auditor if he was also the internal auditor of the company for the same period for which he is conducting the cost audit. The Department is therefore of the view that the cost auditor should not also be the internal auditor of a company for the period for which he is conducting the cost audit, irrespective of the fact whether he is cost audit for one or all the company's production activities.

19.37-7 Penalties

Section 148(8) states that the Company and every officer in default in case of contravention of the provisions of section 148 is liable to punishments as provided in Section 147(1). Accordingly the company shall be liable to fine which shall not be less than rupees twenty-five thousand but which may extend to rupees five lakh. Every officer in default is punishable with fine between rupees ten thousand and rupee one lakhs or imprisonment extending up to one year or both.

The cost auditor in default shall be punishable in the manner provided in sub-sections (2) to (4) of section 147. Accordingly the cost auditor shall be punishable

with fine of rupees twenty-five thousand to rupees five lakhs. If the default is committed knowingly or willingly with the intention to deceive the company or its shareholders or creditors or tax authorities, the fine shall not be less than rupees one lakhs but may extend to rupees twenty-five lakhs and imprisonment which may extend to one year.

The cost auditor if convicted as aforesaid shall also be liable to refund the remuneration received from the company and for damages to the company, statutory bodies or authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report. In case of a firm, the partner or partners concerned shall be jointly and severally liable.

19.38 Secretarial audit

Section 204(1) requires that every listed company and a company belonging to other prescribed class of companies to have mandatory secretarial audit and the secretarial audit report, given by a company secretary in practice to be annexed to the Board's report made under section 134(3). Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) prescribes the following class of companies for the secretarial audit:

(*a*) every public company having a paid up capital of rupees fifty crores or more; or

(*b*) every public company having a turnover of rupees two hundred and fifty crores or more.

The secretarial audit is required to be conducted by a company secretary in practice. The company shall provide all assistance and facilities to the company secretary so appointed to conduct the audit. The auditor is required to submit his report in the form prescribed in Rule 9 of the said Rules (Form No. MR.3). Any qualification or reservation or other remarks made in the secretarial report needs to be explained by the Board in its report under section 134(3).

Any contravention by the company or any officer of the company of the provisions of this section, will attract fine which shall not be less than rupees one lakh but which may extend to rupees five lakh for the company and every officer in default. Any default by the company secretary is practice will also be punishable by similar fine [Section 204(4)].

Section 205(1) prescribes the functions of the company secretary. The company secretary *inter alia* shall ensure compliance with the applicable secretarial standards. The secretarial standards for this purpose are those that are issued by the Institute of Company Secretaries of India and approved by the Central Government.

A mandatory secretarial audit is expected to improve compliance with various legislations including the Companies Act applicable to the company.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF CA (FINAL), CS (INTER & FINAL) AND ICWA (INTER.)]

1. (*a*) Who are the persons who can inspect books of account?
   (*b*) Can a director make inspection of the books of account through an agent?
   (*c*) Can a shareholder inspect books of account?
2. (*a*) What accounting records must be kept by a company to satisfy the requirements of the Companies Act, 2013?
   (*b*) Who may be held responsible if proper books of account have not been maintained? What defence is open to such a person?
3. What is the procedure for removing the auditors before the expiry of their term?
4. PQR Ltd. has no managing director. As a company secretary of that company, advise the chairman about authentication of balance sheet and profit and loss account of the company.
5. Explain the law relating to authentication, circulation, adoption and filing of the annual accounts.
6. The Board of directors of XYZ Ltd. authorised D, the managing director, to sign the directors' report on behalf of the Board. How would you deal with it under the provisions of the Companies Act, 2013?
7. State the circumstances in which the relationship between holding and subsidiary company could arise. What are the obligations imposed on the holding companies regarding disclosure of information pertaining to subsidiaries?
8. The company of which you are the secretary has adopted the financial year as its accounting year. Annual general meetings are usually held in the month of September each year. This year the audit of accounts has not been completed. Your directors intend to hold the annual general meeting in the month of September, as usual, to transact the business other than the consideration of the accounts and to adjourn the meeting to a later date for the purpose of adoption of the annual accounts. They ask you whether this would be in order. State your views.
9. What are the requirements under the listing agreement relating to publication of unaudited quarterly results?
10. (*a*) How is the first auditor of a company appointed?
    (*b*) What are the disqualifications of an auditor?
    (*c*) Can internal auditor act as a statutory auditor?
    (*d*) Can statutory auditor act as a cost auditor?
11. State the procedure for appointment of an auditor in a casual vacancy.
12. Briefly discuss the requirements of Listing Agreement relating to publication of quarterly results.
13. What are the statutory rights and duties of an auditor?
14. Who is empowered to sign auditor's report?
15. State the provisions of law relating to the appointment of a cost auditor. What action can be taken by the Central Govt. on receipt of cost audit report?
16. Is it possible to appoint the first auditor of ABC Ltd. at a general meeting? If so, draft a specimen resolution in this regard.
17. Explain the legal position if the first auditors are not appointed within the stipulated time.

18. Who should sign the directors' report in the absence of the Chairman of the Board of Directors?

19. Auditors appointed at the AGM of XYZ Ltd. resigned within 2 months of appointment. State the legal position.

20. State the legal position in case no auditors were appointed at the annual general meeting of a public limited company.

21. (*a*) What are the contents of the directors' report under the Companies Act, 2013? Explain the provisions relating to signing of directors' report.

(*b*) ABC Ltd. was registered as a public limited company on 5th May, 2013. The first auditor was not appointed within the stipulated time. Advise the company on steps to be taken mentioning the relevant provisions of the Companies Act, 2013.

22. (*a*) "The Companies Act, 2013 prescribes certain disqualifications for appointment as an auditor of a company". Comment.

(*b*) State the number of companies in which a person may be appointed as auditor.

23. An Indian public company has an overseas subsidiary company. Explain the requirements relating to consolidation of accounts of the subsidiary under the Companies Act, 2013.

Hint : No distinction is made between an Indian subsidiary and an overseas subsidiary.

24. What are the qualifications and disqualifications for a cost auditor?

25. What do you understand by "qualification in auditor's report"? How is the qualification expressed in the auditor's report? Is there any responsibility of the Board of directors in this regard?

Hint : Where the auditor is of the opinion that the Balance-sheet does not give a true and fair view of the state of the company's affairs or that the Profit and Loss Account does not give a true and fair view of the profit or loss for the year, he is required to qualify his report. A qualification in the report also becomes necessary when an item requiring specific disclosure under the Companies Act, 2013 is not so disclosed. It is customary for making qualification by the use of expression such as "subject to" before or after referring to the specific note which is qualificatory in character in relation to any of the affirmations made in the auditor's report. The auditor may also use "except that" before referring to the qualificatory note in his report. Under section 134(3)(*f*) of the Companies Act, 2013 Board of Directors of a company are bound to give fullest information and explanation on every reservation, qualification or adverse remark in the auditor's report.

26. Briefly examine the provisions relating to appointment or reappointment of auditors of a Government company?

27. What are the powers of an auditor appointed by a company?

28. Explain the provisions of the Companies Act relating to audit of branch accounts. Can a company appoint any person other than its statutory auditor for the audit of its branch? What are the provisions in case the branch office is situated outside India?

29. How would you deal with the following situations under the provisions of the Companies Act, 2013:

(*i*) The Board of directors of a company decides to revise the accounts already submitted to the auditors of the company, which have not yet been approved by the shareholders in general meeting;

(*ii*) The Board of directors of a company decides to revise the accounts which have already been adopted by the shareholders in annual general meeting; and

30. How will you deal with the appointment of auditors in the following cases :

(*i*) The first auditor has not been appointed by the Board of directors within thirty days of incorporation of the company.

(*ii*) One of the two joint auditors appointed in the last annual general meeting resigned.

(*iii*) One of the partners of the firm of Chartered Accountants appointed as auditors died.

31. Is it in order for an auditor to continue to function as auditor when the next annual general meeting has not been held in time? Can he continue as auditor in case a new auditor has been appointed in his place at the annual general meeting which was adjourned to a later date ?

32. Examine the possibilities of the following with reference to the relevant provisions of the Companies Act, 2013 :

(*i*) Filing of unaudited Balance-sheet with the Registrar of Companies.

(*ii*) Filing of non-adopted Balance-sheet with the Registrar of Companies and preparation of subsequent years' accounts with the balances taken from such Balance-sheet.

33. Briefly explain the requirements of the listing agreement relating to publication of quarterly results by the listed companies.

34. What are the disclosure requirements as provided in Schedule III of the Companies Act, 2013 with regard to 'Investments' in the Balance Sheet of a company. Explain.

Hint: *See* Schedule III to the Companies Act, 2013.

35. (*i*) What is the liability of an auditor for failure to point out in his report that dividend is paid out of sale of the company's real estate.

(*ii*) Can an auditor be disqualified for indebtedness in the following cases:

(*a*) Where he is recovering his fees on a progressive basis even though the job is not complete.

(*b*) Where the auditor's firm has purchased goods from the auditee company and not paid for them for over six months.

36. State the procedure for the following, explaining the relevant provisions of the Companies Act:

(*i*) Appointment of first auditor when the Board of Directors did not appoint the first auditor within thirty days of the date of registration of the company.

(*ii*) Removal of first auditor before the expiry of his term. What difference it would make, if the Auditor was First Auditor appointed by the Board of Directors?

37. Write a short note on 'Inspection of Books of Account'.

38. State the law relating to appointment and remuneration of auditors.

39. "A cost auditor is appointed by the shareholders at the annual general meeting" Comment.

40. State the circumstance in which the accounts can be re-opened?

41. The Board of Directors of the company would like to revise the financial statements in respect of the financial year two year ago. Can they do that?

42. What are the matters to be stated in an auditor's report?

43. Accounting standards are mandatory to be followed. Explain highlighting the role of the Board and Auditors in ensuring that they are followed.

44. Discuss the powers and duties of auditors with reference to leading cases.

45. How are the auditors of a company appointed? How can they be removed? What is the procedure for appointment of auditors to Government companies?

46. Explain the law relating to audit and appointment of auditors of a Government company.

47. How can a new company appoint its auditors for the first term and subsequent terms?

48. The Balance Sheet and Profit & Loss Account of a public company for a particular year has been signed by one of its Directors for the time being in India. Is it valid? Will your answer be different if the company is a private company? Give reason.

49. Discuss the provisions of the Companies Act relating to 'board's report'.

50. What is the law relating to filing of financial statements in case where the AGM has not been held by the due date?

51. Answer in brief:

(*a*) Can the Board of Directors revise/reopen Annual Accounts?

(*b*) Is any person entitled to inspect the books of account and registers of members and debenture-holders of a company?

(*c*) Can books of account of a company be kept anywhere in India?

52. (*a*) Distinguish between the removal and retirement of a statutory auditor and state the procedures to be followed in this regard.

(*b*) Do you think that a statutory auditor will suffer disqualification in the following circumstances in the light of provisions of the Companies Act, 2013:

(*i*) The statutory auditor of a company acquired 100 debentures of a company in a public issue when he was not the statutory auditor and continues to hold them even after his appointment as the statutory auditor.

(*ii*) When in a five partner firm of chartered accountants, one of the partners dies and as per the partnership deed the firm gets reconstituted.

(*iii*) Where one of the managers, who is the audit in-charge of a firm of chartered accountants, buys a colour television on credit from the company for which the firm is the statutory auditor, under a guarantee by one of the partners of the firm?

53. Briefly discuss the requirements relating to compulsory auditor rotation.

54. Comment - "The Accounts duly audited and adopted at an annual general meeting cannot be amended subsequently."

55. Is attachment of document and annexing of a document mean one and the same thing under the Companies Act, 2013 ?

56. State the circumstances in which a company will be deemed not to have maintained proper books of account when winding up order has been passed in respect of the company.

57. Curewell Co. Ltd. is engaged in production of pharma products. It is apprehended that disclosure of quantitative details in the profit & loss account will be detrimental to the interest of the company. Advise.

58. State the items that are covered under the Directors Responsibility Statement prepared under section 134(5).

59. Write short notes on :

(*i*) Investor Education and Protection Fund.

(*ii*) Audit Committee.

60. Write a short note on convergence of Indian accounting standards with International Financial Reporting Standards (IFRS).

61. Amol is a non-executive director of a company. Can Amol inspect books of account and other books and papers during business hours in his capacity as non-executive director? Can Amol get the books inspected by any other person appointed by him? Give reasons and cite case law, if any.

62. Is it incumbent on the statutory auditor of a company to fully incorporate the report of the branch auditor of that company when the accounts of the branch have been audited by another auditor?

63. What is directors' responsibility statement? State its contents.

64. 'An auditor as the watchdog can only bark' - Examine this statement.

65. Write a brief note on the Secretarial Audit.

66. Explain the requirements of the Companies Act, 2013 relating to maintenance of cost records and audit of the same.

67. An internal auditor can also be appointed as the statutory auditor or cost auditor. Do you agree with the statement?

68. What is the reason for the Companies Act, 2013 to bar the auditors of a company to render the specified services to the same company?

69. The auditor has both a right as well a duty to attend the general meeting. Explain.

70. How is the remuneration of cost auditor fixed?

71. Write a brief note on the National Financial Reporting Authority.

72. How do the Companies Act, 2013 ensure that the members of a company receive the audited financial statements?

73. Differentiate between 'internal audit' and 'statutory audit'.

PRACTICAL PROBLEMS

1. The auditors made confidential report to the directors of a company calling the latter's attention to the fact that the security for substantial amount of loans are insufficient and also a major part of the debts are not realisable. Under the circumstances, they advised that no dividend could be paid for the year. In their report to the shareholders, however, the auditors only made a cryptic remark that the value of assets was dependent upon realisation. The directors recommended dividend of 5%.

Discuss with reasons the liability of the auditors and if so, the extent of their liability.

Hint: An auditor who gives to shareholders the means of information, instead of the information itself, in respect of the company's financial position, has failed to discharge his duty and will be liable. A person whose duty is to give information cannot be said to have discharged his duty by simply giving others so much information as is calculated to induce them to ask for more [*Re, The London and General Bank Ltd.* (1895) 2 Ch. 166]. The auditors were expected to have stated in unequivocal terms that the securities for the loans were insufficient and that their realisation would be difficult.

Auditors shall, therefore, be liable to make good the loss which the company has suffered, *viz.*, dividends paid *plus* any other loss that could be shown as directly flowing from breach of duty.

Besides, auditors may be fined up to rupees five lakhs under section 147 for not making a report in accordance with the requirements of section 143.

2. The annual general meeting of a company was convened but stood adjourned without transacting any business. Does the retiring auditor continue in office?

Hint: As the adjourned meeting is treated as a continuation of the AGM, the retiring auditor shall continue in the office till the conclusion of the meeting.

3. The annual general meeting of a company was convened but failed to appoint an auditor in place of the retiring auditor. Does the retiring auditor continue in office?

Hint : As per section 139(10) where at any AGM no auditor is appointed or reappointed, the existing auditor shall continue to be the auditor of the company. Hence the retiring auditor shall continue in office.

4. XYZ Limited would like to adopt the Diwali year for maintenance of its accounts for religious reasons. For that purpose it would like to make an application to the Tribunal. Please advice.

Hint: As per section 129(1) and section 2(*41*) the accounts are required to be maintained on a uniform financial year basis *i.e.* from 1st April to 31st March next. Exception on religious ground is not permitted. Hence application to the Tribunal will not be tenable.

4A. PQR Limited, a subsidiary of a company incorporated outside India would like to adopt the calendar year for maintenance of its accounts for better alignment with its parent company. Please advice.

Hint: As per section 129(1) and section 2(*41*) the accounts are required to be maintained on a uniform financial year basis i.e. from 1st April to 31st March next. However a company which is either a holding or a subsidiary company of a company incorporated outside India may follow a different period after obtaining approval of the Tribunal. PQR Limited is advised to make an application to the Tribunal.

5. The company of which you are the secretary has adopted 31st March as its financial year. The last annual general meeting of the company was held on 30-9-2013 to approve the accounts for the year 2012-13. The audit of the accounts for the year 2012-13 has not been completed. Your directors intend to hold the annual general meeting on 30-9-2013 to transact the business other than the consideration of the accounts for the year 2012-13 and to adjourn the meeting to a later date for the purpose of adoption of the annual accounts for 2012-13. State whether intended procedure would be in order? Comment on holding the adjourned meeting on 31-1-2014, if the audit is completed in December 2013.

Hint: According to section 129(2), at every AGM of the company the Board of Directors of the company shall lay the financial statements for financial year. The AGM is required to be held within six months of the close of the financial year as per section 96(1). The combined reading of sections 96(1) and 129(2) implies that the financial statements shall be ready for placing before the AGM within six months of the close of the financial year. Even the adjourned meeting shall take place within the given timeframe [Refer para 10.10].

6. SSS Limited is incorporated on 10th October 2014. It would like to have its first financial year to close on 31st March 2016. Please advice.

Hint: The first financial year for a company incorporated between 1st April and 31st December shall end on the 31st March. Accordingly the first financial year of SSS Limited will be shorter than 12 months and will end on 31st March 2015 [see para 19.3].

7. STU Limited is incorporated on 10th January 2014. It would like to have its first financial year to close on 31st March 2014 and thereafter follow the financial year for maintenance of its accounts. Please advice.

Hint: The first financial year for a company incorporated between 1st January and 31st March shall end on the 31st March of the following year. Accordingly the first financial year of STU Limited will be longer than 12 months and will end on 31st March 2016 [see para 19.3].

8. ABC Limited prepared its last financial statements of the year ended 30th September 2014. To comply with the requirements of the Companies Act, 2013 it needs to adopt the financial year for preparation of the financial statements. Please advice.

Hint: Under proviso to Section 2(41) of the Act, companies are permitted a period of two years from the commencement of the Act to align their financial year. ABC Limited may close its accounts on 31st March 2015 (*i.e.* for six months) and follow the financial year from 2015-16 onwards.

9. S. K. Gupta, Chartered Accountant is auditor of 20 companies including seven private companies. He is proposed to be appointed as auditor of PQR Limited. Decide whether this is in consonance with the applicable law.

Hint: As per Section 141(3)(*g*) the ceiling is on twenty companies without exception for private companies. As he has already hit the ceiling, the proposed appointment is not valid [see para 19.16-2].

10. Ramesh Chand has recently been appointed as the MD of ABC Limited. He observed that the financial statements of the preceding two financial years violated the requirements of Section 129/134 of the Act. What course of action would you suggest to Ramesh Chand?

Hint: See para 19.11.2. Section 131 permits the company to voluntarily revise its financial statements or Board's report subject to approval of the Tribunal.

11. A firm of Chartered Accountants which is the statutory auditors of a company has also been maintaining their accounts for the last many years. Can it continue to render the services of maintenance of accounts after the commencement of the Companies Act, 2013?

Hint: Under Section 144 accounting and book keeping services is one of the restricted non-audit activity for the auditors. Proviso of Section 144 state that an auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act shall cease to provide such service before the closure of the first financial year after the date of such commencement.

12. XYZ Private Limited has a paid up share capital of rupees fifteen crores. It has borrowings of rupees forty crores form banks. If is subject to compulsory rotation of its auditors? What if the borrowings from the banks were rupees sixty crores?

Hint: An unlisted private company is subject to compulsory rotation of auditors if it has paid up capital of rupees twenty crores or more or has public borrowings exceeding rupees fifty crores. [See para 19.21]

13. An individual auditor has already completed six years as auditor of PQR Limited covered by Section 139(2) in the first AGM after the commencement of provisions of Section 139(2). What is the maximum period for which he may be appointed in the same company? What if he has completed only one year in the first AGM?

Hint: refer Para 19.21-1. A period of three years has been allowed from the commencement of the Act to comply with the provisions relating to rotation. Accordingly the auditor may be appointed for a maximum period of three more years (aggregating to 9 years). In second case the auditor can be appointed for four more years.

14. An audit firm has already completed nine years as auditor of PQR Limited covered by Section 139(2) in the first AGM after the commencement of provisions of Section 139(2). What is the maximum period for which it may be appointed in the same company? What if he has completed only three year in the first AGM?

Hint: refer Para 19.21-1. A period of three years has been allowed from the commencement of the Act to comply with the provisions relating to rotation. Accordingly the audit firm may be appointed for a maximum period of three more years (aggregating to 12 years). In second case the auditor can be appointed for seven more years.

EXPOSURE DRAFT SECRETARIAL STANDARD ON REPORT OF BOARD OF DIRECTORS

SCOPE

This Standard prescribes a set of principles for preparation and presentation of the Report of the Board of Directors of a company and matters relating thereto.

1. FUNDAMENTAL DISCLOSURES

1.1 Financial summary and highlights

1.2 Details of revision of Financial Statements or Board's Report

1.3 Amount, which the Board proposes to carry to any reserves

1.4 Major events during the year

(*a*) State of the company's affairs

(*b*) Change in the nature of business

(*c*) Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the Financial Statements relates and the date of the Report

2. GENERAL INFORMATION

2.1 Brief history of the company, overview of the industry and important changes in the industry during the last financial year;

2.2 Brief description of business segments and geographic segments

2.3 External environment and economic outlook;

2.4 Induction of strategic and financial partners during the last financial year;

2.5 Brief description of the whistle blower mechanism and mechanism evolved for redressal of stakeholder's grievances.

3. CAPITAL STRUCTURE

3.1 Details of preference and equity shares issued

3.2 Issue of equity shares with differential rights

3.3 Issue of Sweat Equity Shares

3.4 Issue of employee stock options

3.5 Issue of shares to trustees for benefit of employees

3.6 Issuance of any other securities which carries a right or option to convert into equity shares

3.7 Credit Rating

4. MANAGEMENT

4.1 Directors and Key Managerial Personnel

4.2 Statement on declaration by Independent Directors

4.3 Number of Board & Committee Meetings

4.4 Composition of Committees and details of changes, if any

4.5 Company's Policy on Director's appointment and remuneration

4.6 Board Evaluation

4.7 Details of remuneration of Directors of Listed Companies

4.8 Remuneration received by Managing/Whole time Director from holding or subsidiary company

4.9 Directors' Responsibility Statement

4.10 Internal financial controls

4.11 Disclosure regarding frauds

5. DISCLOSURES RELATING TO SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES

5.1 Report on performance and financial position of each of the subsidiaries, associates and joint ventures

5.2 Companies which have become or ceased to be subsidiaries, associates and joint ventures

6. DETAILS OF DEPOSITS

7. PARTICULARS OF LOANS, GUARANTEES AND INVESTMENTS

8. PARTICULARS OF CONTRACTS OR ARRANGEMENTS WITH RELATED PARTIES

9. DISCLOSURES PERTAINING TO CORPORATE SOCIAL RESPONSIBILITY

10. DETAILS OF REMUNERATION OF EMPLOYEES

11. CONSERVATION OF ENERGY, TECHNOLOGY ABSORPTION, FOREIGN EXCHANGE EARNINGS AND OUTGO

(*a*) Conservation of energy -

(*b*) Technology absorption -

(*c*) Foreign exchange earnings and Outgo

12. RISK MANAGEMENT

13. MATERIAL ORDERS OF REGULATORS

14. DETAILS OF ESTABLISHMENT OF VIGIL MECHANISM

15. AUDITORS

16. SECRETARIAL AUDIT REPORT

17. EXPLANATIONS IN RESPONSE TO AUDITORS' QUALIFICATIONS

18. COMPLIANCE WITH SECRETARIAL STANDARDS

19. DETAILS OF SICKNESS OF THE COMPANY

20. FAILURE TO COMPLETE BUY BACK

21. EXTRACT OF ANNUAL RETURN

22. OTHER DISCLOSURE

22.1 The Report should state, wherever applicable, that the consolidated financial statements are also being presented in addition to the standalone financial statements of the company.

22.2 The Report should also include the following:

(*a*) reasons for delay, if any, in holding annual general meeting;

(*b*) key business developments during the year.

(*c*) key initiatives with respect to the following

- Stakeholders relationship;
- Customers relationship;
- Environment;
- Sustainability;
- Health and safety.

23. DISCLOSURES UNDER SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

23.1 Statement of deviation(s) or variation(s)

23.2 Management Discussion and Analysis Report

23.3 Certificate on compliance of conditions of corporate governance

24. DISCLOSURES UNDER THE SEXUAL HARASSMENT OF WOMEN AT THE WORKPLACE (PREVENTION, PROHIBITION & REDRESSAL) ACT, 2013

25. ADDITIONAL DISCLOSURES PURSUANT TO DIRECTIONS OF RESERVE BANK OF INDIA

25.1 Systemically Important NBFCs and Deposit taking NBFCs

25.2 NBFCs, Miscellaneous Non-Banking Companies and Residuary Companies

The Report should include the information on:

(*a*) **the total number of depositors with the company whose deposits have not been claimed by the depositors or not paid by the company after the date on which the deposit became due for repayment or renewal, as the case may be, according to the contract with the depositor or the Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 2016 or the Residuary Non-Banking Companies (Reserve Bank) Directions, 2016, as applicable; and**

(*b*) **the total amounts due under such accounts remaining unclaimed or unpaid beyond the due date for repayment;**

(*c*) **compliance with the Residuary Non-Banking Companies (Reserve Bank) Directions, 2016, if applicable.**

26. ADDITIONAL DISCLOSURES PURSUANT TO NATIONAL HOUSING BANK DIRECTIONS

The Report should include information on:

(*a*) **the total number of accounts of public deposit of the housing finance company which have not been claimed by the depositors or not paid by the housing finance company after the date on which the deposit became due for repayment; and**

(*b*) **the total amounts due under such accounts remaining unclaimed or unpaid beyond the due date for repayment**

27. ADDITIONAL DISCLOSURES PURSUANT TO FEMA REGULATIONS

28. ADDITIONAL DISCLOSURES BY PRODUCER COMPANY

29. APPROVAL OF THE REPORT

The Report should be considered and approved by means of a resolution passed at a duly convened meeting of the Board. The same cannot be approved by circulation. It shall also not be dealt with in a Board meeting held through video conferencing or other audio visual means.

30. SIGNING AND DATING OF THE REPORT

The Report should be signed by the Chairman of the company, if any, authorised in that behalf by the Board, or, by not less than two Directors of the company, one of whom should be Managing Director, where there is one. In case the company has only one Director, the Report should be signed by the said Director.

If the Auditor's Report is available for consideration at the time of approving the Board's Report, the Board's Report may bear the same date as that of the Auditor's Report or a later date as authorised by the Board. However, if the Auditor's Report is dated subsequent to the date of Board's Report, then the Board's Report may bear the same date or a date after the date of the Auditor's Report.

The following are required to be annexed to the Board's Report:

- Particulars of prescribed contracts/arrangements with related parties in Form AOC-2. This Form shall be signed by the persons who have signed the Board's Report.
- Prescribed particulars of remuneration of Directors and employees
- Secretarial audit report for the relevant financial year in Form MR-3
- Extract of Annual Return in Form MGT-9
- Annual report on CSR activities. This Report shall be signed by Chief Executive Officer/ Managing Director/Director and by the Chairman of CSR Committee.
- Policy relating to remuneration of Directors, Key Managerial Personnel and other employees.
- Prescribed details of conservation of energy, research and development, technology absorption, foreign exchange earnings and outgo
- Auditors' certificate on Corporate Governance in case of Listed Companies.

31. COLLECTIVE RESPONSIBILITY OF THE BOARD

31.1 The Report should be the collective responsibility of all the Directors though the Report may have been approved only by a majority of the Directors.

31.2 The Board should be collectively responsible for any statement in its Report which is materially false or for any omission of a material fact, knowing it to be material.

32. FILING OF THE BOARD'S REPORT

The Report along with the audited Financial Statements of the company should be filed with the Registrar of Companies within the prescribed time limit.

33. CONSISTENCY

The Board should ensure consistency of information given in the Report, the Report on Corporate Governance and the explanatory statements to resolutions.

34. RIGHT OF MEMBERS TO COPIES OF REPORT

34.1 A copy of the Report alongwith the Financial Statements and the Auditor's Report should be sent, either physically or in electronic form, so as to reach every Member not less than 21 days before the date of the annual general meeting.

34.2 The Report should be supplied to each Member of the company.

SUMMARY OF REQUIREMENTS FOR MAINTENANCE OF COST RECORDS AND COST AUDIT AS PRESCRIBED UNDER RULE 3 AND RULE 4 OF THE COMPANIES (COST RECORD AND AUDIT) RULES, 2014.[20]

Class of Companies	Threshold limits for maintenance of Cost Record	Conditions for the conduct of Cost Audit
A. Regulated Sector 1. Telecommunication services made available to users by means of any transmission or reception of signs, signals, writing, images and sounds or intelligence of any nature (other than broadcasting services) and regulated by the Telecom Regulatory Authority of India under the Telecom Regulatory Authority of India Act, 1997 (24 of 1997); 2. Generation, transmission, distribution and supply of electricity regulated by the relevant regulatory body or authority under the Electricity Act, 2003 (36 of 2003); 3. Petroleum products regulated by the Petroleum and Natural Gas Regulatory Board under the Petroleum and Natural Gas Regulatory Board Act, 2006 (19 of 2006); 4. Drugs and Pharmaceuticals; 5. Fertilisers; 6. Sugar and industrial alcohol;	Overall turnover from all its products and services of rupees thirty five crores or more during the immediately preceding financial year. Not applicable to a company classified as a micro enterprise or small enterprise under Micro, Small and Medium Enterprises Development Act, 2006.	Overall annual turnover from all its products and services during the immediately preceding financial year is rupees fifty crores or more and aggregate turnover of the individual product or products or services for which cost records are required to be maintained is rupees twenty five crores or more.
B. Non-Regulated Sector 1. Machinery and mechanical appliances used in defence, space and atomic energy sectors excluding any ancillary item or items; Explanation: - For the purposes of this sub-clause, any company which is engaged in any item or items supplied exclusively for use under this clause, shall be deemed to be covered under these rules. 2. Turbo jets and turbo propellers; 3. Arms and ammunitions; 4. Propellant powders; prepared explosives, (other than propellant powders); safety fuses; detonating fuses; percussion or detonating caps; igniters; electric detonators; 5. Radar apparatus, radio navigational aid apparatus and radio remote control apparatus; 6. Tanks and other armoured fighting vehicles, motorised, whether or not fitted with weapons	Overall turnover from all its products and services of rupees thirty five crores or more during the immediately preceding financial year. Not applicable to a company classified as a micro enterprise or small enterprise under Micro, Small and Medium Enterprises Development Act, 2006.	Overall annual turnover from all its products and services during the immediately preceding financial year is rupees one hundred crores or more and aggregate turnover of the individual product or products or services for which cost records are required to be maintained is rupees thirty five crores or more.

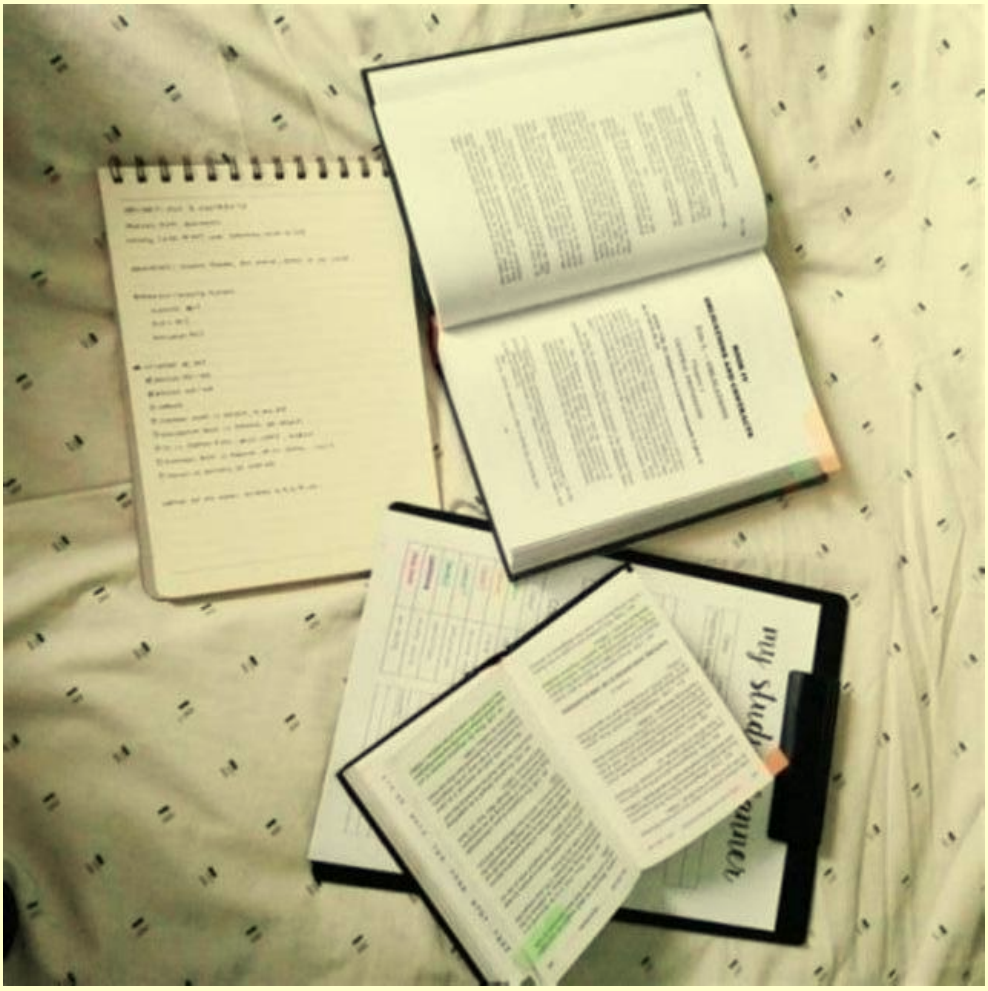
20. Companies (Cost Records and Audit) Amendment Rules, 2016; G.S.R. 695E dated 14 July 2016

Class of Companies	Threshold limits for maintenance of Cost Record	Conditions for the conduct of Cost Audit
and parts of such vehicles, that are funded (investment made in the company) to the extent of ninety per cent or more by the Government or Government Agencies; 7. Port services of stevedoring, pilotage, hauling, mooring, re-mooring, hooking, measuring, loading and unloading services rendered for a Port in relation to a vessel or good regulated by the Tariff Authority for Major ports under the Major Port Trusts Act, 1963 (38 of 1963); 8. Aeronautical services of air traffic management, aircraft operations, ground safety services, ground handling, cargo facilities and supplying fuel rendered at the airports and regulated by the Airports Economic Regulatory Authority under the Airports Economic Regulatory Authority of India Act, 2008 (27 of 2008); 9. Iron & Steel; 10. Roads and other infrastructure projects; 11. Rubber and allied products being regulated by the Rubber Board; 12. Coffee and Tea; 13. Railway or tramway locomotives, rolling stock, railway or tramway fixtures and fittings, mechanical (including electro mechanical) traffic signalling equipment's of all kind; 14. Cement; 15. Ores and Mineral Products; 16. Mineral fuels (other than Petroleum), mineral oils etc.; 17. Base metals; 18. Inorganic chemicals, organic or inorganic compounds of precious metals, rare-earth metals of radioactive elements or isotopes, and Organic Chemicals; 19. Jute and Jute Products; 20. Edible Oil 21. Construction Industry; 22. Health services *viz.* functioning as or running hospitals, diagnostic centres, clinical centres or test laboratories; 23. Education services, other than such similar services falling under philanthropy or as part of social spend which do not form part of any business; 24. Milk Powder; 25. Insecticides; 26. Plastics and polymers; 27. Tyres and tubes; 28. Pulp and Paper;		

Class of Companies	Threshold limits for maintenance of Cost Record	Conditions for the conduct of Cost Audit
29. Textiles; 30. Glass; 31. Other Machinery; 32. Electricals or electronics machinery; 33. Production, import and supply or trading of following medical devices namely:- (*i*) Cardiac Stents; (*ii*) Drug Eluting Stents; (*iii*) Catheters; (*iv*) Intra Ocular Lenses; (*v*) Bone Cements; (*vi*) Heart Valves; (*vii*) Orthopaedic Implants; (*viii*) Internal Prosthetic Replacements; (*ix*) Scalp Vein Set; (*x*) Deep Brain Stimulator; (*xi*) Ventricular peripheral Shud; (*xii*) Spinal Implants; (*xiii*) Automatic Impalpable Cardiac deflobillators; (*xiv*) Pacemaker (temporary and permanent); (*xv*) patent ductus arteriosus, atrial septal defect and ventricular septal defect closure device; (*xvi*) Cardiac Re-synchronize Therapy ; (*xvii*) Urethra Spinicture Devices; (*xviii*) Sling male or female; (*xix*) Prostate occlusion device; and (*xx*) Urethral Stents.		

However a company whose revenue from exports in foreign exchange exceeds seventy five percent of its total revenue or which is operating from a special economic zone would be exempt from the requirement of cost audit. A company which is engaged in generation of electricity for captive consumption through Captive Generating Plant shall also be exempt from the requirement of cost audit.

Companies (Cost Records and Audit) Amendment Rules, 2016; G.S.R. 695E dated 14 July 2016 as amended by Notification No. G.S.R 1157 (E), dated 3rd December 2018.



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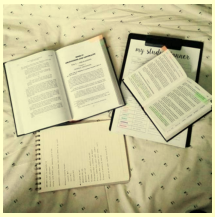

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20 Inspection, Inquiry and Investigation

INSPECTION

20.1 Power to call for information, inspect books and conduct inquiries

Section 206(1) provides that if the Registrar on a scrutiny of any document filed by a company or on any information received by him, is of the opinion that any further information or explanation or any further documents relating to the company is necessary, he may require the company to furnish in writing such information or explanation or to produce such documents. The registrar will give a written notice to the company for that purpose specifying to provide the desired information or documents within a reasonable time. The expression "document" includes summons, notice, requisition, order, declaration, form and register, whether issued, sent or kept in pursuance of this Act or under any other law for the time being in force or otherwise, maintained on paper or in electronic form [Section 2(36)].

The Registrar may by another notice call on the company to produce for his inspection such further books of accounts, books, papers and explanations if –

(*i*) The company fails to furnish the information or explanation within the time specified; or

(*ii*) The Registrar is of the opinion that the information or explanation furnished is not adequate; or

(*iii*) The Registrar is satisfied that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information.

The Registrar shall specify the time and place for production of books etc. Before serving the notice the Registrar shall record the reason in writing for issuing such notice [Section 206(3)].

Under Section 206(4) If the Registrar is satisfied, on the basis of information available with or furnished to him or on a representation made to him by any person that:

(*i*) the business of a company is being carried on for a fraudulent or unlawful purpose; or

(*ii*) not in compliance with the provisions of this Act; or

(*iii*) if the grievances of investors are not being addressed;

he may call on the company to furnish in writing any information or explanation on matters specified in the order within such time as may be specified. The Registrar shall inform the company of the allegations made against it by a written order and carry out such inquiry as he deems fit after providing the company a reasonable opportunity of being heard. Central Government may, if it is satisfied that the circumstances so warrant, direct the Registrar or an inspector appointed by it for the purpose to carry out the inquiry under this sub-section [proviso to Section 206(4)].

The Central Government may —

a. if it is satisfied that the circumstances so warrant, direct inspection of books and papers of a company by the Registrar or an inspector appointed by it for the purpose [Section 206(5)]

b. having regard to the circumstances by general or special order, authorise any statutory authority to carry out the inspection of books of account of a company or class of companies [Section 206(6)].

A combined reading of the various sub-section of Section 206 suggests that the Central Government may order the inspection either by the Registrar or an inspector appointed under sub-section (5) or by any statutory authority under sub section (6). The subject matter of inspection in sub-section (6) is 'books and papers' whereas the sub-section (7) the expression used is 'books of account'. The definition of 'books and paper' as per Section 2(12) is much wider and include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or electronic form.

Inspection is a useful instrument and the preliminary step for finding out materials and facts which would justify initiation of investigation under section 210. It is noticed from the Annual Reports of the Department of Company Affairs[1] that the books of account and other records of the companies are inspected selectively by officers of the Directorate of Inspection authorised for this purpose under this section. Inspection, *inter alia*, covers the companies with paid up capital exceeding certain level, companies incurring losses and companies in respect of which complaints are received. The material brought out in the inspection reports is made use of for taking actions under important provisions of the Act including, *inter alia*, appointment of Government directors, ordering investigations into the affairs of the companies under section 210, and consideration of application seeking approval for the appointment of managerial personnel in companies. In certain cases, prosecutions are also launched on the basis of the finding contained in the inspection reports. Besides, cases involving non-compliance of certain provisions of the Act, including inadequate maintenance of statutory records noticed during such inspections, are also taken up with the companies for necessary remedial

1. Now corporate affairs.

action. Information of interest to other Government Departments/agencies as brought out in the inspection reports is also communicated to them for suitable and appropriate action.

20.2 What books and papers can be inspected?

Under section 206(3), the Registrar is authorized to call for production of books of account, books, papers and explanations as he may require. The expressions used here is quite wide. The expressions 'book' and 'books of account' has been defined in Section 2(12) and 2(13) of the Act respectively. Accordingly "book and paper" and "book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form. The "books of account" includes records maintained in respect of all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place; all sales and purchases of goods and services by the company; the assets and liabilities of the company; and the items of cost as may be prescribed under section 148 in the case of a company which belongs to any class of companies specified under that section. From the above it is clear that the Registrar or the inspector appointed under Section 206 has the authority to call for such books or paper as may be necessary.

Department's views

The views of the Department on the subject are as under :

(*a*) The inspecting officer has a right to examine the books and records of any firm in which the company concerned is a partner (*Letter No. 7/9/74-CL : II, dated 24-1-1976).*

(*b*) The inspecting officer has a right to examine the books and records of any joint venture in which the company concerned has an interest (*Circular No. 25/75, dated 19-11-1975*).

20.3 Place and time of inspection

The place at which inspection may be carried out need not be the registered office of the company. The books of account have to be kept either at the registered office of the company or at some other place, after an intimation to the Registrar. The books of account can be inspected at such other place also. Thus, the authorised officer or the Registrar was held entitled to demand inspection of the books of account even in his office - *Indra Prakash Karnani* v. *ROC* [1985] 57 Comp. Cas. 62 (Cal.).

20.4 Duties of directors, officers, employees of the company to assist in inspection

Sub-section (1) of section 207 casts a duty on every director, other officer or employee of the company to produce to the person making inspection all such documents and to furnish him with any statement, information or explanations relating to the affairs of the company in such form as the said person may require of him within such time and at such place as he may specify.

Further, it shall also be the duty of every director, other officer or employee of the company to give to the person making inspection under this section all assistance in connection with the inspection which the company may reasonably be expected to give.

20.5 Powers of the inspector

1. *Power to make copies* - A person making the inspection under this section may, during the course of inspection make or cause to be made copies of books of account and other books and papers.
2. *Power to place identification marks* - The inspector may, during the course of inspection place or cause to be placed any marks of identification thereon in token of the inspection having being made.
3. *Powers of civil courts* - Sub-section (3) of section 207 provides that notwithstanding anything contained in any other law for the time being in force or any contract to the contrary, any person making an inspection shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters, namely:
   (*i*) the discovery and production of books of account and other documents, at such place and such time as may be specified by such person;
   (*ii*) summoning and enforcing the attendance of persons and examining them on oath;
   (*iii*) inspection of any books, registers and other documents of the company at any place.

4. *Powers to search and seizure* – Under Section 209 (1) if the Registrar or inspector making inspection has reason to believe that books and papers of a company or relating to the key managerial personnel or any director or auditor or company secretary in practice are likely to be destroyed, mutilated, altered or falsified, he may, after obtaining order from the Special Court for seizure of such books and papers enter and search the place or places where the relevant books or papers are kept and seize such books and papers. The company is allowed to take copies of or extract from such books or papers at its cost.

For every search and seizure under this section the provisions of the Code of Criminal Procedure, 1973 shall apply. The books and papers seized shall be returned to the company as soon as possible but within one hundred and eighty days. Before returning the books and papers the person making the inspection may take copies of or extract from them or place identification mark on them. If such books and papers are needed again, the same may called again for a further period of one hundred and eighty days.

Penalty for default – The following penalties have been prescribed for default -

Failure to furnish information under Section 206 - A company and every officer of the company, who is in default which fails to furnish any information or explanation or produce any document required under Section 206, shall be punishable with a fine which may extend to rupee one lakh and in the case of a continuing failure, with an additional fine which may extend to rupee five hundred for every day after the first during which the failure continues.

Default under Section 207 – Disobeying the direction issued by the Registrar or the inspector under Section 207 shall make the director or the officer punishable with imprisonment which may extend to one year and with fine which shall not be less than rupees twenty-five thousand but which may extend to rupees one lakh. A director or an officer of the company which has been convicted of an offence under Section 207, shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company. It may be noted that the company cannot be made liable for committing the default - *Indra Prakash Karnani* v. *ROC* [1985] 57 Comp. Cas. 662 (Cal.).

However, the offence under this section is not a continuing one and is deemed to be committed on a particular date. Limitation begins to run on that date. A prosecution launched more than one year after the date of the offence is barred by limitation - *State* v. *S. Seshamal Pandia* [1986] 60 Comp. Cas. 889 (Mad.).

20.6 Supply of report

Where an inspection of the books of account and inquiry has been made under section 206 or other books and papers under Section 207, Section 208 requires that the person making the inspection or inquiry shall make a report in writing to the Central Government. The report may include a recommendation for further investigation into the affairs of the company. If further investigation is recommended reasons and documents in support of such recommendation shall be given. There is no requirement to make the copy available to the company.

The Central Government has delegated the power to receive the report from the Registrar to the Regional Directors at Mumbai, Kolkata, Chennai, Delhi, Ahmedabad, Hyderabad and Shillong in cases of offences which are punishable with imprisonment of less than two years. However, in respect of violations under Chapters III and IV and Sections 127, 177 and 178, the report will be received by the Central Government*.

20.7 Inspection by Reserve Bank

In case of all the non-banking companies, the Reserve Bank has also a right of inspection of their books and papers under section 45N of the Reserve Bank of India Act, 1934, sub-section (1) of which provides as follows :—

"The bank may, at any time, cause an inspection to be made by one or more of its officers or employees or other persons (hereafter in this section referred to as the inspecting authority)—

(*i*) of any non-banking institution, including a financial institution, for the purpose of verifying the correctness or completeness of any statement, information or particulars furnished to the bank or for the purpose of obtaining any information or particulars which the non-banking institution has failed to furnish on being called upon to do so; or

(*ii*) of any non-banking institution being a financial institution, if the bank considers it necessary or expedient to inspect that institution."

*Vide Notification F No. 3/76/2015-CL-II dated 31 December 2015

INVESTIGATION

20.8 Investigation

Sections 210 to 229 contain provisions relating to investigation into the affairs of companies. Section 211 provides for the establishment of Serious Fraud Investigation Office (SFIO) whereas Section 212 deals with the investigation into affairs of a company by the SFIO.

20.9 Who can apply and the scope of investigation

Section 210(1) provides that the Central Government may order investigation into the affairs of a company on receipt of a report from the Registrar or inspector under Section 208 or where a company has passed a special resolution for the investigation of the affairs of the company or in public interest. The Central Government has discretion to order investigation as the expression used is 'may'. Section 210(2) makes it mandatory for the Central Government to order an investigation into the affairs of a company if there is an order by a court or the Tribunal directing that the affairs of a company ought to be investigated.

Whether discretionary [sub-section (1)] or mandatory [sub-section (2)], the Central Government may appoint one or more person to investigate into the affairs of the company.

20.9-1 On the report of Registrar or inspector

Sub-clause (*a*) of section 210(1) empowers the Central Government to order investigation into the affairs of a company on the report of the Registrar or inspector under Section 208.

When an inquiry or inspection of books of account or other papers is made under Section 206 or Section 207, the person making the inquiry or inspection may recommend further investigation into the affairs of the company. On such a report having been made, giving reasons for the recommendation, the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as it may direct.

Where a company is consistently violating provisions of the Act, and is yet carrying on substantial business, the Registrar is competent to take steps for investigation of the affairs of the company - *Standards Brand Ltd., In re* [1980] 50 Comp. Cas. 75 (Cal.).

20.9-2 The company, by passing special resolution [Section 210(1)(b)].

Central Government may order investigation into affairs of a company on intimation of a special resolution passed by company that the affairs of the company ought to be investigated.

20.9-3 The Court or Tribunal, by order [Section 210(2)]

The Central Government shall appoint one or more competent persons as inspectors to investigate the affairs of a company and to report thereon in such manner as the Central Government may direct, if a Court or the Tribunal in any proceedings before it, by order, declares that the affairs of the company ought to be investigated by an inspector appointed by the Central Government. For passing an order for

investigation, it is not necessary that a proceeding be pending before the court or the Tribunal.

It has been contended in several cases that the power and discretion of the Government were uncontrolled and the court could direct an investigation whenever it suspected that all was not well with the company, and it was not necessary for the petitioner to prove his allegations before the court for, he could prove them before the Inspectors. However, in *Mrs. U.A. Sumathy* v. *Digvijay Chit Fund (P.) Ltd.* [1983] 53 Comp. Cas. 493 (Ker.), the High Court observed:

> "No doubt, clause (*a*)(*ii*) of section 237 [now Section 210(2)] does not lay down what circumstances are to be proved before the Court and on what materials, the Court could act but that does not mean that mere allegations are sufficient. A Court can act only on the materials placed before it and those materials should at least be such as to satisfy the Court that a deeper probe into the company's affairs is desirable in the interest of the company itself." [Also *see A.P. Civil Supplies Corpn. Ltd.* v. *Delta Oils and Fats Ltd.* [2007] 73 SCL 242 (AP)].

It may be noted that company court itself is not vested with any powers of investigation under section 237 [now Section 210]. All that it can do is to consider the plea of the petitioners as to whether it is a fit case to direct the Central Government to do so. [*Uunet India Ltd.* v. *I.C. Rao* [1998] 93 Comp. Cas. 41 (AP).]

In *Safia Usman* v. *Union of India* [1999] 22 SCL 372 (Ker.), it has been held that before invoking High Court's discretionary jurisdiction, CLB [now Tribunal], the statutory body created specifically for the purpose under section 237 [now Section 210], must first be approached. The Court further held that the High Court can only issue a declaration with reference to affairs of a company and cannot direct Central Government to conduct investigation.

20.9-4 In public interest

Under sub-clause (*c*) of Section 210(1) the Central Government has discretion to order an investigation into the affairs of company 'in public interest'.

In the case of a company intended to operate in modern welfare State, the concept of 'public interest' takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community, at any rate, not in manner detrimental to the public goods. [*N.R. Murthy* v. *Industrial Development Corporation of Orissa Limited* [1977] 47 Comp. Cas. 389 (Ori.)].

20.10 Guidelines for ordering investigation into company's affairs

In exercising the discretionary powers under this section, the Central Government, while examining each case on its merits, applies certain tests which are calculated to ensure that a substantial and worthwhile basis exists, warranting investigation. Where the allegations are more of a recriminatory nature arising out of factional fights between two or more predominant groups of shareholders, the Government will not ordinarily lend itself to be a party to such disputes. In other cases, based on the relevant provisions of the company law or any law in force, the following objectives may generally form the prerequisite for ordering of an investigation :

- Where an inspector can bring to light any major contravention of company law or any other law on the basis of which necessary corrective or remedial measures can be applied.

- Where the application of such measures alone will be enough to lend succour to the aggrieved parties, where necessary, or to set right the affairs of companies so as to bring them in conformity with the accepted principles and standards of good and efficient management.
- Where the allegations bring out clearly or, by implication, a charge of irregular accounting, the truth of which can be established only by the analysis of the books by a qualified chartered accountant (*Taxmann's Circulars & Clarifications,* 1992 edition, page 264).

It was held by the Delhi High Court that the objective of investigation under section 210 (Section 235 of the Companies Act, 1956) is to unearth and find out new material or data. If no further information beyond documents pertaining to company was likely to be obtained by investigation, application for investigation is liable to be rejected. [*Amaan Sachdev* v. *Fahed Abdulrahman Ali Alkhamiri* [2016] 70 taxmann.com 337 (Delhi)]

20.10-1 Complaint for violation by SEBI - Whether a bar to investigation

A complaint by SEBI for violation of the provisions of the SEBI Act by itself is not a bar to investigation into the company's affairs when substantial reason exists for investigation - *Sonkh Technologies Ltd.* v. *Union of India* [2009] 89 SCL 335 (Delhi). Again, in *Rasoi Ltd.* v. *Jaideep Halwasiya* [2009] 89 SCL 317 (Kol.), it was held that where violation of SEBI Take Over Code is alleged and also a petition under section 111A [now Section 59] for rectification of the membership register is pending, application for relief under section 250(1) [now Section 222] cannot be entertained unless circumstances suggest that investigation under section 247(1A) [now Section 216] is called for. In a petition under section 397/398 [now Section 241] an allegation of diversion of fund by the company was found supported by audit report. The CLB [Now Tribunal] ordered investigation under section 237(*b*) [now section 213] while continuing with the petition - *Securities Ltd.* v. *Kowa Spinning Ltd.* [2009] 89 SCL 80 (CLB).

20.10-2 Fraud on creditors and on the court

The Allahabad High Court in *United Western Bank Ltd.* v. *Khaitan Hostombe Spinels Ltd.* [2009] 91 SCL 221 ordered the Official Liquidator of the company in respect of which winding up petition was filed to inform the Central Government to order investigation of the company under sections 235-237 [now Sections 210-214] as the court found that the directors of the company did not file the Statement of Affairs of the company and had left the country misleading the court and the creditors by a fake scheme of merger which was approved by the appropriate Court, so as to get the company wound up without payment to the creditor.

20.11 Investigation into affairs of a company by Serious Fraud Investigation Office

Under Section 211 the Central Government shall by notification establish a Serious Fraud Investigation Office to investigate frauds relating to a company. The Central Government may order the SFIO under Section 212(1) to investigate the affairs of a company in the following circumstances –

a. on receipt of a report of the Registrar or inspector under section 208;

b. on intimation of a special resolution passed by a company that its affairs are required to be investigated;

c. in the public interest; or

d. on request from any Department of the Central Government or a State Government.

An Investigation under section 212 by Serious Fraud Investigation Office (SFIO) ought to be on the basis of opinion of Central Government that it was necessary to investigate into affairs of company by SFIO. [*Parmeshwar Das Agarwal* v. *Additional Director (Investigation)* [2016] 75 taxmann.com 261 (Bombay)]

The SFIO shall carry out the investigation following procedure prescribed under this chapter and submit a report to the Central Government within the time frame specified by the Central Government. Under Rule 3 of the Companies (Inspection, and Investigation and Inquiry) Rules, 2014 the Central Government is authorized to appoint experts in the fields of investigations, cyber crimes, financial accounting, management accounting, cost accounting and any other fields for efficient discharge of SFIO functions.

SFIO would have the sole responsibility of investigation of the alleged offence. Once the case has been assigned to the SFIO, no other investigation agency shall proceed with similar investigation and any pending investigation with any other investigative agency shall also be transferred to the SFIO with the relevant records and documents.

Power to call for information - Sub-section (5) cast a duty on the company and its officers and employees, who are or have been in employment of the company to provide all information, explanation, documents and assistance to the Investigating Officer as may be required by him for conduct of the investigation.

Power to arrest - Sub-section (8) of Section 212 empowers the designated officials authorized by the Central Government by a special or general order to arrest a person if he has reasons to believe the person is guilty of any offence punishable under sub-section (6).

Submission of Report to the Central Government – The SFIO, upon completion of the investigation is required to submit the investigation report to the Central Government. Any person concerned may make an application to the court to obtain a copy of the investigation report. Upon examination of the report the Central Government may order the SFIO to initiate prosecution against the company and its officers and employees, current and former, and any other person directly or indirectly connected with the affairs of the company. Before taking a decision to prosecute, the Central Government may take legal advice as may be necessary.

Action against managerial personnel - The Central Government is empowered to file an application to the Tribunal if the report of the investigation states that a fraud has taken place in the company and any director, key managerial personnel, other officers of the company or any other person or entity has taken undue benefit from the fraud. The Tribunal may order disgorgement (paying back) of the asset, property or cash that was the subject matter of the fraud and may also hold the managerial personnel concerned liable personally without any limitation of liability. [Section 212(14A)]*

Sharing of information – Any other investigating agency, State Government, police authority, income tax authorities having information or documents relating to the

*Inserted *vide* the Companies (Amendment) Act, 2019.

offence being investigated by the SFIO shall share the same with the SFIO. Likewise SFIO has a reciprocal duty to share any information or document with other agencies mentioned which may be relevant or useful to such agency.

20.12 Investigation into company's affairs in other cases

Under Section 213 the Tribunal may pass an order that the affairs of a company ought to be investigated by an inspector or inspectors appointed by the Central Government. If such an order is passed by the Tribunal, the Central Government shall appoint inspector(s) to investigate the affairs of the company in respect of such matter. The Tribunal may pass an order to investigate in the following conditions –

(*a*) on an application made by not less than one hundred members or members holding not less than one-tenth of the total voting power, in the case of a company having a share capital; or not less than one-fifth of the persons on the company's register of members, in the case of a company having no share capital. An application as such needs to be supported by evidence to show that there are good reasons for seeking an order.

(*b*) on an application made to it by any other person or otherwise, if it is satisfied that there are circumstances suggesting that—

(*i*) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose, or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose;

(*ii*) persons concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, misfeasance or other misconduct towards the company or towards any of its members; or

(*iii*) the members of the company have not been given all the information with respect to its affairs which they might reasonably expect, including information relating to the calculation of the commission payable to a managing or other director, or the manager, of the company.

The application is required to be made in **Form NCLT-1** and accompanied with documents as mentioned in the National Company Law Tribunal Rules, 2016 (Rule 80). Before passing an order under Section 213, the parties concerned shall be given a reasonable opportunity of being heard.

In the case of *Central Bank of India* v. *Surya Pharmaceutical Ltd.* [2018] 97 taxmann.com 673 (NCLT - New Delhi), it was held that where there were allegations of manipulation of accounts by company which raised inference of misappropriation and diversion of funds with intent to defraud creditors, petition to direct Central Government to take steps to investigate into affairs of company was to be allowed. The Tribunal is empowered under section 213 to investigate into affairs of a company on an application made by certain number of members of company; and, on an application made by any other persons.

The object of an investigation under section 213 is to discover something that is not apparent to naked eyes. However unless there are circumstances suggesting that business of company was being conducted with an intent to defraud creditors, members, or any other person or otherwise, for fraudulent or unlawful purpose, or in a manner oppressive of its members or that company was formed for any

fraudulent or unlawful purpose, it would not be just and appropriate to pass an order for investigation - *Tushar Clothing (P.) Ltd.* v. *Ramesh D. Shah* [2015] 59 taxmann.com 300 (CLB - Mumbai). On similar grounds the NCLT refused to initiate investigation into the affairs of the company as there were no circumstances suggesting that company was doing any fraudulent or unlawful business or attempted to defraud its creditors, members or any other persons. [*Haridas Pottath* v. *Peerless Engineering Products (P.) Ltd., Bangalore* [2017] 85 taxmann.com 186 (NCLT - Bang.)]

If the report of investigation proves that the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud in the manner as provided in section 447.

Some of the judicial pronouncements defining the scope of Section 237(*b*) of the Companies Act, 1956 [now Section 213(b)] are given below. It may be noted that the power of the Company Law Board (CLB) under the former Act have been transferred to the Tribunal in the Companies Act, 2013.

Thus, under section 237(*b*) [now Section 213(*b*)] although the power to appoint inspectors to conduct investigation and to act on the reports of the investigation rests with the Central Government, it can do so only if CLB (Tribunal under the Act) expresses its opinion as regards existence of circumstances calling for investigation.

It is important to note that the above three grounds limit the justification for ordering investigation under section 237(*b*) [now Section 213(*b*)], and it cannot go on a fishing expedition to find evidence - *Barium Chemicals Ltd.* v. *Company Law Board* [1966] 36 Comp. Cas. 639 (SC).

Economic working of a company cannot be a matter for investigation. There must be allegation of illegal acts or malpractices, malfeasance, etc., to sustain an order of investigation - *Delhi Flour Mills Company Ltd.* (*supra*). Contravention of the provisions of the other laws for the time being in force, is, of course, within the scope of clause (*b*) of section 237 [now Section 213(*b*)] - *New Central Jute Mills Company Ltd.* v. *Deputy Secretary, Ministry of Finance* [1966] 36 Comp. Cas. 512 (Cal.).

In *M. Subbiah* v. *Madras Cricket Club*, the CLB [Now Tribunal] has held that grievance of petitioners regarding induction of friends and associates of members of executive committee in the club, who have no sports background, does not fall within the ambit of section 237(*b*) [now Section 213(*b*)] - [2007] 80 SCL 155.

The power to form an opinion regarding investigation under section 237(*b*) [now Section 213(b)] to is an exclusive jurisdiction conferred on the CLB [Tribunal under the Act] and as such no other forum including District consumer forum or authority including the Central Government can exercise this power. The fact that the petitioner was an insignificant shareholder shall have no bearing. [*Chandrika Prasad Sinha* v. *Bata India Ltd.* [1996] 9 SCL 108 (CLB).]

An investigation was ordered in the affairs of the respondent company under Section 213 where applicant, a shareholder holding 37 per cent of equity capital of respondent Company, had shown that there were illegalities in maintenance of

minutes of respondent company. [*PTC Energy Ltd.* v. *R.S. India Wind Energy (P.) Ltd.* [2016] 74 taxmann.com 215 (NCLT - New Delhi)]

Investigation is to be ordered if a *prima facie* opinion is formed by the CLB [Tribunal under the Act] that the business of the company is being/has been conducted with intent to defraud creditors, members or any other persons or the conduct of company is oppressive to any of its members or there is misfeasance or misconduct on the part of the management in carrying on the affairs of the company [*Incab Industries Ltd., In re* [1996] 10 SCL 390 (CLB)]. The Bombay High Court in *Panther Fincap & Management Services Ltd.* v. *Union of India* [2007] 74 SCL 202 has held that when a company is found to be engaged in any business authorised by its memorandum, even though its dominant business might remain stalled by various orders of the Government, nevertheless, the company has to be treated as running its business and the requirement if section 237(*b*)(*i*) [now Section 213(*b*)(*i*)] will be satisfied.

To order investigation, requirements of section 213(*b*) must be complied with. On a single instance of alleged oppression, extraordinary powers could not be invoked. In *N.M. Pimpalkar* v. *Shree Narkeshari Prakashan Ltd.* [1998] 17 SCL 259 (CLB-New Delhi), investigation was sought for an allegation that one R, who was appointed as managing director for one year in AGM, was relieved of his post within 2 months on obtaining resignation under pressure exerted by the chairman, but the petitioner had not been able even *prima facie* to prove how a fraud or oppression of members had been committed based on the instances cited by him which is a requirement under section 237(*b*) [now Section 213 (*b*)] and on the other hand, the company proved that resignation was voluntary and further R, though a shareholder, did not join petitioners, investigation could not be ordered.

Where, from the allegations made one was not in a position to form an opinion that the business of the company was being carried on with intent to defraud members and other persons or for fraudulent and unlawful purpose or that the members of the company had not been given an information with respect to the affairs of the company and the only ground was that the petitioner was aggrieved against the proposal for amalgamation/merger, which matter was already pending before the Division Bench of the Allahabad High Court, investigation could not be ordered - *Bank of Madura* v. *KHSL Industries Ltd.* [1999] 21 SCL 162 (CLB - New Delhi).

In a petition under section 237 [now Section 213], the company and its managing director or other directors are necessary parties and in the absence of impleading such parties in petition, relief cannot be granted - *Safia Usman* v. *Union of India* (*supra*).

As per, the decision in *Bank of Rajasthan Ltd.* v. *Rajasthan Breweries Ltd.* [2007] 79 SCL 395 (CLB - New Delhi), the scope of section 237(*b*) [now Section 213(*b*)] is very wide as compared to inspection under section 209A [now Section 207]. Violations of the provisions of the Act noticed on inspection strengthens the ground for ordering investigation under section 237(*b*) [now Section 213 (*b*)].

The CLB in *Union of India* v. *Sunair Hotels Ltd.* [2007] 81 SCL 283 has held that the scope of section 237(*b*) [now Section 213(*b*)] is wide enough to include past acts alleged to be fraudulent. The CLB [Now Tribunal] has the onerous duty to form an opinion as regards intent to defraud before ordering an investigation on the ground of fraudulent conduct of business. Also, *see Union of India* v. *Shonkh Technologies International Ltd.* [2007] 78 SCL 41 (CLB).

20.13 Security for payment of costs and expenses of investigations

If an investigation is ordered by the Central Government under clause (*b*) of Section 210(1) [on intimation of a special resolution by a company] or under Section 213 [on order passed by a Tribunal on application made to it], it may require the applicant to give security for payment of costs and expenses. The security demanded shall not exceed rupees twenty five thousands and shall be refunded to the applicant if the investigation leads to prosecution [Section 214]. The intent behind Section 214 appears to be to discourage frivolous and baseless applications under Sections 210 and 213 by concerned parties. Rule 5 of the Companies (Inspection, Inquiry and Investigation) Rules, 2014 prescribe the security to be given by the applicant under Section 210(3) as set out below:

S. No.	Turnover as per previous year balance sheet (Rs.)	Amount of Security (Rs.)
1	Up to Rs. 50 crores	Rs.10,000
2	Between Rs. 50 crores and up to Rs. 200 crores	Rs. 15,000
3	More than Rs. 200 crores	Rs. 25,000

20.14 Firm, body corporate or association not to be appointed as inspector

Section 215 disallows the appointment of a firm, body corporate or other association as an inspector. Thus, only an individual or individuals may be appointed as an inspector(s).

20.15 Investigation of ownership of a company [Section 216]

It may sometimes become necessary in public interest for the Central Government to know the persons who are financially interested in a company and who control the policy or materially influence it. For this reason, section 216 provides that where the Central Government is satisfied that there is good reason to do so, it may appoint one or more inspectors to investigate and report on the membership of the company and other matters relating to it, for the purpose of determining the true persons :

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

(*ii*) who are or have been able to control or materially influence the policy of the company; or

(*iii*) who have or had beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owner of a company.*

The sub-section (2) of the section requires the Central Government to appoint one or more inspectors under sub-section (1), if the Tribunal in the course of any proceedings before it, declares by an order that the affairs of the company ought to be investigated, as regards the membership of the company and other matters relating to the company, for the purpose of determining the true persons who are or have been financially interested in

* Inserted *vide* the Companies (Amendment) Act, 2017.

the success or failure, whether real or apparent, of the company who are or have been able to control or materially influence the policy of the company.

In *Bakhtawar Construction Co. (P.) Ltd.* v. *Blossom Breweries Ltd.* [1997] 24 CLA 211 (CLB), it was alleged that the names of shareholders given by the company were fictitious, non-existent or benami and that the Registrars for Shares & Securities had not complied with the provisions of law in processing the applications for shares, their allotment and transfers where applicable and urged that an investigation under section 247(1A) [now Section 216(2)] would help to find out the relevant facts about the true owners of the shares. The CLB [Now Tribunal] dismissed the petition on the ground that it had been instituted purely on unfounded apprehensions and suspicions. The power of investigation under section 216(2) could be invoked *bona fide* in public interest only. Section 216 however does not empower the Tribunal to direct investigation into affairs of a company which is merely party to proceedings but is not a company in respect of which there is any allegation of oppression and mismanagement - *Worship Impex (P.) Ltd.* v. *Manoranjana Sinh* [2015] 54 taxmann.com 233 (Delhi).

The Central Government may define the scope of investigation by the inspector as respect matters and the periods and may limit the investigation to matters connected with particular shares or debentures. The inspector may also investigate whether there are any secret arrangements or understandings observed in practice, even though they may not be legally binding. The inspector may also, with the prior approval of the Central Government, investigate the ownership of other connected companies such as subsidiary companies, holding companies and the associates.

20.16 Powers of inspectors

An inspector or inspectors appointed to investigate the affairs of a company shall have the following powers :

1. *Power to carry investigation into affairs of related companies (Section 219)* - Section 219 states that the inspector appointed under Section 210 or Section 212 or Section 213 may, if considered necessary, investigate even the affairs of another company under the same management or in the same group. Under this section, an inspector is empowered to investigate the affairs of the following persons and/or bodies corporate and report on their affairs also, if he thinks that such an investigation is relevant to the affairs of the company under investigation:

   (*a*) any other body corporate which is, or has at any relevant time been the company's subsidiary or holding company or a subsidiary of its holding company;

   (*b*) any other body corporate which is or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time either the managing director or the manager of the company under investigation;

   (*c*) any body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of—

      (*i*) the company, or

      (*ii*) any of the directors of the company, or

(*d*) any person who is, or has been at any relevant time, the company's managing director or manager.

The inspector is required to obtain the prior approval of the Central Government before undertaking any investigation into the affairs of the company or the persons mentioned aforesaid.

Thus, when the tests of necessity and relevancy are satisfied, the inspector is permitted to investigate the affairs of any direct or indirect holding company or subsidiary company of the company for the investigation of whose affairs he had been appointed. For this purpose he does not need any approval from the Central Government. However, approval of the Central Government would be required where the inspector wants to take power to investigate the affairs of the managing director or manager of the company for which he had been appointed or for investigation into the affairs of any other body corporate which is either managed directly or indirectly controlled by the company for whose investigation he had been appointed.

Duties of inspectors are not judicial or quasi-judicial in nature; there are no litigants before him, nor is he bound by any procedure; nor is his report binding on Government - *Coimbatore Spinning & Weaving Co. Ltd.* v. *M.S. Srinivasan* [1959] 29 Comp. Cas. 97 (Mad.).

Inspector is not debarred from taking help of other persons in conducting enquiry, but he should himself consider all materials thus collected, while preparing his report - *Titagarh Paper Mills Co. Ltd.* v. *Union of India* [1986] 59 Comp. Cas. (Cal.); *New Central Jute Mills Co. Ltd.* v. *Deputy Secretary* (*supra*).

2. *Power to compel production of documents* - Section 217 sub-sections (1) and (2) deals with the powers of the inspector as also the duties of officers, employees and agents of any company or related body corporate under investigation in connection with the actual work of investigation.

Section 217(1) imposes a duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter, and where the affairs of any other body corporate or a person are investigated under section 219, of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person to preserve and to produce to an inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power and otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give. The inspector may also require any body corporate, other than a body corporate referred to in sub-section (1), to furnish such information to, or produce such books and papers before him or any person authorised by him in this behalf as he may consider necessary, if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation [Section 217(2)].

All officers, employees and agents of the company or related body corporate, as the case may be, are required to co-operate not only in producing all books and papers but also ensuring that they are not destroyed, mutilated or secreted away. This duty or power also extends to furnishing information which the inspector may require. It may be noted that officers, in the first instance, include also trustees for debenture

holders. Besides, 'officers' also include past officers. Similarly, employees and agents include both present and past employees and agents.

Power to examine on oath - The inspector may examine on oath any of the person referred to in sub-section (1) of Section 217 and any other person not mentioned therein. To examine any other person he may apply to the Central Government for necessary orders. For this examination he may require any of those persons to appear personally before him [Section 217(4)]. The prior approval of the Director, SFIO would be sufficient if the investigation is being conducted under Section 212.

The person making the investigation shall have all the powers as are vested in a civil court under the Code of Civil Procedures regarding the discovery and production of books or account and other documents and summoning and enforcing the attendance of persons and examining them [Section 217(5)].

Penalty [Section 217(6)] - If any director or officer of the company disobeys the directions issued by the person making the investigation, he shall be punishable with imprisonment for a term which may extend to one year and with fine not less than rupees twenty five thousands but which may extend to rupees one lakh twenty thousand rupees. Any director or officer convicted under this section would be deemed to have vacated his office and shall be disqualified from holding an office in any company.

Section 217(8) further provides that refusal by any person, without a reasonable cause to produce any book or paper or furnish any information or appear before the inspector personally when required or answer any question or sign the notes of any examination shall make is punishable with imprisonment for a term which may extend to six months and with fine which shall not be less than rupees twenty-five thousand but which may extend to rupees one lakh, and also with a further fine which may extend to rupees two thousand for every day after the first during which the failure or refusal continues.

It may be noted that the company cannot be made liable for committing the default - *Indra Prakash Karnani v. ROC (supra).* The offence under this section is not a continuing one and is deemed to be committed on a particular date. Limitations begin to run on that date. A prosecution launched more than one year after the date of the offence is barred by limitation – *State v. S Seshamal Pandia* (1986) 60 Comp. Cas. 889 (Mad.).

4. *Power to take down notes of examination in writing* - Under sub-section (7) of section 217, an inspector is empowered to take down, in writing, the notes of examination of any person in relation to investigation. This sub-section also permits the notes of examination, when reduced to writing, to be signed by the person examined after the notes have been read over to him. Thereafter, these notes may be used as evidence against him.

5. *Power of seizure of documents* - Section 220 of the Act provides that where an inspector has reasonable grounds to believe that relevant books or papers may be destroyed/falsified/altered or secreted, he may enter the place, where such books and papers are kept, to search the place and seize them after allowing the company to take copies of or extracts from such books and papers. At the conclusion of the investigation, he must return these books and papers. Before returning the books, the inspector can place identification marks on them or any parts thereof or take

copies of or extract from them. For the purpose of the search and seizure, the provisions of the Code of Criminal Procedures, 1973 shall apply *mutatis mutandis*. It may be noted that the power to search and seizure can be exercised by the Inspectors without requiring any order from a court.

6. *Power to seek support from other authorities* – The inspector may with the prior approval of the Central government seek support from other officers of the Central Government, State Government, police or statutory authority for the purpose of inspection, inquiry or investigation. Such authorities or officers are bound to provide the necessary support or assistance to the inspector [Section 217(9)]

7. *Power to seek evidence in other countries* – If the inspector has reasons to believe that any evidence is or may be available in a country outside India, it may make an application to a court to issue a letter of request to a court or competent authority in such country to examine orally or otherwise a person who is supposed to be acquainted with the facts or may be in possession of documents pertaining to the case [Section 217(11)]. For this purpose the Central Government may enter into a reciprocal agreement with the Government of a foreign State to assist in any inquiry or investigation under this Act or under the corresponding law in force in that State.

20.17 Report of the Inspector

Under section 223 of the Act, the inspector has to prepare and submit a report to the Central Government. The inspector may, in his discretion, make interim report. But if he is so directed by the Government, he is required to make and submit such interim reports as may be required. Every report under this section is required to be in writing and authenticated either by the seal if any[2] of the company whose affairs have been investigated or by a certificate of a public officer having the custody of the report as provided under Section 76 of the Indian Evidence Act, 1872. A copy of the report may be obtained by members, creditors or any other person whose interest is likely to be affected by making an application in this regard to the Central Government. These provisions do not apply to investigation report of SFIO under section 212.

20.18 Follow up action by the Central Government on the investigation report of the inspector

On receipt of the report of the inspector appointed to investigate the affairs of the company, the Central Government may take one or more of the following actions :

(*i*) *Prosecution for criminal offence* - If the report reveals that any person has, in relation to the company or in relation to any other body corporate whose affairs have been investigated under this chapter, been guilty of any offence for which he is criminally liable, the Central Government, after taking such legal advice as it thinks fit, prosecute such person along with officers. In such a case it shall be the duty of all officers and other employees and agents of the company to render to the Central Government all assistance in connection with the prosecution which they are reasonably able to give [Section 224(1)].

2. Amended *vide* the Companies (Amendment) Act, 2015.

It should be noted that the provisions of section 242 [now section 224] do not bar the cognizance of offence, if punishable under the Indian Penal Code. Further, it does not contemplate a hearing to the company before launching prosecution - *Titagarh Paper Mills Co. Ltd.* v. *Union of India* (*supra*).

(*ii*) *Winding up of the company* - If the report reveals that—

(*a*) the affairs of the company are being conducted with intent to defraud its creditors, members or other persons or for a fraudulent or unlawful purpose or it was formed for any fraudulent or unlawful purpose.

(*b*) the persons concerned with the formation of the company or of the management of its affairs have been guilty of fraud or misconduct,

the Central Government, unless the company is already being wound up, may cause taking of the following action, by a person authorised by the Central Government, namely :—

(*i*) present a petition to the Tribunal for winding up of the company or the body corporate on the ground that it is just and equitable to do so; or

(*ii*) make an application for order under section 241 of the Act for grant of relief against oppression or mismanagement of the company; or

(*iii*) make a petition for winding up as well as make application for relief under section 241 of the Act [Section 224(2)].

(*iii*) *Recovery of damages* - Section 224(3) provides that where from the inspector's report it appears that a fraud, misfeasance or misappropriation of property has been committed and the company is, therefore, entitled to bring an action for damages for misconduct misfeasance or for the recovery of any property which has been misapplied or wrongfully retained, the Central Government may itself in public interest bring proceedings for winding up in the name of the company. In such proceedings the report shall be admissible as evidence of the opinion of the inspection in relation to any matter contained in the report.

The Central Government should be indemnified by the company against any cost or expenses incurred by it or in connection with any proceedings brought by it.

20.19 Expenses of investigation

According to section 225, the expenses of investigation (other than expenses under Section 214) are to be defrayed in the first instance by the Central Government. But the Central Government is entitled to be reimbursed: (*i*) by any person, who has been convicted on a prosecution instituted in pursuance of the report or required to pay damages as a result of the report; (*ii*) the company in whose name proceedings are brought. The company is bound to reimburse the Central Government to the extent of the amount or value of any sums or property recovered by it as a result of the proceedings; (*iii*) similarly, cost can be recovered from any managerial personnel dealt with by the report; and (*iv*) reimbursement may also be claimed at the discretion of the Central Government, from the applicants where inspector was appointed in pursuance of section 213 (*i.e.*, on an application by the members).

The sum for which a company or body corporate is liable as aforesaid shall constitute a first charge on the sums or property mentioned as such.

20.20 Protection of employees during investigation

Section 218 of the Act protects against dismissal, discharge, removal, etc., of the employees of the company under investigation, who make disclosure during the course of investigation. The section provides that if during the course of investigation under sections 210, 212, 213, 216 and 219 the company proposes to discharge any employee from service or punish him by way of dismissal, removal or reduction in rank or change the terms of employment to his disadvantage, then the company must take approval of the Tribunal of the action proposed against the employee. If the Tribunal has any objection to the action proposed to be taken, it must send a notice thereof to the employer. The CLB (now Tribunal) is not bound to hear the company or any other person before issuing the notice - *Ashoka Marketing Ltd.* v. *Company Law Board* [1968] 38 Comp. Cas. 519 (Cal.). If the company does not receive any notice of objection from the Tribunal within thirty days of sending of the previous intimation of the action proposed against the employee, then the company may proceed to take the proposed action against the employee.

If the company is dissatisfied with the objection raised by the Tribunal, it may, within thirty days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal in the prescribed manner and on payment of the prescribed fee.

The decision of the Appellate Tribunal on such appeal shall be final and binding on the Tribunal and on the company.

The aforesaid provisions of section 218 are without prejudice to the provisions of any law for the time being in force.

20.21 Publication of Inspector's Report

As regards publication of the inspector's report the CLB has expressed the following opinion:

> "It has now been decided by the Company Law Board that in important cases where the reports of investigation into the affairs of ownership of companies by inspectors appointed for the purpose are likely to be of interest to the general public, such reports will be published. The criterion for selection would be the size, the extent of public interest and participation, the nature of industry engaged in, the extent of consumer and creditor's interest and the relationship, if any, with other companies fulfilling these requirements"— *Company News and Notes, dated 17-8-1964, page 10.*

However, a report made under section 239 [now Section 241] should not be disclosed to the public before its acceptance by the Central Government - *Swadeshi Cotton Mills Ltd.* v. *Swadeshi Polytex* [1982] 52 Comp. Cas. 483 (All.).

20.22 Freezing of Assets of company

The Tribunal may under Section 221(1) by order prohibit the company from the transferring, removing or disposing its funds, assets or properties during the specified period of time not exceeding three years. Alternatively it may impose

appropriate conditions or restriction upon such transfer, removal or disposal of the funds, assets or properties. Such an order may be passed by the Tribunal –

(*i*) on a reference made to it by the Central Government;

(*ii*) in connection with any inquiry or investigation into the affairs of the company under this chapter;

(*iii*) on a complaint made by

a. number of members specified under Section 244(1);

b. a creditor having rupee one lakh outstanding ;

c. any other person

having a reasonable ground that to believe that the funds, assets or properties of the company may be transferred, removed or disposed in a manner prejudicial to the interest of the company of its shareholders or creditor or in public interest.

If case of a contravention of the order of the Tribunal the company shall be liable to fine which shall not be less than rupee one lakh but which may extend to rupee twenty-five lakh. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than rupees fifty thousand but which may extend to rupees five lakh or with both.

20.23 Imposition of restrictions upon securities [Section 222]

Section 222(1) empowers the Tribunal in connection with any investigation under Section 216 or on a complaint made by any person in this behalf to impose such restrictions as it may think fit on any securities issued or to be issued by a company. The restrictions may be imposed by the Tribunal for a period not exceeding three years to find out the relevant facts about any securities issued or to be issued by a company. The expression securities means the securities as defined in clause (*h*) of section 2 of the Securities Contracts (Regulation) Act, 1956 and is not restricted to shares only. It may be noted that the restrictions may be imposed not only in respect of securities already issued but also on securities to be issued by the company. Furthermore the Tribunal is empowered to impose such restrictions as it may think necessary. The section does not define or limit the kind of restrictions that may be imposed so long they are necessary to find the relevant facts.

Penalty for violation – Section 222(2) prescribes penalties for any violation of conditions imposed under sub-section (1) on issue or transfer or otherwise dealing with the securities issued or to be issued by the company. The company shall be punishable with fine which shall not be less than rupees one lakh but which may extend to rupees twenty-five lakh. Every officer of the company who is in default shall also be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than rupees twenty-five thousand but which may extend to rupees five lakh, or with both

Voluntary winding up of a company, etc., not to stop investigation proceeding [Section 226]- An investigation may be initiated notwithstanding that an application has been made for an order for prevention of oppression or mismanagement under Section 241 or that the company has passed a special resolution for voluntary

winding up or any other proceedings for the winding up of the company is pending before the Tribunal.

In case a winding up order is passed by the Tribunal, it shall be the duty of the inspector to inform the Tribunal about the pending proceedings to enable the Tribunal to pass such order as it may deem fit. A winding up order does not absolve the directors or employees from participating in the investigation proceedings or any liability arising therefrom.

20.24 Saving for legal advisors and bankers [Section 227]

A legal advisor need not disclose to the Tribunal or to the Central Government or to the Registrar or to an inspector appointed by the Central Government, a privileged communication made to him except as respects the name and address of his client. Again, a banker of the company, body corporate or other person shall not disclose any information as to the affairs of his customers other than such company, body corporate or person.

20.25 Investigations etc. of foreign companies [Section 228]

The foreign companies are also subject to the provisions of this chapter. All the provisions relating to inspection, inquiry or investigation shall be applicable *mutatis mutandis* to foreign companies as well.

20.26 Non-disclosure of information in certain cases [Section 457]

Notwithstanding anything contained in any other law for the time being in force, the Registrar, any officer of the Government or any other person shall not be compelled to disclose to any Court, Tribunal or other authority when he got any information which—

(*a*) had led the Central Government to order an investigation under section 210; or

(*b*) is or has been material or relevant in connection with such investigation.

20.27 Penalty for furnishing false statements, mutilation or destruction of documents

Section 229 imposes penalties for false statements, mutilation or destruction of documents on any person who is required to provide an explanation or make a statement during the course of inspection, inquiry or investigation. Similar penalties are prescribed for an officer or other employees of a company under investigation. Accordingly if such a person:

(*a*) destroys, mutilates or falsifies, or conceals or tampers or unauthorisedly removes, or is a party to the destruction, mutilation or falsification or concealment or tampering or unauthorised removal of, documents relating to the property, assets or affairs of the company or the body corporate;

(*b*) makes, or is a party to the making of, a false entry in any document concerning the company or body corporate; or

(*c*) provides an explanation which is false or which he knows to be false, he shall be punishable for fraud in the manner as provided in section 447.

20.28 Difference between Inspection and Investigation

1. Inspection of books of account and other books and papers of the company is authorised under section 206 of the Companies Act, while investigation can be ordered under section 210 or 212 or 216 or 219 of the Act.

2. Inspection of books of account and other books and papers is not an investigation though it may lead to investigation in case anything wrong or objectionable is found during inspection. Its object is to ensure that there is nothing objectionable in the books of account and other books and papers. Investigation into the affairs of the company is wider in scope. It includes investigation of all the business affairs, profit and loss, assets including goodwill, contracts and transactions, investment and other property interests and control of subsidiary, holding and other related companies too.

3. Inspection can be done either by the Registrar or by an officer authorised by the Central Government. But, investigation can be conducted by competent persons only, appointed as inspectors (investigators) by the Central Government or SFIO. Inspectors may be appointed by the Government from amongst the officers of the Government or persons from outside the Government.

4. Under section 206, the inspection is initiated based upon the scrutiny of books of account and other books and papers the inspecting authority need not assign any reason. The object of inspection is to keep a watch over the companies to ensure that the statutory books and papers are maintained and the business of the company is being managed at proper level of efficiency. Investigation, on the other hand, may be ordered by the Central Government under section 210(1) on the report of the Registrar under Section 208 or where a company has passed a special resolution for the investigation of the affairs of the company or in public interest. Under Section 210(2) the Central Government shall order an investigation into the affairs of a company if there is an order by a court or the Tribunal directing that the affairs of a company ought to be investigated. Under Section 212 the Central Government may order an investigation by the SFIO under certain circumstances. Section 216 empowers the Central Government to order investigation as to the ownership of the company. Under Section 219 the inspector appointed under Section 210 or Section 212 or Section 213 may, if considered necessary, investigate even the affairs of another company under the same management or in the same group.

5. An inspecting officer can inspect only that company for which he is so authorised by the Central Government. But an inspector has the power to investigate the affairs of the holding company, or the subsidiary of the company being investigated and the affairs of the managing director or the manager of the company without the approval of the Central Government and the affairs of the connected companies with the approval of the Central Government [Section 239].

6. Further, no company or member can ask for a copy of inspection report, while a copy of investigation report may be obtained by anybody by making an application to the Central Government.

7. The expenses of inspection are borne entirely by the Government and are not recoverable. In the case of investigation, the expenses, in the first instance, are borne by the Central Government but may be reimbursed partly or fully by the applicants in the case of investigation in accordance with any direction of the Central Government in this regard [Section 225]. Besides, the Central Government under section 214 has the right to ask for a security deposit not exceeding rupees twenty five thousand from applicants.

20.29 Role of secretary with regard to investigation

Before an inspector commences investigation into the affairs of a company, it is advisable for the secretary to himself prepare a report touching on various aspects of the activities of his company. This exercise will enable the secretary to handle the investigation into the affairs of his company with courage and confidence. The aspects which should be considered by the secretary will include:

1. *Basic information about the company* - Name of the company; date of incorporation; location of the registered office, branches, factories and other offices; status of the company - public or private; objects of the company; capital structure, voting rights attached to the shares; shareholding pattern in the company.
2. *Business activities* - Nature of existing business, licensed and installed capacities, expansion programme and sources of finance, whether the company belongs to a particular group; if so, the names of other companies falling within the group.
3. Details regarding debentures, bank finance and deposits.
4. Details regarding foreign collaboration agreements.
5. *Management* - Brief history of past management set-up; existing management set-up; composition of Board of directors; whether the terms and conditions of the appointment of managerial personnel are being adhered to; details regarding appointment of directors and their relatives to office of profits, etc.
6. Whether all the statutory registers including minutes books are being maintained up-to-date ?
7. Whether the internal control system is being properly followed ?
8. *Working results and financial position* - General assessment of working of the company, evaluation of the level of performance and efficiency of the management, a review of the profits of the company, performance data, financial position of the company in the context of its working results for the last three years.
9. Compliance with the provisions of the Companies Act.
10. Compliance with the provisions of other applicable Acts.
11. *Accounts* - The accounting practice in vogue, compliance with the provisions of Schedule III to the Act; whether adequate provisions were made for provident fund, gratuity, taxes, bonus, dividend, etc.; whether the system of

reporting to the top management on the financial performance is smooth; whether the provisions of sections 123, 124 and 137 have been complied with as also the position of the cost records, if any.

12. Details of the loans taken and loans advanced.
13. Details of the investments made.
14. Particulars of sole selling agency.
15. Instances of mismanagement and other irregularities.
16. Particulars of acquisition/disposal of substantial assets.
17. A scrutiny of abnormal/heavy expenditure items.
18. Complaints, if any, against the company and its management should be listed.
19. Brief particulars of the litigations against the company and the reasons thereof.
20. Management's relation with the employees and labour.
21. *Shareholders* - Instances of oppression on minority shareholders, allegations of non-receipt of dividend, notices of meetings, accounts, share certificates, etc.; illegal forfeiture of shares, etc.
22. *Auditors* - Names and addresses of statutory auditors. Whether the provisions of sections 139, 142 and 143 and 145 have been complied with?
23. *Points requiring close scrutiny* - Any instance of concealment of income by falsification of accounts; instances of mismanagement of the company, intent to defraud the creditors, shareholders, and Government; and serious omission by the auditors.
24. *Action points* - After the above-mentioned information is compiled, the next step should be to list out the action points and pursue them vigorously. This may rectify many aspects which would otherwise lead to problems later on.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (FINAL), C.S. (INTER)/FINAL, ICWA (INTER)]

1. What books and papers of a company can be inspected by an officer authorised to carry out inspection under section 206 of the Companies Act, 2013?
2. What registers of a company can be inspected by its members?
3. Explain the difference between 'Inspection' and 'Investigation' under the provisions of the Companies Act, 2013.
4. State the circumstances on the basis of which Central Government may order investigation into the affairs of a company.
5. What are the provisions available in the Companies Act, 2013 for protection of employees during investigation?
6. When (*i*) may; and (*ii*) must the Central Government order investigation into the affairs of a company?
7. When and by whom an application for investigation into the affairs of a company can be made?

8. Enumerate the powers of the inspectors appointed by the Central Government to investigate into the affairs of a company. State the manner in which the Central Government may dispose of the inspector's report.

9.. State with reasons whether the following statement is correct - "Inspection under section 206 and investigation under section 210 are the same."

11. Roxy Ltd. proposes to take disciplinary action against its secretarial officer whom the company alleges of disclosure of certain information during the course of investigation ordered by the Tribunal. The Tribunal decides to object the same. Clarify the procedure to be adopted by the Tribunal and remedy available to the company.

12. Inspection of the books of account of Joy Ltd. revealed that certain statutory provisions of the Companies Act, 2013 were violated and hence a notice was issued to that effect. Joy Ltd. pleaded that violation was not wilful. However, a further notice was issued to Joy Ltd. to show cause why action should not be taken against it pursuant to section 448. Joy Ltd. filed a petition to the court praying for relief under section 463. Will the court grant relief?

13. Your company has received a letter for an inspection of the company. What are the duties of directors, other officers and employees of the company in relation to such inspection ?

[**Hints :** Paras 20.4 and 20.29]

14. Can a company and its authorised officers obtain a copy or carryout an inspection of the report submitted under section 206 ?

[**Hints :** *See* Para 20.6.]

15. Detail circumstances in which Tribunal can impose restrictions on transfer of shares and debentures of a company, which is being investigated.

16. An order for conducting investigation of a company having one lakh member cannot be made by the Tribunal on the application of 750 members of that company - Comment.

17. Briefly explain the provisions relating to investigation by the Serious Fraud Investigation Office.

18. In matters of investigation into the affairs of a company, the Central Government has only a discretionary power to order the investigation restricted only to the concerned company - Do you agree? Give reasons.

19. The powers of the court under section 213(*b*) are uncontrolled and the Tribunal can direct an investigation whenever it is suspected that all is not well with the company - Comment.

20. Big Ball Ltd., a reputed Public Company, over the years, has performed excellently and its General Reserve in many times more than the paid-up capital of the company. The Chairman of the company came to know that a group of unscrupulous persons is cornering the shares of the company and may lodge them for transfer in their names. It is apprehended that such transfer may lead to change in the composition of Board of Directors which may be prejudicial to the public interest. You are required to state with reference to the provisions of the Companies Act, 2013, as to how Big Ball Ltd. can block the above stated transfer of shares.

[**Hint :** *See* Para 20.23.]

21. Write a short note on right of inspection of books of account by a director or his duly appointed attorney.

22. Mr. A is a non-executive director of a company. Can Mr. A inspect books of account and other books and papers during business hours? Can Mr. A get the books inspected by any other person appointed by him? Give reasons and cite case law, if any.

23. Mr. U, a member of your company holding 3000 equity shares, suspects management fraud and serves a notice on the company demanding inspection of the books of account of the company. How would you deal with this?

24. Briefly explain the provisions of the Companies Act, 2013 regarding the cost and expenses of investigation.

PRACTICAL PROBLEMS

1. The Central Government appointed inspectors under section 213(*b*) to investigate the affairs of the company on the following grounds :

(*a*) Delay, bungling and faulty planning, entailing double expenditure to install the plant.

(*b*) Continuous losses wiping out one-third of the share capital.

(*c*) Shares quoted at half the face value.

(*d*) Some eminent directors severed their connections with the company.

The company challenges the order of the Central Government:

(*i*) Discuss whether the appointment is proper.

(*ii*) What are the grounds on which the Central Government may *suo motu* (on its own) appoint inspectors?

Hint: Part (*ii*) should in fact be answered first. Under section 213(*b*), the Central Government may appoint inspectors only on grounds stated thereunder. Accordingly, in the given problem, appointment of the Inspector on the four given grounds is improper since they are in variance with the grounds stated under section 213(*b*). Also refer to *Barium Chemical Ltd.'s* case referred in this Chapter - no fishing enquiry.

2. Fifty members of a company holding 1/10th of the voting power applied to the Tribunal for investigation on the ground that the circumstances establish fraud on the part of the directors. Is the application to the Tribunal valid? If the Tribunal finds in favour and order an investigation into the affairs or the company, can the Central Government refuse to do so?

Hint: In situations where directors or other officers of the company are suspected to be guilty of misconduct or misfeasance in the affairs of the company, section 210 makes it mandatory for the Central Government to appoint an inspector to investigate into the affairs of the company. In accordance with section 213, such an application by shareholders must be made by at least 100 members or members holding at least 1/10th of the total voting power in the case of a company having a share capital. Thus, since this requirement of 1/10th of the shareholders is satisfied in the given case and the matter relates to misconduct and misfeasance, the application to the Tribunal is valid. If the Tribunal's findings are in favour of the applicant, the Central Government shall order an investigation.

3. The Central Government has assigned a case involving fraud against STU Limited to the Serious Fraud Investigation Office (SFIO). There is another pending case against the STU Limited being investigated by the police authorities covering the same subject matter. Would both the cases be allowed to be proceeded independently?

Hint: No, see para 20.11. Once a case is assigned to SFIO, the concerned agency shall not proceed with the case further and shall transfer the relevant documents and records to SFIO.

21 Majority Rule and Minority Protection

21.1 Rule of majority

The principle of rule by majority has been made applicable to the management of the affairs of companies. The members pass resolutions on various subjects either by simple majority or by three-fourth majority. Once a resolution is passed by the requisite majority then it is binding on all the members of the company. As a resultant corollary, the court will not ordinarily intervene to protect the minority interest affected by the resolution, as on becoming a member, each person impliedly consents to submit to the will of the majority of the members. Thus, if wrong is done to the company, it is the company which is the legal entity having its own personality, and that can only institute a suit against the wrongdoer; and shareholders (members) individually do not have a right to do so.

The aforesaid rule was laid down in the leading case of *Foss* v. *Harbottle*[1].

According to *Palmer*[2] "the rule in *Foss* v. *Harbottle*" is a phrase used to refer to two distinct, but linked, propositions of law. *The first* proposition, which is that the court will not ordinarily intervene in the case of an internal irregularity if the matter is one which the company can ratify or condone by its own internal procedure. *The second* is that where it is alleged that a wrong has been done to a company, *prima facie*, the only proper plaintiff is the company itself.

Briefly, the facts in *Foss* v. *Harbottle* were as follows :

An action was brought by two shareholders, 'F' and 'T', of a company, on behalf of themselves and all other shareholders against the directors and solicitor of the company, alleging that by concerted and illegal transactions they had caused the company's property to be lost. It was alleged that the directors were acting in concert and effecting various fraudulent and illegal transactions whereby the property of the company was misapplied and wasted. It was prayed that the defendant might be decreed to make good to the company the losses. The question was as to the maintainability of the suit.

1. [1843] 2 Hare 461
2. Palmer's Company Law, 24th Edition, Para 65-03

The Court held that the action could not be brought by the minority shareholders. The wrong done to the company was one which could be ratified by the majority of members. The company was the proper plaintiff for wrongs done to the company, and the company can act only through its majority shareholders. The majority of the members should be left to decide whether to commence proceedings against the directors.

The pre-eminently procedural character of 'the rule in *Foss* v. *Harbottle*' was clearly expressed in the following restatement of the rule by *Jenkins, L.J. in Edwards* v. *Halliwell*[3] :

> "The rule in *Foss* v. *Harbottle*, as I understand it, comes to no more than this. *First*, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is *prima facie* the company or the association of persons itself. *Secondly*, where the alleged wrong is a transaction which might be made binding on the company or association and on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done, then *cadit quaestio* (cannot be questioned)."

The rule in *Foss* v. *Harbottle* was given its widest expression by *Mellish L.J.*, in the following words[4] :

> "In my opinion, if the thing complained of is a thing which in substance the majority of the company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes. Is it not better that the rule should be adhered to so that if it is a thing which the majority are the masters of the majority in substance shall be entitled to have their will followed ?"

Similarly, in *Rajahmundry Electric Supply Co.* v. *Nageshwara Rao* AIR 1956 SC 213, the Supreme Court observed that :

> "The Courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general, do nothing about it."

One may notice that the aforesaid decisions are essentially a logical extension of the principle that a company is a separate legal person from the members who compose it. Once it is admitted that a company is a separate legal person, it follows that if a wrong is done to it, the company is the proper person to bring an action. This is a simple rule of procedure which applies to all wrongs, *viz.*, only the injured party may sue. If, for instance, X intentionally pushes Y down the stairs and Y breaks his leg in consequence. C, who has seen the whole incident cannot bring an action against X. C has not been hurt; he is not the injured party; he is the wrong plaintiff. The right plaintiff is Y.

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3. [1950] 2 All ER 1064
4. *Mac Dougall* v. *Gardiner* [1875] 1 Ch. D 13 at 25.

The rule, as applied to companies, however, appears a little more complicated. After all, the directors who have been fraudulent, have injured the company. The company is composed of members. Losses to the company affect all the members, not simply the majority or the minority or any particular member. Why then, should an individual member not sue, since he has been injured ?

The answer is that injury is not enough. The plaintiff must show that the injury has been caused by a breach of duty to him. In the course of existence a person suffers many injuries for which no action can be brought, for no duty owed to him has been broken. The individual shareholders or even the minority shareholders who try to show that the directors owe a duty to them personally in their management of the company's assets will definitely fail. The directors owe no duty to the individual members, but only to the company as a whole. A company is a person and if it suffers injury through breach of duty owed to it, then the only possible plaintiff is the company itself acting, as it must always act, through its majority.

Application of Foss v. *Harbottle Rule - How far relevant in India* - The Delhi High Court in *ICICI* v. *Parasrampuria Synthetic Ltd.* SCL July 5, 1998 has held that a mechanical and automatic application of *Foss* v. *Harbottle Rule* to the Indian situations, Indian conditions and Indian corporate realities would be improper and misleading. The principle, in the countries of its origin, owes its genesis to the established factual foundation of shareholder power centering around private individual enterprise and involving a large number of small shareholders, is vastly different than the ground realities in our country. Here the modern Indian corporate entity is not the multiple contribution of small individual investors but a predominantly and indeed overwhelmingly state-supported funding structure at all stages by receiving substantial funding up to 80% or more from financial institutions which are entirely state-controlled or represent substantial interest and, thus, their shareholding may be small but it is these financial institutions which provide entire funds for the continuous existence and corporate activities. If the *Foss* v. *Harbottle Rule* is applied mechanically, it would amount to giving weightage to that majority of the shareholding having notionally holding more percentage of shares, than to the financial institutions which may own a small percentage of shares though contributed 80% or more in terms of the finances to such companies. It is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the Principles of *Foss* v. *Harbottle Rule* would be unjust and unfair.

21.2 Personal rights of members

It should, however, be noted that the aforesaid '*Principles of Foss* v. *Harbottle*' only applies where a corporate right of a member is infringed. The rule does not apply where an individual right of a member is denied.

The individual rights of a member arise in part from the contract between the company and himself which is implied on his becoming a member, and in part from the general law. Under the contract implied from his membership, he is entitled to have his name and shareholding entered on the register of members and to prevent unauthorised additions or alterations to the entry[5], to vote at meetings of mem-

5. *Re British Sugar Refining Co.* (1857) 4 K & J 408.

bers[6], to receive dividends which have been duly declared or which have become due under the articles[7], to exercise pre-emption rights over other members' shares which are conferred by the articles[8], and to have his capital returned in the proper order of priority in the winding up of the company or on a duly authorised reduction of capital[9]. Under the general law he is entitled to restrain the company from doing acts which are *ultra vires*[10]; to have a reasonable opportunity to speak at meetings of members[11] and to move amendments to resolutions proposed at such meetings[12], to transfer his shares[13], not to have his financial obligations to the company increased without his consent[14], and to exercise very many rights conferred on him by the Companies Act, 2013, such as his right to inspect various documents and registers kept by the company, to have a share certificate issued to him in respect of his shares, and to appoint a proxy to vote on his behalf at meetings of members.

The dividing line between personal and corporate rights is very hard to draw, and perhaps the most that can be said is that the court will be inclined to treat a provision in the memorandum or articles as conferring a personal right on a member only if he has a special interest in its observance distinct from the general interest which every member has in the company adhering to the terms of its constitution. A consequence of the distinction between personal and corporate rights is that a member cannot bring a personal action for the loss he has suffered by the diminution in the value of his shares resulting from breaches by the defendants of provisions of the company's memorandum or articles which do not confer personal rights on members, or from breaches of fiduciary duties owed by the defendants to the company; even if the member can prove a conspiracy between the defendants to commit the breaches complained of, the diminution in the value of his shares is merely a reflection of the loss suffered by the company, and the proper remedy therefore is for the company to sue the defendants or, in appropriate circumstances for a derivative action to be brought[15].

21.3 Representative and Derivative Action

In certain circumstances an individual member may bring an action to remedy a wrong done to his company or to compel his company to conduct its affairs in accordance with its constitution and the rules of law governing it, even though no wrong has been done to him personally, and even though the majority of his fellow members do not wish the action to be brought. The form of his action in these

6. *Pender* v. *Lushington* [1877] 6 Ch. D. 70.
7. *Wood* v. *Odessa Waterworks Co.* [1889] 42 Ch. D 636.
8. *Rayfield* v. *Hands* [1960] Ch 1, [1958] 2 All ER 194.
9. *Griffith* v. *Paget* [1877] 5 Ch. D 894.
10. *Simpson* v. *Westminster Palace Hotel Co.* [1860] 8 HL Cas. 712.
11. *Wall* v. *London and Northern Assets Corpn.* [1898] 2 Ch. 469.
12. *Henderson* v. *Bank of Australasia* [1890] 45 Ch. D 330.
13. *Re Smith Knight & Co. Weston's* case [1868] 4 Ch. App. 20
14. *Hole* v. *Garnsey* [1930] AC 472. This is now made mandatory by the English Companies Act, 1985, section 16(1).
15. *Prudential Assurance Co. Ltd.* v. *Newman Industries Ltd.* (No. 2) [1982] Ch. 204 at 222-223, 48-50, [1982] 1 All ER 354 at 366-367

exceptional cases is peculiar, because the plaintiff does not sue in his own right alone, but on behalf of himself and all his fellow members other than those, if any, against whom relief is sought. If the member sues for relief against the company, it must, of course, be made a defendant; if he seeks to enforce a corporate claim against other persons, the company must still be joined as a co-defendant so that it may be bound by the judgment, and so that it may enforce any order giving relief against the substantive defendants[16].

The individual member's action in these exceptional cases may be described as representative, because it is brought on behalf of himself and persons other than himself who would go along with him to protect their legitimate corporate rights. When relief is sought against third parties for the company's benefit, the action may also be described as derivative, because the individual member sues to enforce a claim which belongs to the company, and his right to sue is derived from it.

If the action succeeds, any property or damages recovered go, not to the plaintiff, but to the company - *Spokes* v. *Grosvenor, etc., Hotel* 2 QB 124.

The plaintiff shareholder can complain in a derivative action of wrong committed before he became a member - *Bloxham* v. *Metropolitan Rly.* [1868] L.R. 3 Ch. App. 337. But a derivative action commenced by a member may not be continued by him if he ceased to be a member. Court may, however, allow it to be continued by some other member who is then substituted as plaintiff - *Ffooks* v. *South Western Rly. Co.* [1853] 1 Sm & G 142.

The plaintiff in a representative action is not an agent for the persons on whose behalf he sues. Consequently, he can discontinue the action without their consent[17]; the defendant can raise any defences against him which could be raised if he were suing in his own right alone[18], including his participation or acquiescence in the defendant's wrong doing[19], and the other persons on whose behalf he sues are not liable for costs if the action is unsuccessful[20].

The court will only allow a derivative action to proceed if it is brought for the benefit of the company, and so if the plaintiff's motive is to benefit a rival concern which has encouraged him to sue and has indemnified him against costs, the action will be stayed[21]. Likewise, if directors have paid dividends out of capital, but the company has since earned sufficient profits to replace the capital expended, it seems that the court will not permit a member to bring a derivative action to compel the directors to repay the dividend out of their own pockets, because the company could immediately use the money received from the directors to pay a further dividend, so that the result would be to benefit not the company, but its members individually[22].

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16. *Spoke* v. *Grosvenor etc., Hotel* [1897] 2 QB 124.
17. *Re Alpha Co. Ltd.* [1913] 1 Ch 203.
18. *Burr* v. *British Nation Life Assurance Association* [1859] 4 De G&J 158.
19. *Nurcombe* v. *Nurcombe* [1985] 1 All ER 65 : [1985] 1 WLR 370.
20. *Price* v. *Rhondda UDC* [1923] WN 228.
21. *Forrest* v. *Manchester, Sheffield and Lincoln Rly. Co.* [1861] 4 De GF&J 126.
22. *Re. Exchange Banking Co. Flitcroft's* case [1882] 21 Ch. D 519 at 536, per Cotton LJ

Can the plaintiff claim indemnity of his costs from the company? In *Wallersteiner* v. *Moir (No.2)*.[23], it was said that the test for whether an indemnity ought to be granted was whether the legal action constituted "a reasonable and prudent course to take in the interests of the company"[24]. In *Smith* v. *Croft*[25], Walton, J. held that an indemnity should not be granted if it could not be shown that the proceedings had an even chance of success or if it was opposed by a majority of the independently held shares.

21.4 Exceptions to 'the rule in Foss v. Harbottle'

In the following cases the rule in *Foss* v. *Harbottle* does not apply, *i.e.*, the minority shareholders may bring an action to protect their interest :

21.4-1 Ultra vires and illegal acts

'The rule in *Foss* v. *Harbottle* does not apply where the act complained of is *ultra vires* the company[26], since not even a unanimous vote of the shareholders can ratify such an act. In such cases it appears that the plaintiff shareholder can bring either a personal action, basing himself upon the company's breach of its memorandum, or a derivative action, basing himself upon the wrong done to the company by those who have caused it to act *ultra vires*[27].

If the action is designed to prevent a threatened *ultra vires* act, the plaintiff may bring either a personal or a representative action against the company, and the directors may be joined as co-defendants so that an injunction may be made against them too but if the plaintiff member seeks an order that the company shall recover compensation for an *ultra vires* act which has already been committed, or shall recover property disposed of by an *ultra vires* transaction, the action must be a derivative one.

21.4-2 Breach of fiduciary duties

A derivative action may be brought against directors and promoters who have been guilty of a breach of their fiduciary duties to the company, if they are able to prevent the company from suing them in its own name because they control a majority of the votes at a general meeting, or because they are otherwise able to prevent a general meeting from resolving that the company shall sue them. Thus, derivative actions have been permitted against directors who were in control of the company for misappropriating the company's property[28] or misapplying it in breach of the Companies Act[29], to compel such directors to account to the company for profits made by appropriating for themselves a business opportunity which the company would otherwise have enjoyed[30], or to deprive the members who controlled the

23. [1975] 1 QB 373, 391.
24. [1975] 1 QB 373, 392.
25. [1986] 2 All ER 551, 564-65
26. *Edwards* v. *Halliwell* [1950] 2 All ER 1064, 1067.
27. *Simpson* v. *Westminster Palace Hotel Co.* [1897] 2 QB 124.
28. *Spokes* v. *Grosvenor Hotel Co.* [1897] 2 QB 124.
29. *Wallersteiner* v. *Moir* [1974] 3 All ER 217/[1974] 1 WLR 991.
30. *Cooks* v. *Deeks* [1916] 1 AC 554.

company of their power to control it in the future[31], and to compel such directors to make a call on their own shares equal to a call which they had made on the shares of the other members[32]. Likewise, derivative actions have been permitted against promoters who were in control of the company to rescind contracts made between them and the company when they had been guilty of misrepresentations[33] or had failed to disclose a secret profit which they obtained from the transaction[34], and in those cases the court ordered the promoters to repay to the company all money received by them under the contracts.

In *Satya Charan Lal* v. *Rameshwar Pd. Bajoria* [1950] S.C.R. 394, it was observed that when a director is in breach of fiduciary duty, every shareholder may be regarded as an authorised organ to bring the action.

21.4-3 Fraud or oppression against minority

Where the majority of a company's members use their power to defraud or oppress the minority, their conduct is liable to be impeached even by a single shareholder - *Edward* v. *Halliwell* [1950] 2 All ER 1064.

The fraud or oppression need not amount to a tort at common law, but it must involve an unconscionable use of the majority's power resulting, or likely to result, either in financial loss or in unfair or discriminatory treatment of the minority, and it must certainly be more serious than the failure of the majority to act in the interest of the company as a whole, which will induce the court to annul a resolution altering the company's memorandum or articles[35].

In the words of *Lord Davey,* in *Burland* v. *Earle* [1902] A.C. 83, fraud embraces all cases where the wrongdoers "are endeavouring, directly or indirectly, to appropriate to themselves money, property or advantages which belong to the company or in which the other shareholders are entitled to participate".

The leading example of the kind of fraud or oppression of this kind is found in *Menier* v. *Hooper's Telegraph Works Ltd*[36]. In that case a company was formed to lay down a transatlantic telegraph cable which was to be made by Hooper's Telegraph Works Ltd. The majority shareholder 'Hooper' found that it could make a greater profit by selling the cable to another company which wished to lay it down on the same route, but which would not buy unless it had the necessary Government concessions for the undertaking. The first company had obtained such concessions, and so Hooper induced the trustee in whom they were vested to transfer them to the second company, which they bought the cable from Hooper. To prevent the first company from suing to recover the concessions, Hooper procured the passing of a resolution that the first company should be wound up voluntarily, and that a liquidator should be appointed whom Hooper could trust not to pursue the

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31. *Howard Smith Ltd.* v. *Ampol Petroleum Ltd.* [1974] AC 821 : [1974] 1 All ER 1126
32. *Alexander* v. *Automatic Telephone Co.* [1900] 2 Ch. 56.
33. *Mason* v. *Harris* [1879] 11 Ch. D 97
34. *Atwool* v. *Merryweather* [1867] LR 5 Eq 464n
35. *Pennington's Company Law,* 5th Edition, Page 734.
36. [1874] 9 Ch. App. 350.

company's claim against Hooper and the trustee. Menier, a minority shareholder of the first company, brought a derivative action against Hooper to compel it (Hooper & Co.) to account to the company for the profits it derived from the improper arrangements it had made. It was held that Hooper's machinations amounted to an oppressive expropriation of the minority shareholders, and that a derivative action would therefore lie against it. Sir W.M. James, L.J., said[37] :

"The defendants, who have a majority of shares in the company, have made an arrangement by which they have dealt with matters affecting the whole company, the interest in which belongs to the minority as well as to the majority. They have dealt with them in consideration of their obtaining for themselves certain advantages.... The minority of the shareholders say in effect that the majority has divided the assets of the company, more or less, between themselves, to the exclusion of the minority. I think it would be a shocking thing if that could be done, because, if so, the majority might divide the whole assets of the company, and pass a resolution that everything must be given to them, and that the minority should have nothing to do with it. Assuming the case to be as alleged in the bill, then the majority have put something into their pockets at the expense of the minority. If so, it appears to me that the minority have a right to have their share of the benefits ascertained for them in the best way in which the court can do it, and given to them."

21.4-4 Inadequate Notice of a resolution passed at a meeting of members

It has been held in many cases that if an insufficiently informative notice is given of a resolution to be proposed at a general meeting, any member who does not attend the meeting, or who votes against the resolution, may bring a representative action to restrain the company and its directors from carrying out the resolution[38] .

21.4-5 Qualified majority

Where the Act or the articles require a qualified (or special) majority for passing of a resolution, 'the rule in *Foss* v. *Harbottle*' cannot be invoked to override these requirements. If this were not so, provisions requiring qualified majorities would be valueless because a bare majority could always confirm a special resolution passed irregularly. The action brought by a shareholder to complain of an irregularity in the passing of a special resolution would seem to be a personal one.

21.4-6 Where the personal rights of an individual member have been infringed

As already noted, the principle of majority rule is applicable only to the corporate membership rights of a member. Infringement of a member's individual rights like right to vote, right to receive dividends, etc., entitles him to proceed in his own name.

21.4-7 Statutory exceptions

The Companies Act, 2013, *vide* certain specific provisions, extends protection to the minority shareholders by conferring certain rights on them:

(*i*) *Variation of class rights* [*Section 48*] - Where the share capital of a company is divided into different classes of shares, the rights attached to the shares of

37. [1874] 9 Ch. App. 353.

38. *Tiessen* v. *Henderson* [1899] 1 Ch. 861, *Mac Connell* v. *E. Prill & Co. Ltd.* [1916] 2 Ch.57.

any class can be varied as provided in the memorandum or articles of the company with the consent of the 3/4th majority of the shareholders of that class. Where this is done and the rights are varied by the requisite majority vote, the holders of not less than ten per cent of the issued shares of that class who had not assented to the variation may apply to the Tribunal for cancellation of the variation under section 48(2) of the Act.

(*ii*) *Request for investigation* - Under Section 213 one hundred or more members or members holding not less than one-tenth of the total voting power may apply to the Tribunal for conducting an investigation into the affairs of the company. In case the company without share capital, the application may be made by not less than one fifth of the members. The application needs to be supported by evidence to show that there are good reasons for an order for conducting an investigation.

(*iii*) *Scheme of compromise or arrangement* - Section 230 which provides for schemes of compromise or arrangement with creditors and members also gives protection to minorities. Sub-clause (*c*) of Section 230(7) provides if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provision of Section 48. Clause (*e*) of Section 230(7) requires that the Tribunal order may also provide for the exit offer to dissenting shareholders to effectively implement the terms of the compromise or arrangement.

(*iv*) *Oppression and mismanagement* - The principle of majority rule does not apply to cases where section 241 is applicable for prevention of oppression and mismanagement. A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against public interest, he may apply to the Tribunal by petition under section 241 of the Act. In *O.P. Gupta* v. *Shiv General Finance (P.) Ltd.* [1977] 47 Comp. Cas. 297, the Delhi High Court held that a member's right to move the Court under section 397 [now Section 241] was a statutory right and cannot be affected by an arbitration clause in the articles of association of a company.

(*v*) *Rights of dissentient shareholders under take-over bids [Section 235]* - When an offer for the purchase of all the shares is received and the offer is accepted by the holders of 90 per cent of the shares, the party making the offer may, on the same terms acquire the remaining shares also. But a notice is to be given to the dissenting shareholders who have a right to apply to the Tribunal praying that their shares should not be allowed to be acquired on the terms of the scheme. On hearing the parties concerned, the Tribunal may make an order, as it may think fit.

(*vi*) *Class action [Section 245]* – An application may be made by the prescribed number of members before the Tribunal under Section 245 seeking certain reliefs on the grounds that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or its members. The Tribunal may grant such reliefs as may be appropriate including restraining the company from committing an act that is *ultra vires* the Articles or Memorandum or in contrary to any law (see next chapter for details).

Legal measures to deal with situations of oppression and mismanagement and class action are dealt with in the following chapter.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Examine the following statements:

   (*a*) The cardinal principle of corporate management is the rule by the majority of shareholders.

   (*b*) "Majority has its way but minority has its say."

2. Briefly state the 'rule of majority' and its exceptions.
3. Explain the true scope of the rule in *Foss* v. *Harbottle* on the majority rule and minority's rights. State the exceptions to the rule.
4. The rule in *Foss* v. *Harbottle* presently has lost its importance because of adequate statutory provisions made in the Companies Act, 2013. Discuss how adequate are the provisions of the Companies Act, 2013 in this regard.
5. Where the outsider has knowledge of irregularity, the doctrine of indoor management protects the outsider - Comment.
6. Discuss the rule of *Foss* v. *Harbottle*.
7. The principle laid down in the case of *Foss* v. *Harbottle* covers both corporate rights and personal rights of members - Do you agree? Give reasons.
8. Discuss the majority rule and minority rights. State the remedies available to minority shareholders.
9. Discuss the rule of *Foss* v. *Harbottle*. Enumerate the main advantages that flow from the said rule.
10. X, the Chairman of a company, borrowed Rs. 5 lakhs from a bank under a promissory note. A suit was filed against the company for recovery of the amount in the promissory note. The company refused to accept the liability on the plea that the chairman had borrowed funds without authorization of the company. State with reasons whether the company's refusal will be successful in a Court of Law.

22 Prevention of Oppression and Mismanagement

In addition to the protection afforded to the minority by the exceptions to the Rule of the supremacy of majority[1], the Companies Act contains special provisions for prevention of oppression and mismanagement. The aim of such provisions, contained in Chapter XVI (Sections 241 to 246) of the Companies Act, 2013, is to safeguard the interest of investors, including minority shareholders in companies and also to protect the public interest.

22.1 Application to Tribunal for relief in cases of oppression etc.

22.1-1 Application to the Tribunal

The first remedy in the hands of oppressed minority is to move the Tribunal. Whenever the affairs of a company have been or are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members, an application can be made to the Tribunal under sub-clause (*a*) of section 241(1). Alternatively, an application can be made under sub-clause (*b*) on the grounds that material change has taken place in the management or control of the company which is not in the interest of any creditors, debenture holders or class of shareholders of the company. The change may be due to an alteration in the Board of Directors, or manager, or in the ownership of the company's shares, or if it has no share capital, in its membership, or in any other manner whatsoever. The applicant has reasons to believe that due to such change the affairs of the company are likely to be conducted in a manner prejudicial to the interest of the company or its members or class of members. The application under clause (*a*) or (*b*) is required to be made in **Form NCLT-1** and accompanied with documents as mentioned in the National Company Law Tribunal Rules, 2016. A copy of the application is required to be served on the company, other respondents and all such persons as the Tribunal may direct (Rule 81).

Under Section 241(2) an application may be made to the Tribunal for an order by the Central Government if it is of the opinion that the affairs of the company have

1. Discussed in the preceding chapter.

been or are being conducted in a manner prejudicial to the public interest. In the case of a company intended to operate in modern welfare State, the concept of 'public interest' takes the company outside the conventional sphere of being a concern in which the shareholders alone are concerned. It emphasises the idea of the company functioning for the public good or general welfare of the community, at any rate, not in manner detrimental to the public goods [*N.R. Murthy* v. *Industrial Development Corporation of Orissa Limited* [1977] 47 Comp. Cas. 389 (Ori.)].

It may be noted that an application under Section 241(1) for grant of relief may be made both for the past acts as well as continuing matters as the words used relating to the alleged affairs 'have been or are being'. Furthermore the complaint is tenable if the affairs have been or are being conducted in a manner prejudicial to him or any member or members or to the interest of the company not amounting to oppression.

An application in respect of such company or class of companies as may be prescribed, shall be made before the Principal Bench of the Tribunal and such application shall be dealt with by such Bench.*

The petition must be made within the prescribed period of limitation. In the case of *Sangeeta Maheshwari* v. *Premsagar Agricultural (P.) Ltd.* [2017] 88 taxmann.com 88 (NCLT - Ahd.), the petition was held to be barred by limitation as the period of limitation provided under Limitation Act for complaint of oppression and mismanagement is three years. The petition was filed by petitioner on 24-11-2016 for cause of action that arose on 22-10-2013 and therefore was barred by limitation.

22.1-2 Who can apply [Section 244]

The requisite number of members who must sign the application is given in section 244. The requirement varies with the fact as to whether the company has a share capital or not and is discussed below:—

1. *In case of a company having a share capital*, the application must be signed by : (*i*) at least one hundred members, or (*ii*) by at least 1/10th of the total number of its members, whichever is less.

   In the alternative, a valid application may be made by any member(s) holding not less than 1/10th of the issued share capital of the company.

   The application to be valid, the applicant or applicants must have paid all calls and other sums due on their shares. Joint holders of shares shall be counted as one member. The CLB [now Tribunal] in *Kishan Khariwal* v. *Ganganagar Industries Ltd.* [2004] 50 SCL 567 has held that if a person's shareholding which was 10% or more gets below 10% by issue of further shares, such person can maintain the petition provided he has challenged further issue in his petition.

2. *In case of a company not having share capital*, application will be valid if signed by at least 1/5th of the total number of members of the company.

The Tribunal has the right to waive all or any of the requirements as aforesaid to enable the members to make the application under section 241. In case of joint holding of the shares, the joint holders will be counted as one. A member after taking

*Inserted *vide* the Companies (Amendment) Act, 2019.

consent of the requisite number of members may make the application on behalf of all of them.

To properly understand these provisions the discussion that follows would be useful:

Sub-section (1) of section 244 states that in the case of a company having share capital, not less than one hundred members of the company or not less than one-tenth of the total number of its members, whichever is less, can make the application to the Tribunal for relief against oppression and/or mismanagement. Where the company does not have share capital, the application can be made by not less than one-fifth of the total number of its members. This criterion is based on numerical strength of the applying members. In the case of a company having share capital, an alternative is available in terms of shareholding strength. The sub-section enables holders of not less than one-tenth of the issued share capital of the company to make the application. Issued share capital is not restricted to only the equity share capital of the company; it covers the preference share capital also. In other words, the calculation of not less than one-tenth of the issued capital of the company has to be done taking into account both the types of share capital that have been issued. It is to be ensured that the applying member or members have paid all calls and other sums due on their shares.

The required numerical strength generally suggests association of more than one member to make the application. As a matter of fact it is not less than one-hundred members[2]. However, where one-tenth of the total membership of the company comprising the equity holders and preference holders is below one hundred, then such number will meet the requirement of section 244(1)(*a*) of the Act based on numerical strength. There can be a position where total membership of a company is ten or less. If it is ten or less, then of course, one member will be eligible to make the application. But if the total number of members exceed ten but does not exceed twenty, then the number of applicants has to be a minimum of two. In this way, the requirement of numerical strength has to be reckoned. Even based on shareholding strength *i.e.* "not less than one-tenth of the issued share capital", a minimum of one member has to be the applicant where such member holds not less than 1/10th of the issued capital. It will be more where such a member does not hold the aforesaid minimum proportion. The rest will be only arithmetic taking care to see that the number of applicants together hold at least 1/10th of the total issued capital of the company. In no case any member who has defaulted in paying calls or other dues to the company on account of share capital can be an applicant whether singly or in company with others. In respect of a company not having share capital, the minimum number of applicant has to be one where the total membership does not exceed twenty. If it is exceeding twenty but does not exceed forty, then the minimum has to be two and so on. There is no ceiling in either case in the number of members who can make the application.

In the case of *Arvind Parasramka* v. *Minwool Rock Fibres Ltd.* [2018] 90 taxmann.com 319 (NCLT - Mum.) adhesive stamps on instruments of transfer of shares were not

2. In *All India Shaw Wallace Employee's Federation* v. *Shaw Wallace & Co. Ltd.* [1998] 18 SCL 172, it has been held that when not less than one hundred members are applicants, the insignificance of their aggregate holding is not relevant as it fulfils one of the conditions stated in Section 399 (now Section 244).

cancelled, instrument was deemed to be unstamped and shares were not transferred in favour of petitioners. As petitioners were not members of the company, they were not entitled to file the petition for oppression and mismanagement.

When a shareholder's shareholding falls below 10% because of further issue of shares, which is the subject matter of petition under section 397 [now Section 241] by that shareholder, he retains his right to make petition under section 399 [now Section 244] - *Woodbriar Estate Ltd.* v. *V.N.A.S. Chandran* [2007] 78 SCL 393. Also *see Mohinder Singh* v. *Hoshiarpur Express Tpt. Co. Ltd.* [2008] 86 SCL 155 (CLB).

Recently, the NCLAT refused to dismiss the appellant's petition under Section 241 alleging oppression and mismanagement on the ground that the appellant did not have 1/10th of total shareholdings. In this case the petitioner had alleged that his shareholding in the company was brought down by way of oppression and mismanagement. [*Anup Kumar Agarwal* v. *Crystal Thermotech Ltd.* [2017] 79 taxmann.com 454 (NCLAT)].

A subscriber to the Memorandum and Articles of a company who has not paid for the number of shares subscribed does not have *locus standi* to file petition under sections 397, 398 and 111 [Now section 241, and section 58] - *Vipul Kumar Dahyalal Bheda* v. *V.S. Cosmopharma (P.) Ltd.* [2012] 111 SCL 751.

In case of death of original petitioner under section 241, the name of his legal representatives could be substituted, though each of the legal representatives did not have the requisite shareholding. [*Kanubhai C. Patel* v. *Doloo Tea Co. (India) Ltd.* [2017] 79 taxmann.com 229 (NCLT - Guwahati)]

FORUM SHOPPING/JURISDICTION SHOPPING - LEGAL DOCTRINE OF 'ELECTION' - In *M.S. Mewar* v. *Lake Palace Hotels & Motels (P.) Ltd.* [1997] 4 CLJ 440 (Delhi), the CLB [now Tribunal] recognised the right of members of a private company holding less than 10% of the share capital to make a valid application based on the criterion of number of members in the company. Withdrawal of a similar petition made in a High Court was not considered to be a bar to subsequent filing of the petition at the CLB (now Tribunal). It was also held that the law of limitation does not apply to proceedings before the CLB (now Tribunal). Subsequent decisions of the Principal Bench, CLB (New Delhi) [now Tribunal], however followed a different logic insofar as forum shopping, *i.e.*, where alternative recourses are available, to try such recourses, one after the other or to withdrawing from one to go for the other, is concerned. In the *M.S. Mewar's* case, it was held by the CLB [now Tribunal] that withdrawal from the High Court a similar petition by the same petitioner is not a bar to subsequently filing a petition before the CLB [now Tribunal]. In *A.P. Jain* v. *Faridabad Metal Udyog (P.) Ltd.* [1998] 18 SCL 27, the Principal Bench held that forum shopping/jurisdiction shopping was not allowable as the petitioner earlier filed a suit in a High Court and withdrew the same. Also, the petition failed as it was made after abnormal delay, *i.e.*, seven years, after the alleged occurrence of mismanagement even though the effects of such mismanagement were still continuing, and there existed no time bar in making petition to the CLB [now Tribunal]. On appeal, the Delhi High Court ruled that in the circumstances of the case *i.e.* withdrawal of the case from the Court at the direction of the Court itself and filing the petition before CLB [now Tribunal] is not an instance of forum shopping and accordingly directed the CLB [now Tribunal] to dispose of the petition [2004] 50 SCL 268. In another case, *Pradip Kumar Sengupta* v. *Titan Engineering Co. (P.) Ltd.* [1998] 18 SCL 20, the same Bench disallowed

admission of a petition under sections 397 and 398 [now Section 241] when a suit filed earlier before a court on the same grounds by the same petitioner was withdrawn from the Court, which in its order allowing the withdrawal, disallowed the petitioner liberty to agitate the matter before the CLB [now Tribunal]. This order of the Court was based upon the legal doctrine of 'election'. In this context, Black's Law Dictionary, 6th Edition, Page 518 was cited wherein it is stated that if two or more remedies exist, which are repugnant and inconsistent with one another, a party will be bound if, he has elected for one of such remedies. He is blocked to move to the other alternative as he has already elected in favour of one of them. It is, however, to be observed that the Principal Bench (New Delhi) of the CLB [now Tribunal] did not consider it as forum shopping when some shareholders *other than the Petitioners* before the CLB [now Tribunal] had filed a suit in a Court on the same grounds as have been preferred by the petitioners under sections 397 and 398 [now section 241] [*All India Shaw Wallace Employees' Federation* v. *Shaw Wallace & Co. Ltd.* [1998] 18 SCL 172].

In the case of *Dilip Kumar Ari* v. *Matrikalyan Nursing Home (P.) Ltd.* [2017] 86 taxmann.com 25 (NCLT - Kolkata), the NCLT refused to admit the petition on the grounds of forum shopping. In this case, the dispute arose in 2005 and petitioner pleaded his grievance before civil Court and High Court before filing petition for oppression and mismanagement in year 2014. The Tribunal held that the petitioner had adopted forum shopping and petition was untenable for delay and laches.

A petition filed under Sections 397 to 403 (now section 241) relating to rights of members and oppression and mismanagement, invoking arbitration clause on the same subject matter was held to be inappropriate and therefore reference of dispute to arbitration was dismissed. [*Mysore Realty (P.) Ltd* v. *H.P. Basavaraju* [2014] 52 taxmann.com 174 (CLB - Chennai)].

Effect of Arbitration Agreement - In case the issue raised in the petition are fully covered by a shareholder agreement and arbitration agreement, a petition under section 241 would not be maintainable. [*Rishima SA Investments LLC* v. *Shristi Infrastructure Development Corpn. Ltd.* [2017] 88 taxmann.com 212 (NCLT - Kolkata)]. However, where the arbitration agreement did not describe the dispute and governance of terms of reference, petition for oppression and mismanagement was permitted. [*AAR KAY Chemicals (P.) Ltd.* v. *A.P. Refinery (P.) Ltd.* [2017] 88 taxmann.com 291 (NCLT - Chd.)]

Tribunal's Power - Primarily section 244 allows the right to make application to the Tribunal on two criteria - numerical strength of the members or shareholding strength of the members. Overriding these two, proviso of section 244 enables the Tribunal to authorize any member(s) to make the application notwithstanding that such member(s) does not fulfil any of the criteria. This, the Tribunal may do, on an application made to it in this behalf. Application for such waiver needs to be made in Form No. NCLT-9 of NCLT Rules (Rule 84) with the prescribed fees.

Proviso to Section 244(1) is intended to waive the minimum requirements of section 244(1) and, normally, it is the nature of the allegations made, rather than the number or proportion of members who make an application to it that is considered by the Tribunal while granting permission. The Tribunal has to satisfy itself that the member or members concerned would have had the right to apply to the Tribunal but for the statutory requirements specified in sub-section (1). *Secondly*, it should

be satisfied that *prima facie* the matters complained of fall within the purview of section 241. *Thus,* the scope of the inquiry postulated by proviso is two-fold. *First,* to ascertain whether indeed, *prima facie,* any case is made out of oppression or mismanagement so as to affect public interest prejudicially, as postulated by section 241. *Secondly,* whether the applicant or applicants are indeed members who should in the circumstances be allowed to move the Tribunal not for their personal gain but in the interest of the company and the general body of shareholders and the public. Also *see Universal Music India Ltd.* v. *Union of India* [2008] 87 SCL 51 (Delhi).

For granting waiver from the minimum requirements, the Tribunal needs to consider the circumstances and apply its mind as to whether the application related to oppression and mismanagement. In the case of *S. Ahmed Meeran* v. *Ronny George* [2017] 86 taxmann.com 260 (NCLT - New Delhi), the bench set aside a non-speaking order granting waiver of requirements under section 244. It was found that the order was passed in a mechanical manner without considering any exceptional circumstances to allow application for waiver. In *Ramprasad Dalmia* v. *Board of Directors* [2018] 90 taxmann.com 173 (NCLT - Chd.) the petitioner was not having requisite shareholding to file oppression and mismanagement petition and also failed to make out a case of exemption. The petition was dismissed.

Consent for Application - Where any members of a company are entitled to make an application by virtue of sub-section (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them [Section 244(2)].

The question now arises is how to take consent in writing from other members who are not the applicants as such on the body of the application but nevertheless consented that the application is to be made. In this context, it is reiterated that the consent has to be in writing and the cumulative number or share holding strength of the consent givers and the applicant(s) meets the minimum required by the provisions and such minimum is not vitiated by any one or more members being defaulters to the company in regard to the calls made on the share capital or other dues on the share capital *e.g.,* the concerned share(s) being in lien for certain transaction, in terms of the Articles of Association. In reckoning the minimum, the joint holders of shares will be counted as one.

The applicant(s) under section 241 in the context of sub-section (2) of section 244 are representative applicants in the eye of law and obtaining the consent in writing from other members is a condition precedent to make the application. Rule 81(2) of the National Company Law Tribunal Rules, 2016 requires that letter of consent signed by rest of members and their names and addresses are also to be filed with the application.

Section 244(2) has made it abundantly clear that when the representative application is to be made, the application should be not only for the applicant(s) but also should be for and on behalf of the consent givers and for their benefit as well. Consent in writing as stipulated in section 241(2) is consent to the filing of a particular petition with particular allegations and for a particular relief under section 241.

On the issue of consent, the Supreme Court has made it clear that purport of section 399(3) [now Section 244(2)] is to obtain consent for the petition and it is not

mandatory that the consent be annexed to the petition - *J.P. Srivastava & Sons (P.) Ltd.* v. *Gwalior Sugar Co. Ltd.* [2004] 56 SCL 1.

Parameters to be applied for deciding validity of consent in writing - (1) Member(s) giving consent should have applied his mind to the issue before consenting in writing and should have known what relief has been claimed in the petition. There cannot be a blanket consent divorced from issues, grounds and relief.

(2) Members who desire to file a petition under section 397/398 [now Section 241] will have to file the petition in their own names and they have to file an affidavit verifying the petition and also have to indicate that they hold the prescribed number of shares and that all calls made have been paid. Sub-section (3) [sub-section (2) of Section 244 of the Act] is an exceptional provision, according to which, with the consent of other members, a member or members can file a petition. In cases where they have the consent of other shareholders which would make the petition maintainable, unless their consent in writing are enclosed with the petition, it would not be possible to determine whether, on the date of filing the petition, the requirements of section 399 [now Section 244] are fulfilled. Therefore, obtaining the consent in writing is a condition precedent to the making of the application [*Makhan Lal Jain* v. *Amrit Banaspati Co. Ltd.* [1953] 23 Comp. Cas. 100 (All.)].

(3) It should be noted that consent obtained subsequent to making of the application is ineffective. It is, however, not necessary that the consenting members should have the petition before them before they give their consent. It is enough if they have considered the question of petition being moved under section(s) 397 and/or 398 [now Section 241], as the consent envisaged in section 399(3) [now Section 244(2)] is not consent to the petition as such but a consent to certain action being taken, namely, an application under section 397/398 [now Section 241]. [*Rai Bahadur Satish Chowdhary* v. *Bengal Luxmi Cotton Mills Ltd.* [1965] 1 Comp. Law Journal 35 (Cal.)].

(4) Mere consent to an application under section 397 and/or 398 [now Section 241] being filed is not enough. If consent is given on the basis of one set of facts and the application is made on another, the application cannot be said to be in pursuance to the consent [*V.K. Mathur* v. *K.C. Sharma* [1987] 61 Comp. Cas. 143 (Delhi)].

(5) A mere consent to represent them for the proposed action against the management for gross mismanagement of the company's affairs and oppression of members is not sufficient. [*Kilpest (P.) Ltd.* v. *Shekhar Mehra* [1987] 62 Comp. Cas. 717 (MP)].

(6) A petition with defective consent is liable to be dismissed as not being in accordance with legal requirements [*P.S. Nanawati* v. *Jaipur Metals & Electricals Ltd.* [1990] 69 Comp. Cas. 769 (Raj.)]. The question of validity of signatures appended in a schedule to the petition was examined by the CLB [now Tribunal] in *S.S. Laxminarayanan* v. *Mather Platt (India) Ltd.* [1997] 26 CLA 245. In this case two applicants submitted the petition alleging oppression and mismanagement. Along with the petition they submitted a schedule containing signatures of 146 members signifying their consent to the petition. It was held that the schedule containing the signatures of the shareholders who were purported to have given their consent did not meet the requirement of section 399(3) [now section 244(2)]. Mere, signature unaccompanied by affirmation of the consent is not enough.

(7) In *Kuttanad Rubber Co. Ltd.* v. *K.T. Ittiyavirah* [1997] 88 Comp. Cas. 438 (Ker.), in a petition under section 397 [now Section 241], the company raised an objection that the petition did not satisfy the statutory requirement of section 397 [now Section 241] in that for any member to be entitled to make an application he should hold a minimum of 1/10th of the shares; it was not enough that the requirement of 1/10th share holding was satisfied by the shares held by the petitioners as well as shareholders who had given their consent.

The Kerala High Court dismissed the plea of the company. In terms of sub-section (3) of section 399 [now Section 244(2)], when a petition was moved with the consent in writing of some of the shareholders, such a petition was on behalf of and for the benefit of all of them, namely, the petitioners and the consenting shareholders.

(8) It has been held by the Supreme Court in *Rajahmundry Electric Corporation* v. *A. Nageshwara Rao* AIR 1956 SC 213 that if some of the consenting members have, subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the application. The *Punjab High Court* went a little further in *Jagdish Chandra Mehra* v. *New India Embroidery Mills* [1964] 1 Comp. LJ 291 by holding that where a petition has been properly presented, it does not cease to be maintainable merely because three of the applicants have transferred their shares and ceased to be shareholders of the company. The validity of the petition must be judged on the facts as they were at the time of its presentation. Neither the right of the applicant to proceed with the application, nor the jurisdiction of the CLB (now Tribunal) to dispose it of on its own merits, can be affected by events happening subsequent, to the presentation[3]. In *Gees Marine Products (P.) Ltd.* [2005] 63 SCL 82 (CLB), it has been held that if original petitioners do not want to continue the proceedings, the CLB (now Tribunal) may allow substitution of the names of petitioners, on the basis of the merits of the petition. The Madras High Court in *L. Rama Subbu* v. *Madura College Board* [2007] 73 SCL 146 has held that a consent giver cannot be held bound to his past action contrary to the consent, if there arises a new conviction or understanding relating to the subject matter.

Trust as Petitioner/consent giver - The legal position is that all trustees should be Parties to the proceedings and they cannot delegate or give consent to one of them to initiate proceedings. Consent could be given only in respect of matters which one could do by himself. Trustees cannot authorise one of them to launch a proceeding in the name of a trust and therefore the consent given by the trustees is something which they cannot give on their individual rights and as such any petition made on

3. *Rajahmundry Electric Corporation* v. *A. Negeshwara Rao (supra)*; *L.R.M.K. Narayanan* v. *Poduthotam Estate Ltd.* [1992] 74 Comp Cas. (Mad.); [1992] 8 CLA 40; *S Varadarajan* v. *Venkateshwar Solvent Extraction (P.) Ltd.* [1994] 80 Comp. Cas. 693 (Mad.); [1992] 9 CLA 39.

In *Dr. Percy Rutton Kavasmaneck* v. *Gharda Chemicals Ltd.* [2009] 96 SCL 515(Bom.), the Court finding that some of the petitioners, after submission of the petition, had withdrawn from the petition, thereby leaving the remaining petitioners with less than 10% holding of shares, decided that the petition is not maintainable. Even though the Court passed order on the allegations made only by remaining petitioners, by rejecting all the decisions to declare the petition as not maintainable is somewhat incomprehensible, as when the petition was submitted it fulfilled the requirements of Section 399 (now section 244) of the Act. The Court relied upon unconditional withdrawals by some as giving up their complaints and thereby rendering the petition as not maintainable insofar as their complaints were concerned.

the basis of consent given to one or more trustees is not maintainable [*Duli Chand* v. *Mahavir Prasad Trilok Chand Charitable Trust* AIR 1984 Delhi 145].

In *Sir J.P. Srivastava & Sons (Rampur) (P.) Ltd.* v. *Gwalior Sugar Co. Ltd.* [1999] 21 SCL 142, the Principal Bench of the CLB [now Tribunal] has held that a petitioner describing herself as a petitioner on her behalf and on behalf of a trust is not acceptable. It was observed that as long as the petitioners held requisite number of shares, wrong or incorrect mention of the number of shares held was immaterial. However, if one acts on behalf of the other, then, it should be either by virtue of a power of attorney or any other written authority given by such persons.

In a related reference the Supreme Court has settled the issue of maintainability of petition under sections 397 and 398 [now Section 241] by a trust by deciding that the trust can be a party to the petition and the same was maintainable as the appellants along with the trust held more than 10% of the share capital including 1029 preferential shares - *J.P. Srivastava & Sons (Rampur) Pvt. Ltd.* v. *H.K. Srivastava - SLP (C) Nos.* 10235-36 of 2005 dated 3-9-2008.

The CLB, however, has ruled in *Girdhar Gopal Dalmia* v. *Batli Tea Co. Ltd.* [2007] 73 SCL 84 that technicalities relating to proper format of power of attorney or letter of authority are not relevant as long as shareholders show their intention that a petition under section 397/398 [now Section 241] has to be filed.

Deletion of shareholders' names - Deleting shareholders' names from the Register of members after a petition under section 397/398 [now Section 241] has been filed - Whether valid - In a petition under sections 397 and 398 [now Section 241] filed against the company, the petitioner company alleged that *three petitioners in the petition did not have the requisite share qualifications to initiate the proceedings* in that the Board of directors had rectified the register of members by deleting their names on the ground that the stamps on the reverse of the share transfer deeds had not been cancelled and that therefore, registration of the shares in their names was illegal and improper. Since these three petitioners were no longer the shareholders of the company they did not have the qualifications to proceed with the main proceedings (Vide *Sayedabad Tea Co. Ltd.* v. *Samarendra Nath Ghattak* [1995] 83 Comp. Cas. 504). In support of their case they had relied upon the decision of the Madras High Court in *Damodara Reddi* v. *Indian National Agencies Ltd.* [1945] 15 Comp. Cas. 148, which held that the register of members of a company was a public document and there was no provision in the Act which permitted the directors or any officer to make any alteration to the register by removing the names of certain members on the ground that they had been *improperly added to the register*, and that the *remedy of the company was to apply to the court for the rectification of the register and not to take upon itself the power to alter such register.* The Calcutta High Court held that the company could have refused to register the shares on the ground that the stamps had not been cancelled. Once having not done so, it was not open to the company *suo motu* to deregister that without taking recourse to law. It was held in *Rajahmundry Electric Supply Corporation Ltd.* v. *A. Nageswara Rao* (*supra*) that the validity of a petition must be judged on the facts as they were at the time of its presentation and where a petition was valid when it was presented, it could not cease to be maintainable by reason of events subsequent to its presentation. Withdrawal of consent by some of the members subsequent to the presentation of the application would not affect either the right of the applicant to proceed

with the application or the jurisdiction of the court to dispose of the application on merits.

Shares of two of the petitioners were illegally transferred by the Board of directors after filing of the petition, some to one of the respondents and balance to a company to render the petition ineffective. The remaining petitioner applied for impleadment of the company which was the transferee of the balance shares and also to amend the original petition in view of this impropriety. The application was allowed - *B.C. Gupta* v. *Sunair Hotels Ltd.* [2012] 115 SCL 231.

Indirect supersession of the board not allowed

In a very comprehensive decision, the Principal Bench, CLB (New Delhi) in the *Shaw Wallace* case cited earlier, has held :

(*i*) motive for the petition is a relevant consideration when relief sought is examined and ulterior motive, if established, would be a ground for refusal to grant the relief, notwithstanding merit of the case;

(*ii*) prayer for supersession of the entire Board is not sustainable when allegations are against only two directors;

(*iii*) acts of the directors/company leading to a situation of financial crisis are prejudicial to the interests of the shareholders and the company; however, if a charge against a director for misuse of fiduciary position or for fraud/misfeasance could not be established, he would not be removed from the Board merely on suspicion.

In this case, the CLB ordered for restructuring of the Board as against supersession and held that if majority in the Board becomes, as a result of the petition, Government appointees, it would amount to indirect supersession and accordingly, ordered restricted number of appointments by the Government and the financial institutions so that they do not constitute majority in the Board - *Union of India* v. *Eveready Industries India Ltd.* [2005] 62 SCL 34 (CLB).

Motive underlying the petition

As in the former case, in *Vijayan Rajes* v. *MSP Plantations (P) Ltd.*, CLB Chennai, held that if a petition under section 397 or 398, [now Section 241] is found motivated towards an ulterior purpose, it is not maintainable. Also, since the petitioner ceased to be a member as the preference shares held by him had already been redeemed, he is not competent to make the petition [1999] 19 SCL 106. In *Srikanta Datta Narasimharaja Wadiyar* v. *Shri Venkateswara Real Estate Enterprises (P.) Ltd.* [1991] 72 Comp. Cas. 211 (Kar.), the Court emphasised on the clean approach to the Court and Court's jurisdiction being equitable under sections 397 and 398, [now Section 241] if the approach of the petitioner appears to the Court not to be clean, the petition may be dismissed.

Besides members, the following may also apply for relief:

(*i*) Under section 241(2), *the Central Government,* or any person authorised by the Central Government, has a right to file a petition.

A petition was filed by the Union of India filed under section 242 alleging that managerial persons of IL&FS were responsible for negligence and incompetence and affairs of company were conducted in manner prejudicial to public interest. The Tribunal suspended the Board of Directors of IL&FS and Government Directors were directed to take over IL& FS with immediate

effect. [*Union of India* v. *Infrastructure Leasing and Financial Services Ltd.* [2018] 98 taxmann.com 67 (NCLT - Mum.) (SB)]

(*ii*) A *legal representative of a deceased member,* on whom title to the shares devolves by operation of law. Even though not registered as a member he is entitled to present a petition under section 397 [now section 241] - *World Wide Agencies (P.) Ltd.* v. *Margaret T. Desor* [1989] 2 CLA 345 and affirmed on appeal by the *Supreme Court* [1990] 3 CLA 248 and *Kalitara Glass Moulding (P.) Ltd., In re* [1992] 8 CLA 98 (CLB). Also *see Rajkumar Devraj* v. *Jai Mahal Hotels (P.) Ltd.* [2007] 73 SCL 328 (CLB).

(*iii*) *Trustees of a shareholder/member may also make a petition.* The *Calcutta High Court,* in *Power Tools & Appliances Co. Ltd.* v. *Jaladhar Chakraborty* [1992] 8 CLA 50, held that refusal of one of the four trustees (of a public charitable trust) who held bulk of the shares of the company to participate in the proceedings did not render the petition filed by the other three trustees infructuous. In this context, the High Court cited the following passage from *Halsbury's Laws of England*:

> "In trusts of a public or charitable nature a majority of the trustees may as a rule bind the minority, but in a private trust where there is more than one trustee the concurrence of all is, in general, necessary in a transaction affecting the trust property and a majority cannot bind the minority."[4]

(*v*) *Shareholder in management* - There is no bar to any shareholder in management in making petition under section 397/398 [now Section 241] - *K.N. Bhargava* v. *Track Parts of India Ltd.* [2000] 23 SCL 320. However, the application has to be in the capacity of a shareholder alone and not a mixed one as shareholder and lessee of a property leased to the company concerned. *M. Gopalan* v. *Narmada Consumer Stores (P.) Ltd.* [2004] 51 SCL 89 (CLB - New Delhi). However, the CLB [now Tribunal] in *Dinesh Sharma* v. *Vardaan Agrotech (P.) Ltd.* [2007] 73 SCL 338, has held that when a promoter, holding shares as also the managing directorship, is irregularly removed from directorship, it is a case of oppression. This decision also held that reduction of petitioner's shareholding by irregular allotment of further shares, below 10% is also an act of oppression.

22.1-3 Who cannot apply

The following cannot apply for relief under section 241:

(*i*) a member/(s) whose calls are in arrears [Section 244(1)(*a*)].

(*ii*) a holder of a letter of allotment of a partly paid share*

(*iii*) a holder of a share warrant*

(*iv*) a holder of a share certificate to bearer*

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4. Also see discussions under "Trust as Petitioner/consent giver" appearing earlier in this para.

*Re, a company (1985) 2 BCC 951. In an interesting case it has been held by the CLB that even when a transferee's name has not been entered in the register of members but the transferor had parted with the shares alongwith valid transfer deed to the transferee in a circumstance where the company concerned had agreed not to raise any objection in the registration of shares, the transferee will be deemed to be a member and he would be eligible to file petition under section 397/398 - *Serum Institute of India Ltd.* v. *Inderjit Properties (P.) Ltd.* [2005] 64 SCL 33.Re, a company (1985) 2 BCC 951.

(*v*) a transferee of shares who has not lodged the shares for transfer to the company.

(*vi*) [5] Shareholders of a holding company cannot file petition against a subsidiary of the holding company. *Herbertson Ltd.* v. *Kishore Rajaram Chhabria* [1999] 21 SCL 99 (CLB). Also the Board of Directors of the holding company, where the directors did not hold shares in the subsidiary cannot make petition under section 397/398 (now section 241), *BDA Ltd.* v. *Kishore Rajaram Chhabria* [1999] 22 SCL 284 (CLB).

In *Aman Goel* v. *Eileen Tech Communications (I) (P.) Ltd.* [2013] 32 taxmann.com 84 (CLB – Chennai), Petitioners were subscribers to Memorandum of Association and upon its registration were required to be entered as members in register of members. Petitioners claimed to have invested Rs. 14 lakh but alleged to have been thrown out of respondent-company. Petitioners also challenged increase in shareholding in company without any offer to petitioners. They also challenged appointment of directors in a meeting without giving notice to petitioners. Respondents reply was that petitioners were not members of company as in memorandum, petitioners had agreed to take shares, but after registration of memorandum, petitioners failed to pay any amount towards capital; and that they made only some investments which they (petitioners) transferred or withdrew. R-10 and R-11 who were directors alleged that they were induced by petitioners and respondents to invest in respondent-company but were not allotted any shares. *CLB [now Tribunal] held that* since the petitioner along with R-10 and R-11, were not holding requisite shareholding to be eligible under section 399 [now Section 244(1)] to file a petition under section 397/398 [now section 241], the petition was liable to be dismissed. However, since respondent's intentions were *mala fide* in preventing access and shareholding to other proposed members with whom he had initial understanding at time of incorporation of company, petitioners, R-10 and R-11 were to be permitted to take shareholding in respondent-company as per their understanding. Alternatively, petitioners R-10 and R-11 were to be given an option to receive back their investments made in company.

The petitioners were not members of respondent-company but were only transferee of shares and transferor of shares had not authorised petitioners to file petition on date of presentation of petition. As petitioners were not members, they had no right to file and bring a petition. [*Arvind Parasramka* v. *Calcutta Investment Co. Ltd.* [2016] 76 taxmann.com 292 (NCLT - Kolkata)]. In another case, it was held that where the petitioner has transferred his shares and ceased to be a shareholder, he has no *locus standi* to file petition under Section 241/242 of the Companies Act, 2013. (*Yerramaneni Rama Krishna* v. *Peddi Venkata Koteswara Rao* [2016] 70 taxmann.com 384 (CLB - Chennai). The NCLAT held that as appellant/petitioner was not member and shareholder of the company when alleged acts of oppression took place, they could not maintain petition under section 241. [*Power Finance*

5. Also see *Shankar Sundaram* v. *Amalgamations Ltd.* The decision of the case, apart from adhering to the decisions mentioned herein also stated that "affairs of the company" do not include affairs of its subsidiary [2001] 30 SCL 167 (CLB).

Corporation Ltd. v. *Shree Maheshwar Hydel Power Corporation Ltd.* [2018] 92 taxmann.com 68 (NCL-AT)]

In the case of *C.J. Mathew* v. *Greendot Hotels & Resorts (India) (P.) Ltd.* [2018] 97 taxmann.com 416 (NCLT- Chennai), the petitioner claimed to be subscriber of 25000 equity shares representing 50 per cent of share capital of company but there was no proof of payment of subscription money, oppression and mismanagement petition filed by him was dismissed. Similarly on failure on the part of the appellant to produce letter of allotment of shares/share certificates issued by company or share transfer terms to substantiate his shareholding in company, oppression and mismanagement petition filed was not entertained by the Tribunal. [*Jagdish Kumar Dhingra* v. *A.R. Plaza (P.) Ltd.* [2018] 96 taxmann.com 328 (NCL-AT)]

22.2 Power of Tribunal

Members of a company who complaint that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members including one or more of themselves may apply to the Tribunal.

Under Section 242(1) the Tribunal is empowered to make any order as it may thinks fit to with a view to end the matters complained off in Section 241. Before passing an order the Tribunal needs to satisfy itself that -

(*a*) the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and

(*b*) to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up.

22.2-1 Conditions for relief under section 242

In *K.P. Chackochan* v. *Federal Bank* [1989] 66 Comp. Cas. 953 (Ker.), it was observed that in order to grant relief under section 397 [now Section 241], a petitioner must show three things:

1. The affairs of the company are being conducted in a manner oppressive to some part of the members/shareholders including the petitioners. It is to be noted here that the section does not require that the oppressed members should be the minority. 'Shareholders with a minority beneficial interest may, by having control over voting, be able to oppress those with majority beneficial interest.'
2. The facts pleaded justify the making of a winding-up order on the 'just and equitable' ground. In case, winding up of the company is not justified, the Supreme Court in *Kilpest (P.) Ltd.* v. *Shekhar Mehra* [1996] 10 SCL 233 held that the petition for oppression and mismanagement shall not be maintainable.
3. To wind up the company would unfairly prejudice the oppressed members.

In *Subhas Ch. Agarwal* v. *Associated Limestone Ltd.* [1998] 16 SCL 212, the CLB has held that justification of winding up on 'just and equitable' ground is a *precondition* for admission of a petition under section 397(2)(*b*) [now section 241], for relief against oppression. Same view has been taken in *Hanuman Prasad Bagri* v. *Bagress Cereals (P.) Ltd.* [2001] 33 SCL 78 (SC). Interestingly, the CLB in *Dipak G. Mehta* v. *Shree Anupar Chemicals (India) P. Ltd.* [1999] 21 SCL 107, has held that dismissal of a winding up petition on deadlock in management will not be a ground of non-maintainability of petition under section 397 [now Section 241] where oppression is proved.

However, if facts fall short of a case upon which the company should be wound up on just and equitable ground and no ingredient of oppression is otherwise present, relief under section 397 [now Section 241] cannot be granted - *Hanuman Prasad Bagri* v. *Bagress Cereals (P.) Ltd. (supra).* When facts complained of are mostly successfully rebutted but infringement of provisions of the Articles and of the Act could not be, it was held that though under just and equitable ground winding up order can be passed but simply to avoid deadlock in the company the 49% holder of shares (petitioner) was asked to go out of the company on receipt of proper consideration for his shares on the basis of valuation done by statutory auditors— *Ravi Shankar Taneja* v. *Motherson Triplex Tools (P.) Ltd.* [2001] 33 SCL 645 (CLB).

Non-cooperation of respondent: In a petition alleging various acts of oppression and mismanagement, the petitioner served notices on the respondent directors of the company and the same came back as 'refused' or 'unclaimed'. As the CLB (now Tribunal) was satisfied that the respondents had knowledge of the petition, it passed order *ex-parte*, allowing the reliefs prayed for - *Kanumuru Sridhan Reddy* v. *Renovau Telecom* (*P) Ltd.* [2011] 108 SCL 69.

A petition under sections 397 and 398 [now Section 241] should not be dismissed at threshold unless averments made in the petition taken on their face value do not disclose any cause of action in favour of petitioner. Where petitioner fails to establish oppression or mismanagement, even then based on facts of the case, order may be issued to regulate the company - *Anil Kumar Saha* v. *ATS Infrastructure Ltd.* [2012] 112 SCL 376 (CLB)

While during pendency of a petition, the Chairman of CLB (now Tribunal) has passed a consent order, subsequently a member of CLB [now Tribunal] cannot interfere with that order and ask the parties to present their cases on merit. That right rests only with the court - *Ms. Aarti Sponge and Power* v. *Bimal Kumar* [2012] 112 SCL 399 (Chhattisgarh).

22.2-2 Relief under Section 242

The Tribunal is empowered to make order under Section 242(1) to bring an end to the matter complained of. Sub-section (2) of Section 242 that without prejudice to the generality of powers under sub-section (1), the Tribunal's order may provide for the followings:

(*a*) the regulation of conduct of affairs of the company in future;

(*b*) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(*c*) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(*d*) restrictions on the transfer or allotment of the shares of the company;

(*e*) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(*f*) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (*e*):

However no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(*g*) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(*h*) removal of the managing director, manager or any of the directors of the company;

(*i*) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(*j*) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (*h*);

(*k*) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(*l*) imposition of costs as may be deemed fit by the Tribunal;

(*m*) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

It may be noted that sub-section (2) is merely exemplifying the powers of the Tribunal and should not be construed as a restriction on the general power to make an order under sub-section (1).

Filling of the order with the Registrar – A certified copy of the order of the Tribunal is required to be filed by the company with the Registrar within thirty days of the order [Section 242(3].

Interim order - On an application by any party to the proceedings, the Tribunal may make an interim order for regulating the conduct of the company [Section 242(4)]. The NCLT, New Delhi suspended the current directors of the company as the company owed huge sum to depositors, it failed to commence construction after collecting payments from home buyers and there were other irregularities and the

affairs of the company were being conducted against larger public interest. [*Union of India* v. *Unitech Ltd.* [2017] 88 taxmann.com 109 (NCLT - New Delhi)]

Alternation of Memorandum and Articles of Association – Any alternation made to the Memorandum or Articles of Association in pursuant of an order of the Tribunal is assumed to have been duly made in accordance of the provisions of the law applicable for such alteration. The company shall file a certified copy of the order altering or giving leave to alter the memorandum or articles is required to be filed with the company within thirty days with the Registrar [Section 242(6) and (7)]. If the memorandum or articles are altered as per the order of the Tribunal, they cannot be altered subsequently by the company in a manner inconsistent with the Tribunal's order without taking the leave of the Tribunal or to the extent permitted in the order [sub-section (5)]. The company in contravention of clause (5) shall be punishable with fine which shall not be less than rupees one lakh but which may extend to rupees twenty-five lakh and every officer in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than rupees twenty-five thousand rupees but which may extend to rupees one lakh or with both.

Removal of Auditor - The High Court of Delhi in the case of *S.P. Gupta* v. *Packwell Manufacturers (Delhi) (P.) Ltd.* [2013] 38 taxmann.com 90 (Delhi) held that while a petition under Section 397 [now section 241] for alleged oppression and management is pending before the CLB (now Tribunal), it also has a right to give approval for the removal of the auditors provided that exercise of such power will help is achieving the objective sought to be achieved by ultimate order passed under section 402 [now section 242]. Though under section 224(7) [now section 140] Central Government is authorized to accord previous approval for removal of auditors on application of company, the same power can be exercised by the CLB (now Tribunal) while a petition for alleged oppression and mismanagement is pending it. Similarly in *Union of India* v. *Company Law Board, Mumbai Bench* [2013] 39 taxmann.com 129 (Bombay), the Bombay High Court held whilst passing a final order in petition alleging oppression and mismanagement CLB (now Tribunal) can, by exercising its powers under section 402 [now section 242] , remove auditor duly appointed by the Company.

Termination or modification of agreements - Section 243 aims to set aside any claim arising out of termination or modification of any agreement as a consequence of an order by the Tribunal under Section 242. Where any agreement is terminated or modified by an order under Section 242, no claim against the company for damages or compensation for loss of office or in any other respect is tenable by any person [clause (*a*) of Section 243(1)]. It may be noted that this clause applies to both – contracts with managing director, managers etc. and outside parties as well. Clause (*b*) puts a bar on the managing director or other director or manager whose agreement is so terminated for appointment or acting as the managing director or other director or manager of the company for a period of five years from the date of the order without the leave of the Tribunal.

The Tribunal cannot grant a leave as aforesaid unless a notice of intention to apply for leave has to be served on the Central Government and reasonable opportunity of being heard is given to it.

Section 243(2) prescribes punishment for contravention of clause (*b*). Accordingly any person who knowingly acts as a managing director or other director or manager of a company in contravention, and every other director of the company who is knowingly a party to such contravention, shall be punishable with imprisonment for a term which may extend to six months or with fine which may extend to rupees five lakh or with both.

22.3 Meaning of oppression

The expression "Oppression" has not been defined by the Companies Act, 2013. In general oppression means causing harm or injury by unjust exercise of power or discretionary authority, specially with unjust motives. In the context of a company it may mean depriving of one or more shareholders of their legitimate expectations or other unfair treatment by the controlling shareholder(s).[5a]

The meaning of the term "oppression" as explained by *Lord Cooper* in the *Scottish case* of *Elder* v. *Elder & Watson Ltd*[6]*.,* was cited with approval by *Wanchoo, J.* (afterwards CJ) of the *Supreme Court of India* in *Shanti Prasad Jain* v. *Kalinga Tubes.*[7] "The essence of the matter seems to be that the conduct complained of should, at the lowest, involve a visible departure from the standards of their dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to the company is entitled to rely." The complaining shareholder must be under a burden which is unjust or harsh or tyrannical.[8] 'Legitimate expectation' in the capacity of shareholder can also constitute a basis to construe act or acts as oppressive [*vide Elgindata Ltd.,* In re [1991] BCLC 959 Ch. D. and *Chatterjee Petrochemical (Mauritius) Co.* v. *Haldia Petrochemicals Ltd.* [2008] 143 Comp. Cas. 726.

However, an act to constitute oppression need not be illegal or violative of any statutory provision. Oppression is a phenomenon which one has to infer from facts and circumstances of the case by examining impact of the act on complaining members - *Vijay Kumar Narang* v. *Prakash Coach Builders (P.) Ltd.* [2012] 114 SCL 132 (Kar.).

The complaining member must show that he is suffering from oppression in his capacity as member and not in any other capacity. "Oppression involves at least an element of lack of probity or fair dealing to a member in the matter of his property right as a shareholder" - *Kalinga Tubes Ltd.* v. *Shanti Prasad Jain* [1964] 1 Comp. LJ 117. In *Lundi Bros. Ltd., Re* [1952] 2 All ER 692, a minority shareholder of a private company was removed from his position as a working director. As an ordinary shareholder he would have gained nothing as the company had never paid any dividend, director's remuneration being the only return on investment. Yet he could not complain of it because he had suffered as a director and not as a member. Thus, to constitute oppression, persons concerned with the management of the company's

5a. http://www.businessdictionary.com/definition/oppression.html#ixzz3YD9guIi8

6. 1952 SC 49 Scotland.

7. [1965] 1 Comp. LJ 193, 204; 204; AIR 1965 SC 1535/[1965] 1 SCA 556.

8. See Lord Simonds in *Scottish Co-operative Wholesale Society* v. *Meyer* [1959] AC 324 at 342; [1958] 3 All ER 66

affairs must in connection therewith be guilty of fraud, misfeasance or misconduct towards the members. It does not include mere domestic disputes between directors and members or lack of confidence between one section of members and another section in the matter of policy or administration. Much less it covers mere private animosity between members and directors."[9] This statement has been cited with approval in *Kalinga Tubes Ltd.* v. *Shanti Prasad Jain*[10], where *Misra, J.* of the *Orissa High Court* dismissed a petition under the section and his decision was affirmed by the *Supreme Court* in *Shanti Prasad Jain* v. *Kalinga Tubes Ltd.*[11]

In this case, a private company consisted of three groups of shareholders, *i.e.,* the petitioner and the two respondents holding shares in equal proportion and with equal representation on the Board. They had agreed in writing to maintain this equilibrium. But no such agreement was incorporated in the articles of the company. Subsequently, in order to obtain certain loan facilities, the company was converted into a public company and it was proposed to issue 39,000 more shares. Ordinarily, according to section 81 [now Section 62] such new shares should have been offered to the existing shareholders. But the majority of the shareholders consisting of the two respondents' groups passed a resolution to offer these shares to outsiders, which was accordingly done. The petitioner contended that the allottees were friends of the majority group and the allotment had been made purposely to them with the *mala fide* intention to increase their voting strength and to squeeze out the petitioner.

This, he contended, was oppression within the meaning of section 397 [now Section 241]. He relied upon an observation in *Piercy* v. *S. Mills & Co. Ltd.*[12], to the effect that "if shares were issued to the public with the immediate object of controlling the greater number of shares in the company and of obtaining the necessary statutory majority for passing a special resolution, then it will not be a valid and *bona fide* exercise of the powers". The question, therefore, was whether the resolution offering the shares to outsiders was passed in good faith for the benefit of the company or merely to capture an absolute majority and to squeeze out the petitioner.

Barman, J. held that this conduct of the majority amounted to an act of oppression of the minority. But, on appeal, his judgment was reversed. *Misra, J.* of the *Orissa High Court* who delivered the leading judgment, was of the opinion that "the private agreement between the parties to maintain the equilibrium was not binding on the company". "The fact that the affairs of the company were managed with holding of shares in equal proportion amongst the three groups for a period of four years by itself cannot create a right in favour of the petitioner that it must continue in the same manner even when the company becomes public. To compel the majority shareholders, in these circumstances, to offer the new shares only to the existing

9. *See Kalinga Tubes Ltd.* v. *Shanti Prasad Jain* [1964] 1 Comp. LJ 117, where this statement of law has been cited by Misra, J. of the Orissa High Court, at 146-147 from *Scottish Co-operative Wholesale Society* v. *Meyer* [1959] AC 324; [1958] 3 All ER 66 and *H.R. Harmer Ltd., Re* [1958] 3 All ER 689; [1959] 1 WLR 62.
10. [1964] 1 CLJ 117.
11. [1965] 1 CLJ 193.
12. [1920] 1 Ch. 7.

shareholders would, far from being an oppression of the minority, be to deprive the majority of a right conferred upon them by section 81 entitling them to direct free issue of shares. It would also not be compatible with dynamic concept of industrial expansion. *For instance,* the expansion scheme would require large capital in crores and any one of the groups may not be in a position to subscribe its proportionate shares as any one or both or residual groups can do. The balance is bound to be disturbed and equilibrium lost even if the affairs of the company would be conducted wholly *bona fide*."

Again, in *Needle Industries Ltd.* v. *Needle Industry Newey (India) Holding Ltd.* [1981] 3 SC 333, the Supreme Court did not uphold the allegation of oppression as valid. In this case, the articles of a private company contained a clause that when the directors decide to increase the capital of the company by the issue of new shares, the same should be offered to the shareholders proportionately and, if they failed to take, they may be offered to others in such manner as may be most beneficial to the company. The company was a wholly owned subsidiary of an English company. Government of India adopted a policy of diluting foreign holdings. The company accordingly issued new shares to its employees and relatives reducing the foreign holding to sixty per cent. When section 43A [no corresponding section under the Act] came into operation, the company became a deemed public company because more than 25 per cent of its share capital was held by a body corporate. The company, however, chose to remain a private company for all other purposes. The leader of the Indian 40 per cent holding was the chief executive and the managing director of the company. The company was further required to reduce its foreign holding to 40 per cent. At this stage the English and Indian blocks developed a difference. The English block wanted that the 20 per cent reduction of their holding should be allotted to one of the Indian companies in which they had substantial interest. A meeting of the company's Board of directors, on the contrary, adopted the policy of issuing new rights shares to the existing members, which the English company would not be able to subscribe and thereby its holding would be reduced to 40 per cent. Under the resolution 16 days' time had to be given to the members to take their proportion. The letter offering its proportion to the holding company was sent only 4 days before the last date and it received the letter after the date for exercising the option had already expired. *Similarly,* the notice of the meeting of directors for completing the allotment was sent to them with so short a gap of time that they received it in England only on the day on which the meeting was being held in India. Neither was it able to exercise the option of buying its block of rights shares nor was it able to attend the crucial meeting of the Board. Its block of shares was allotted to Indian shareholders.

The holding company complained of oppression on these facts. But the court was not convinced that there was any such thing as a continuous policy of oppression. The ultimate purpose of the scheme was Indianisation to the extent of 60 per cent. This could be achieved either by buying the excess holding of the English company or by increasing the Indian shareholding. The latter course was adopted in the interests of the company as it would make available to the company extra capital. The fact that proper notice was not given, no doubt, deprived the English company of its opportunity of participating in the rights issue. But the facts were such that even if proper notice was given, the English company could neither have subscribed

for its proportion nor renounced it to anyone else. There was no right in the company's articles in favour of any member enabling him to renounce his rights shares in favour of others. In the case of a private company there simply cannot be the right of renouncing rights shares in favour of nominees because that would make it impossible for the company to restrict the number of members. The real loss suffered by the holding company was the loss in terms of the market value of the shares which fell. The market value of the shares was much higher than their nominal value. The allotment was at nominal value. The loss of the holding company was the "unjust enrichment" of those whom the block of rights shares was allotted which, but for the policy restriction, belonged to that company. The Supreme Court accordingly held that the Indian allottees of those shares must compensate the holding company to the extent to which the market value was in excess of the nominal value.

Dealing with the argument that the illegal nature of the board meeting should itself be an indication of the repressive policy, Chandrachud, CJ., said :

> "The question sometimes arises as to whether an action in contravention of law is *per se* oppressive. It is said, as was done by one of us, Bhagwati, J. in a decision of the Gujarat High Court[13] that a resolution passed by the directors may be perfectly legal and yet oppressive, and conversely a resolution which is in contravention of the law may be in the interests of the shareholders and the company."

Lawful action taken by promoters who have overwhelming majority in equity shares and have nurtured the company to prevent the takeover of the company by outsiders, is not an act of oppression - *Hillcrest Realty Sdn. Bhd* v. *Hotel Queen Road (P.) Ltd., supra.*

22.3-1 Oppression may be past or continuing nature

Under Section 241(1)(*a*) any person having a right to apply to the Tribunal if the affairs of the company "have been" or "are being" conducted in a manner prejudicial to public interest or prejudicial or oppressive to him or any member or members of the company or prejudicial to the interest of the company. It may be noted that even the past affairs are also covered by this clause.[14] Relief may be granted by the Tribunal even against past acts of oppression.

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13. *Sheth Mohan Lal Ganpatram* v. *Sayaji Jubilee Cotton & Jute Mills Ltd.* [1964] 34 Comp. Cas. 777; AIR 1965 Guj. 96; [1964] 5 Guj. LR 804.

14. In the corresponding section 397 of the Companies Act, 1956, the words 'have been' was not used accordingly past acts were not covered and a petition was maintainable only in respect of the oppression of continuing nature. It was held in many cases that continuity of oppressive acts is a necessary condition to file a petition. The facts alleged must reveal an oppression of continuing nature. In *Col. Kuldip Singh Dhillon* v. *Paragaon Utility Financiers (P.) Ltd.* [1988] 64 Comp. Cas. 19 (Punj. & Har.), the Punjab and Haryana High Court observed that there must be continuous acts on the part of majority shareholders, continuing up to the date of the petition, showing that the affairs of the company were being conducted in a manner oppressive to some part of the members. In this case, the acts complained of related to 1978-79. Later, when one of the complainants was appointed as the managing director, they kept quiet and subsequently filed the petition in 1982. It was held that the petition was not maintainable as it could not be said that there were continuous acts of the majority shareholders which had been oppressive to the petitioners. Also *see Anil Kumar* v. *Vee Kay Oils (P.) Ltd.* [2007] 74 SCL 60 (CLB).

(Contd. on p. 782)

22.3-2 Applicability of principle of dissolution of partnership

In *Trackparts of India Ltd.* v. *K.N. Bhargava* [2001] 33 SCL 40, the Allahabad High Court held that when both parties (belonging to one family) were found to be guilty of acts of oppression against each other and were conducting themselves, with regard to affairs of the company in an irreconcilliable manner, the CLB (now Tribunal) is empowered to pass appropriate order in the interests of the company and of the shareholders even though the plea of oppression and mismanagement fails. In the instant case the CLB (now Tribunal) passed order for division of assets of the warring groups and it was upheld by the court as trappings of partnership in garb of public limited company were discernible. Originally the family owned a partnership business which was taken over by the company wherein 80% of the shares were with the brothers of the family. It was also held that petition under sections 397 and 398 [now Section 241] is not barred on the ground that the respondents had already taken recourse to alternative remedy of filing civil suit concerning certain matters of the company. A civil court is not a court of a coordinate jurisdiction and is not empowered to grant relief in the context of the

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(Contd. from p. 781)

Similarly, sale of land by a company few years back being the only transaction of that nature cannot be held as continuing oppression - *P. Radhakrishnan* v. *Madurai Hosieries Ltd.* [2012] 113 SCL 58.

However, in *Surinder Singh Bindra* v. *Hindusthan Fasteners Ltd.* AIR 1990 Delhi 32, it was held that past acts shall be relevant if they constitute continuing whole with the present facts or if the single past act complained of is capable of unleashing a continuing oppression. In *R. Khemka* v. *Deccan Enterprises (P.) Ltd.*, the A.P. High Court held that continuity of burdensome, harsh and wrongful conduct of one party against another is necessary to bring such conduct within the ambit of the word "oppression"—[1999] 19 SCL 290. However, the CLB in *Dipak G. Mehta* v. *Shree Anupar Chemicals (I.) (P.) Ltd. (supra)* has held that even though the acts of oppression are not continuous but are successive, yet the petition is maintainable on just and equitable ground. However, as held in *P. Ramkumar* v. *T.V. Chandran* [1994] 1 Comp. L.J. 469 (Ker.) the Court cannot take cognizance of events occurring after filing of the petition.

Based on the facts of a case even a single and isolated act can constitute oppression. In *PIK Securities (P.) Ltd.* v. *United Western Bank Ltd.* [2001] 33 SCL 671, the CLB took the facts of the case including the Chairman's abrupt closing of EOGM and withdrawal of an item from agenda, in arriving at the above general proposition. Also, the decision stated that a petition for oppression against a banking company is maintainable as section 433(*e*) of the Act [now Section 271] is applicable to banking companies also, notwithstanding section 38 of the Banking Companies (Regulation) Act.

The CLB in *Deepak C. Shriram* v. *General Sales Ltd.* [2001] 34 SCL 365, *inter alia,* has held that even a single act of oppression having permanent and continuous effect can be agitated under section 397 [now Section 241].

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible, shareholders should try to resolve their differences by mutual re-adjustment. Moreover, the Courts will not allow these special remedies to become a vexatious source of litigation. In *Lalita Rajya Lakshmi* v. *Indian Motor Co.14,* the petitioner alleged that the board of directors was guilty of certain acts detrimental to the minority shareholders. The allegations were mainly on improper management. It was held that even if each of these allegations were proved to the satisfaction of the Court, there would have been no oppression.

Some of these case laws may not be relevant in view of the language used in Section 241 of the Companies Act, 2013.

facts and circumstances of this case as the CLB (now Tribunal) is empowered. This aspect of the judgment may be construed as going against the principle of 'election'. It is presumed that the facts of the case and wider power of the CLB (now Tribunal) held the key for the apparent departure.

22.3-3 Acts held as oppressive

Looking to the various judicial pronouncements, the acts amounting to oppression may be summarised as under:

1. *Not calling a general meeting, and keeping shareholders in dark - Hindustan Co-operative Insurance Society Ltd., In re* [1961] 31 Comp. Cas. 193 (Cal.). In this case, the shareholders were left completely in the dark, because no annual general meeting was called, with no information regarding the manner in which the affairs of the company were being conducted, while those men who purported to act as directors dealt with the company's money in any fashion they liked and prejudicial to the interest of the company. It was held that these acts of the respondent who had the majority backing no doubt amounted to oppression by them of the minority shareholders and also, oppression in the conduct of the affairs of the company and these were to the detriment of both the company and its members.
2. *Non-maintenance of statutory records and not conducting affairs of the company in accordance with the Companies Act - Bhajirao G. Ghatke* v. *Bombay Docking Co. (P.) Ltd.* [1984] 56 Comp. Cas. 428 (Bom.).
3. *Depriving a member of the right to dividend - Mohan Lal Chandu Mal* v. *Punjab Company Ltd.* [1962] 32 Comp. Cas. 937 (Punj.) - The Court in this case held that if the non-voting members were being dominated and had to submit to excessive use of authority, such a conduct amounted to unjust hardship. "To take away the right of partaking of dividends earned by their contribution is not merely oppressive but even confiscatory". Therefore, such a case calls for an interference by the CLB under section 397 [now Tribunal under section 241].
4. *Transfer of shares held by a company to some shareholders otherwise than by making an offer to all* - In *Col. Kuldip Singh Dhillon* v. *Paragaon Utility Financiers (P.) Ltd.* [1986] 60 Comp. Cas. 1075 (Punj. & Har.) at a board meeting, the shares held by the company were transferred to some of the directors although it had earlier been resolved that they would be offered to all the shareholders. It was held that before deciding to whom the shares should be sold, an offer of sale should have been made to all the shareholders; shares should have been transferred to one who made the highest offer.
5. *Allotment of shares by directors in a manner by which an existing majority of shareholders is reduced to a minority - Gluco Series (P.) Ltd., In re* [1987] 61 Comp. Cas. 227 (Cal.), *Anand Kumar Saigal* v. *Manu Properties (P.) Ltd.* [2001] 32 SCL 367 (CLB); *State Bank of India* v. *Business Development Consultants (P.) Ltd.* [2005] 61 SCL 226 (CLB). This case also held that while no notice of trust can be entered in the register of members, yet name of the trustee can always be entered - *S. Varadarajan* v. *Udhayem, Leasing & Investments (P.) Ltd.* [2005] 62 SCL 315. In this case other issues were also

present and all were held as oppressive. Also *see Priyanka Overseas (P.) Ltd.* v. *Pasupati Fabrics Ltd.* [2006] 71 SCL 239 (CLB). In this case it was further held that a petition under section 397 [now section 241] is maintainable even though the company is a sick company so long as the complaint does not relate to the scheme before the BIFR and annual accounts 'not being ready' cannot be a ground for non-holding of AGM [2007] 79 SCL 259 (CLB). In *Smt. Abha Puri* v. *Amethi Hume Pipes (P) Ltd.* [2009] 95 SCL 263 (CLB), rendering a majority holding by manipulated issue of further shares, removal of petitioner as director etc. was held as act of oppression. Mere signing of balance sheet by or doubtful signature of petitioner reflecting above changes, does not appear to be grounds to dismiss the petition in the context of circumstances surrounding the case.

Majority was turned into minority by management group by allotting shares to its own people without calling meeting or offering corresponding shares to promoters group or other shareholders was held as act of oppression - *Capricorn Oil Ltd.* v. *Ratan Mohan Sarda* [2012] 113 SCL 395 (Cal.). In *Sanjivbhai Kiritbhai Patel* v. *Biocare Remedies (P.) Ltd.* [2017] 78 taxmann.com 208 (NCLT - Ahd.), the respondent company allotted shares without offering them to the petitioners. As a result the petitioners came to minority. The Ahmedabad Bench of NCLT held that this amounted to an act of oppression under section 241/242 of the Act.

6. *Continuous refusal by company to register shares with an ulterior motive of retaining control over affairs of the company - Kumar Exporters (P.) Ltd.* v. *Naini Oxygen and Acetylene Gas Ltd.* [1986] 60 Comp. Cas. 984 (All.). Though refusal once by the company may not be oppressive, but a continuous refusal by the company to register the shares with an ulterior motive of retaining the control over the affairs of the company may be a case where the CLB (now Tribunal) is obliged to interfere and grant relief under section 397 [now Section 241]. Refusal to register transfer of shares held by a company, on its merger with another company, in favour of that other company without sufficient cause is oppression - *'e' First Technologies (P.) Ltd.* v. *Hyperworld Cybertech Ltd.* [2005] 60 SCL 9 (CLB).

7. *Failure to distribute the amount of compensation received on nationalisation of business of company among members, where required to be so distributed - Hindusthan Co-operative Insurance Society Ltd., In re* [1961] 31 Comp. Cas. 193 (Cal.). In this case, the insurance business of the company was nationalised in 1956 and a compensation of Rupees thirty-five lakhs was received by it. The directors did not call any annual general meeting thereafter. In January 1959, the Board resolved to call a general meeting and pass a resolution to continue the company and carry on other businesses authorised by the Memorandum with the compensation money received by the company. Section 39 of the Life Insurance Corporation Act envisaged distribution of compensation to shareholders and dissolution of the company. The question was whether the conduct of directors was oppressive. *Held* that, the resolution and the persistent conduct of the respondent in the affairs of the company since 19-1-1956 clearly would be that they never intended to distribute the compensation money amongst the shareholders, who were

entitled thereto, but to hold it in their hands and at their disposal and benefit by the strength of their majority or controlling voting power. This conduct of the respondent was no doubt oppressive to the company and to the applicant's minority shareholding in the company.

8. *Countermanding decisions of Board by a director who controls majority voting power, and not allowing Board to perform its functions - H.R. Harmer Ltd., In re* [1959] 29 Comp. Cas. 305 (CA).

9. *Where directors of a private company pass a resolution in which they are interested without disclosing nature of their interest - Col. Kuldip Singh Dhillon* v. *Paragaon Utility Financiers (P.) Ltd.* (*supra*).

10. *If a sale of its assets is made by a company to some of its directors and simultaneously loan is made to purchasers to finance this sale - Col. Kuldip Singh Dhillon* v. *Paragaon Utility Financiers (P.) Ltd.* (*supra*). The company whose own financial position was not sound, sold some of its assets to some of its directors and the purchasers adjusted the purchase price partly against the amount due to them from the company, and partly against a loan made to them by the company, it was held that the latter part of the transaction was oppressive to other shareholders.

11. *Refusal to register transmission under will - Gajarabai Patny* v. *Patny Transport (P.) Ltd.* [1966] 36 Comp. Cas. 745 (AP). Refusal to register shares bequeathed under the will while registering other shares bequeathed under the same will may be construed as oppression since it involves violation of the conditions of fair play.

12. *Issue of further shares benefiting a section of the shareholders* - Issue of further shares may form the subject-matter of a petition under this section if it can be proved that the idea of issuing further shares was to benefit one group to the detriment of the other - *Piercy* v. *Mill(s) & Co.* [1920] 1 Ch. 77; also see *Mrs. Rashmi Seth* v. *Chemon (India) (P.) Ltd.* [1992] 9 CLA 83 (CLB). It is a general principle to be observed by the directors that further issue of shares must be made for the benefit of the company and it does not matter if in the process the directors themselves also benefit[15]. What is considered objectionable is the use of their fiduciary powers mainly for an extraneous purpose like maintenance or acquisition of control over the affairs of the company - *Needle Industries'* case *(supra)* and *R.N. Jalan* v. *Deccan Enterprises (P.) Ltd.* [1992] 75 Comp. Cas. 417 (AP). It is not open to the directors to issue and allot shares in a manner by which an existing majority of shareholders is reduced to a minority[16]. The court must be satisfied beyond

15. Also *see Hanuman Prasad Bagri* v. *Bagrees Cereals (P.) Ltd.* [2007] 73 SCL 57 (Cal.).

16. Also *see Mrs. Sentha Marai Munusamy* v. *Micro Particle Engineers (P.) Ltd.* [2000] 28 SCL 108 and *Martin Castelino* v. *Alpha Omega Ship Management (P.) Ltd.* [2001] 33 SCL 210 (CLB). In *Satish Chandra Sanwalka* v. *Tinplate Dealers' Association (P.) Ltd.* [2001] 32 SCL 338, the CLB held that denying membership rights to allottees of forfeited shares on the ground that calls remained to be paid by the original allottee, a fact not made known through the re-issue document, is an act of oppression. When shares are issued with sole object of creating new majority or to convert a majority into minority, the action of the board in not only a severe breach of fiduciary duty but also a grave act of oppression - *Mrs. Uma Pathak* v. *Eurasian Choice International (P.) Ltd.* [2004] 54 SCL 60 (CLB).

reasonable doubt that such issue was unavoidable and was resorted to as an emergency measure with the object of saving the existence of the company. If the issue of shares disturbs the existing majority of the shareholders and if it is not *bona fide,* it will amount to an oppression and mismanagement and the court will grant relief - *Gluco Series (P.) Ltd., In re* (*supra*). The court will interfere if it can be shown that the issue of further shares was made only for the benefit of the directors of the company. However, the directors cannot be charged with breach of trust or can be said to have acted *mala fide* merely because in promoting the interests of the company they have also promoted their own interest. If the directors are also shareholders of the company, they are likely to benefit from any further issue of shares - *Needle Industries (India) Ltd.'s* case (*supra*), *Nanalal Zaver* v. *Bombay Life Assurance Co. Ltd.* [1950] 20 Comp. Cas. 179 (SC) and *Gluco Series (P.) Ltd.'s* case (*supra*). Also *see Girdhar Gopal Gupta* v. *Aar Gee Board Mills (P) Ltd.* [2004] 53 SCL 221 (CLB).

13. *Registration of transfers in violation of articles* - Where the company registered transfers without fulfilling the requirement of the articles relating to transfer of shares which resulted in weakening the minority and strengthening the local group functioning in league with the nominees of a foreign group, it was held that there was oppression - *Bhubaneshwar Singh* v. *Kanthal India Ltd.* [1986] 59 Comp. Cas. 46 (Cal.). Also see *T.A.M. Athavan* v. *Sun Freight Systems (P.) Ltd.* for effecting transfer of shares without approval of Board meeting or extraordinary general meeting [2005] 57 SCL 111 (CLB). In this case lots of other irregularities were committed taking advantage of immobilisation of the petitioner arising out of an accident. His wife, with whom he did not have a happy relation, was inducted in the Board to usurp control and management of the company. Attempt was made to get a legal declaration that the petitioner, who was irregularly removed from directorship, was a person with unsound mind.

14. *Diversion of business opportunity* - The diversion of a business opportunity from one company to another company controlled by a director of the former and who was a majority shareholder of that company was held to be oppressive because it deprived the minority twenty-five per cent of the profits which was attributable to that opportunity - *London School of Electronics Ltd., In re* [1985] BCLC 273.[17] Incorporating separate companies by directors with an intention to sabotage image and goodwill of the company and diverting business of the company to these newly established entities amounted to oppression and mismanagement. [*S. Radhakrishnan* v. *Hyderabad Pollution Controls Ltd.* [2017] 88 taxmann.com 200 (NCLT - Hyd.)].

15. Sale of major part of land belonging to the company without informing the petitioner director with substantial shareholding was held to be oppressive.

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17. The Bombay High Court in *Vaishnav Shorilal Puri* v. *Kishor Kundan Sippy* [2006] 69 SCL, however, has held that when an independent third party had terminated its contract with the company on just reasons and entered into contract with a company promoted by a group of directors of the first company, this diversion is neither oppression nor mismanagement.

[*Gangadhar Madupu* v. *Katta Corp. (P.) Ltd.* [2018] 90 taxmann.com 73 (NCLT - Hyd.)].

16. Issue of shares by book entry only, director removed in EGM for which he received no notice, shares allotted by defending director to himself without Board meeting, a family partition deed executed after the alleged acts of oppression and even then not brought before the Board or the EGM. [*Ganapathy Mudaliar* v. *S.G. Pandurangan* [1999] 19 SCL 13, CLB Chennai].

17. Irregularities in allotment and transfer of shares, siphoning off funds of the company to other companies for unknown/unwanted purposes, irregular removal of petitioner from the Board, deflection in stock maintained by the company, petitioner having been projected as an expert in the line of business of the company in the prospectus and on the strength of a general body resolution keeping such expert out of the due posts in the company - *KRS Mani* v. *Anugraha Jewellers Ltd.* [1999] 19 SCL 145.

18. In a family centred company even though it is a public company, or a company in guise of partnership, wherein participation of family members or partners is provided in articles of association or established to have been agreed to by members/partners, removal of a member/a partner from management can be considered to be an act of oppression inspite of the fact that the same is a directorial complaint, which as such cannot be entertained for relief under sections 397 and 398 [now Section 241] - *Vinod Kr. Mittal* v. *Kaveri Lime Industries Ltd.* [2000] 23 SCL 176 (CLB). In a different case *Rajendra Kr. Malhotra* v. *Harbans Lal Malhotra & Sons Ltd.* [2000] 23 SCL 207 (Cal.), the rights of two segments of the founding family of a family centred public company to transfer their shares to a third party on the backdrop of objection by the other segment of the family was considered. Since in this case CLB (now Tribunal) passed orders without finding facts and rejected un-controverted statements of the opposing segment, the High Court held that the construction of CLB's order leads to question of law and referable under section 10F [now section 465]. The High Court ordered CLB [now Tribunal] to look afresh in the case.

19. The managing director-*cum*-chairman for life of a closely held company was removed from the position of managing director by invoking section 274(*1*)(*b*) [now Section 164] claiming that he was an undischarged insolvent. In the EGM another person was appointed as the managing director and two non-family members were also inducted into the Board. As the insolvency petition filed was dismissed by the High Court, the removal of the original managing director stood ineffective and the disturbance in the Board caused by induction of two more directors amounted to oppression in the context of a family company - *S. James Fredrick* v. *Mrs. Minnse R. Fredrick* [2000] 24 SCL 183 (CLB).

20. In a family centred company and Board consisting of family members, when Board meeting is held in an irregular manner and decisions of far reaching significance taken without the presence of all the directors and specially the managing director, the acts of such decision taking constitute grave oppression. The appointment of five non-family members as additional directors

was considered to be an act to upset the family control over the company at the cost of good faith, fair play and the interests of the family members and of the company - *Prabhu Dayal Chitlangia* v. *Trinity Combine Associates (P.) Ltd.* [2000] 23 SCL 132 (CLB). In *T.V. Prasadachandran Nair* v. *Anandamandiram Hotels (P.) Ltd.,* CLB [now Tribunal] held exercise of casting vote by the M.D. of the family centred company having only two directors and taking decisions on the strength of casting vote to induct new directors to upset the balance in management and eventually removing the petitioner from directorship amount to oppression [2000] 23 SCL 143.

21. With a view to seeing that the NRI petitioner does not attend the Board meeting of the company of which he was the chief promoter, notices of such meetings, contrary to the provisions of the Articles, were sent to his Indian address and systematically his majority shareholding was reduced to minority - *Held,* it is a case of oppression. Also shares issued by the company (respondent) behind the back of the petitioner were deprived of voting rights till disputes pending before the High Court were decided - *Dr. Kamal K. Dutta* v. *Ruby General Hospital Ltd.* [2000] 23 SCL 91.

22. A company incorporated long back as an association not for profit sought to amend its articles to provide that any Christian church or other Christian body in India or abroad shall be entitled to nominate one member to the association on paying a sum of rupees 20,000 per annum and that too for two years was held as discriminatory as other members were not subject to such conditions and hence oppressive against the background that since 1887 all such bodies could nominate members and were not subject to these conditions. The order in this case maintained *status quo ante* - *Church of South India* v. *Madras Christian College Association* [2001] 31 SCL 70.

23. In a petition under section 397/398 [now Section 241] only rights as shareholders can be agitated and no private agreement can be considered. Even where power to issue further shares is vested in the Board and when such power is not used for the benefit of the company but to create a new majority or to reduce majority into minority, it amounts to operation - Also, in the context of the petitioner holding a substantial stake, when its nominee is removed from the Board, it may amount to oppression—*B.N. Jain & Sons Co. (P.) Ltd.* v. *Bombay Cable Car Co. (P.) Ltd.* [2001] 30 SCL 140 (CLB).

24. Lack of equity in allotment of further shares or not making even an offer to a shareholder—*Dale and Carrington Investments (P.) Ltd.* v. *P.K. Prathapan* [2001] 32 SCL 323 (CLB). Also *see Deepak C. Shriram* v. *General Sales Ltd.* [2001] 34 SCL 365; *V. Ramesh Kumar* v. *Shanthini Jay Krishnan* [2007] 79 SCL 520 (CLB).

25. Sending notices to a shareholder to a place where he did not reside - *Shivnath Rai Bajaj* v. *NAFABS India (P.) Ltd.* [2002] 35 SCL 448 (CLB). This case also held that an NRI shareholder has the *locus standi* to file the petition against oppression.

26. Irregular appointment of director on the strength of irregular allotment of shares is an act of oppression - *Radhe Shyam Tulsian* v. *Panchmukhi*

Investments Ltd. [2002] 35 SCL 849 (CLB). Also see *Micromerities Engineers (P.) Ltd.* v. *S. Munusamy* [2005] 58 SCL 301 (Mad.)

27. Allotment of shares behind the back of the appellant to turn minority into majority is an act of oppression[18]. The issue of technical irregularity of allotment of shares to the appellant cannot be raised after 10 years when the respondent himself induced the petitioner to invest in the company knowing fully that the petitioner was an NRI - *P.K. Prathapan* v. *Dale & Carrington Investment (P.) Ltd.* [2002] 38 SCL 827 (Ker.). Also *see Goldmark Enterprise Ltd.* v. *Pondy Metal & Rolling Mills (P.) Ltd.* [2007] 74 SCL 259 (CLB).

28. Where it is difficult to appreciate appointment of directors, holding of Board meetings and transfer of shares by respondents as no conclusive evidence could be produced, the petition filed u/s 397/398 [now Section 241] has to be allowed. The CLB [now Tribunal] ordered one of the respondents to sell his shares to the petitioner at par to relieve the company from continuous disputes—*Jagdeep Rajain* v. *Goodwill Plastchem (P.) Ltd.* [2004] 53 SCL 244.

29. If the nominee of the strategic partner appointed as the managing director under an agreement is put under restriction to act in that capacity by passing a circular resolution, the act of restriction is a grave act of oppression and the concerned circular resolution is illegal and void-*AES OPGC Holding (Mauritius)* v. *Orissa Power Generation Corpn. Ltd.* [2004] 54 SCL 1 (CLB).

30. Non-issue of share certificate after receipt of application money and allotment by the Board is an act of oppression - *Dhananjay Pande* v. *Dr. Basis Surgical & Medical Institute (P.) Ltd.* [2005] 60 SCL 348 (CLB).

31. The personal guarantees given by erstwhile promoters for loans take by the company have to be replaced by new guarantees for releasing the original guarantors, when they either cease to be in the management of the company or when their stakes in the company get substantially reduced. The refusal by the company is an act of oppression - *N.K. Dhir* v. *GIVO Ltd.* [2006] 66 SCL 388 (CLB).

32. The CLB in *A. Arumugam* v. *Pioneer Bakeries (P.) Ltd.* [2007] 80 SCL 190 has held (*i*) transfer of shares disturbing parity of shareholding between contesting parties; (*ii*) respondent garnering controlling interest through (*i*); (*iii*) appointment of respondent group's members as directors with a view to control the board; and (*iv*) ouster of the managing director in a board meeting, where no notice of the meeting was served on the person ousted, constitute oppression.

33. Forfeiture of shares by amending the Articles of Association to effect forfeiture of shares of minority shareholders for cessation of business and non-payment of business dues is an act of oppression. These do not relate to the minority shareholders *qua* shareholding - *Tapas Sinha Roy* v. *Linkmen Services (P.) Ltd.* [2007] 78 SCL 75 (CLB).

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18. The Supreme Court, on appeal, has upheld the findings of the CLB (now Tribunal) and the High Court that the allotment to further shares was with an ulterior motive but modified the relief granted by CLB [now Tribunal] by ordering cancellation of the allotment - [2004] 54 SCL 601.

34. In a situation of quasi partnership, where members held equal shares and took part in the management, breach of a decision collectively taken is an act of oppression - *Badrinath Galhotra* v. *Aanam (P) Ltd.* [2007] 76 SCL 241 (CLB).

35. When a company is incorporated with restriction as to type of persons who may be its members, provisions can also be introduced in articles by amendment that confine members of a class of persons having common business. Therefore, confining members to cable operators *in business* by amendment of articles is not illegal. Also, when the only business of the company is to provide service to its members and some members failed to pay for services, company's articles might permit to expel such members and forfeit the concerned shares. Therefore, amendments of the articles to provide for the above situations do not constitute oppression - *Linkmen Services (P.) Ltd.* v. *Tapas Sinha* [2008] 83 SCL 143 (Cal).

36. When, in terms of will of a deceased person, his shares in a company are passed on to a trust and a bank was appointed as the trustee of the trust, refusal by the company to rectify the register of members to substitute the name of the bank in place of the deceased and surreptitiously raising the share capital of the company to decrease the shareholding of the deceased, amount to oppression as *mala fide* intention was evident from the actions of the company - *Business Development Consultants (P.) Ltd.* v. *State Bank of India* [2008] 88 SCL 188 (Cal.).

37. While no grievance, which does not relate to the affairs of the company can be entertained under section 397 [now Section 241], acts of irregular removal of a director *cum* shareholder and wrongful transfer of shares recorded in the Board meeting do constitute oppression. Having regard to irreconcilable position between the parties, CLB [now Tribunal] allowed either party to purchase the shares of the other - *B.V. Reddy* v. *Legend Technologies (India) (P.) Ltd.* [2009] 80 SCL 73 (CLB).

38. *Illegal appointment and removal of directors, allotment of shares and manipulation of accounts, amounts to oppression and mismanagement in affairs of company.* In *Smt. Hema Singh* v. *ANC Construction (P.) Ltd.* [2013] 32 taxmann.com 81 (CLB - New Delhi), the petitioner-promoter director alleged oppression and mismanagement in affairs of company on grounds of illegal appointment of additional directors, illegal allotment of shares to certain directors of respondent group, illegal removal of petitioner as director, non-recovery of amounts from sister concern of respondent director, manipulation of accounts, misappropriation of funds and refusal to allow inspection of statutory records to petitioner. *CLB [now Tribunal] held that* since respondents failed to meet contentions of petitioner, they were guilty of oppression and mismanagement in affairs of company.

39. Illegal and *ultra virus* action by the Board controlled by CMD and his group constituting majority is an act of as a consequence of mismanagement - *Birla Education Trust* v. *Birla Corpn. Ltd.* [2012] 114 SCL 31 (CLB).

40. *Voting by interested director on a resolution* - In *Ashish Deora* v. *Pan India Motors (P.) Ltd.* [2014] 44 taxmann.com 336 (CLB - Mumbai), the CLB, Mumbai [now Tribunal] granted *ad interim* reliefs to stay allotment of

shares. The petitioner alleged in its petition that allotment of shares by the respondent company to another company (Cross Links) was in violation of Section 299 (now section 184) as two of its directors were also directors of Cross Links and therefore were interested directors not eligible to vote on the allotment of shares to Cross Links. It was held that the board meeting was not held by following due process of law.

41. *At attempt by the persons managing company to sell immovable property of company at under price* for their personal gain was held to be oppressive and prejudicial conduct detrimental to interest of all stakeholders in *Pravin N. Nahar* v. *Nahar Textiles (P.) Ltd.* [2014] 46 taxmann.com 86 (CLB - Mumbai). On a petition alleging oppression and mismanagement it was held that under section 402(*e*) (now Section 242(2)(*f*)) CLB (now Tribunal) is empowered to terminate, set aside or modify an unlawful agreement to bring an end to oppressive or prejudicial conduct.

42. *Sale of property to a relating entity at throw away price* - A petition was permitted by CLB for the alleged acts of oppression in *Smt. Bina Chawda* v. *Rezcom Realty (P.) Ltd.* [2014] 43 taxmann.com 153 (CLB - Mumbai). The petitioner, a director, was holding 30% shares in the respondent company. The other directors (respondents 2 to 10) allotted additional shares at the back of the petitioner and also sold office premises of the company to their own entity at a throw away price without even inviting the intended buyer for negotiation as suggested by the petitioner. On the basis of facts it was held that a case of oppression and mismanagement was made out.

43. *Non allotment of shares as per promoters' agreement* – In *Sajal Dutta* v. *Ruby General Hospital Ltd.* [2015] 56 taxmann.com 93 (CLB - New Delhi), a petition was filed under section 241 read with sections 242 and 62 of the Companies Act, 2013/Sections 397, 398 and 81 of the Companies Act, 1956. Respondent-1 Company had come into existence to set up a hospital. K, his brother S and B promoted the R-1. K was permanent US resident practicing as medical doctor. The shareholding of NRIs was to be 88.88 per cent and Resident Indian Shareholding would be 11.12 per cent, out of 88.88 per cent, 44.44 per cent would be allotted for medical equipment that came from NRIs. K supplied medical equipment to company and hospital started with that equipment and admittedly made profits thereafter. When K applied for allotment of shares against value of medical equipment supplied, the same was challenged by S on ground that impugned allotment had been made against obsolete, dysfunctional and over-invoiced equipment. It was held that equipment had come into company for all practical purposes as capital and it did its job as capital. S, the petitioner was privy to all decisions taken by Board and company in sending application to RBI for approval for allotment of shares to K in consideration to medical equipment. Therefore the allotment of shares to K was perfectly valid. The petition by S was only to somehow oust majority of K and to see that equipment supplied by K was not converted into allotment of shares, it amounted to oppression against K and not against S.

44. Removal of the petitioner from the directorship appointment of another director and further increase in the share capital without giving any notice

to the petitioner who was a 50 per cent shareholder was held to be an act of oppression. *[K.P. Bopanna* v. *Vector NDT Technologies (P.) Ltd., Bangalore* [2017] 85 taxmann.com 290 (NCLT - Bang.)]

45. Sale of the land of company to an outsider and transfer of his entire shareholding to an outsider by a majority shareholder without holding an EOGM or AGM were held to be oppressive in nature and thus impugned transfer of shares as well as land was set aside. [*Dr. M.A.S. Subramanian* v. *T.S. Sivakumar* [2018] 97 taxmann.com 17 (NCL-AT)]

22.3-4 Acts held as not oppressive

The following acts have been held as not oppressive :

1. *An unwise, inefficient or careless conduct of a director* - *Needle Industries (India) Ltd.* v. *Needle Industries Newey (India) Holding Ltd.* [1981] 51 Comp. Cas. 743 (SC) - The Supreme Court in this case ruled that on a true construction of section 397 [now Section 241], an unwise, inefficient or careless conduct of a director in the performance of his duties cannot give rise to a claim for relief under that section. The person complaining of oppression must show that he has been constrained to submit to a conduct which lacks in probity, conduct which is unfair to him and which causes prejudice to him in the exercise of his legal and proprietary rights as a shareholder.
2. *Non-holding of the meeting of the directors* - It may affect the rights of the petitioner as a director but his rights as a minority shareholder would not be affected - *Chander Krishan Gupta* v. *Pannalal Girdhari Lal (P.) Ltd.* [1984] 55 Comp. Cas. 702 (Delhi).
3. *Not declaring dividends when company is making losses* - *Chander Krishan Gupta* v. *Pannalal Girdhari Lal (P.) Ltd.* (*supra*) - Delhi High Court in this case observed that if the company makes profit and the management for ulterior reasons and motives, primarily with a view to deprive the shareholders of any share of the profits, does not declare dividend, then it may possibly be argued that non-declaration of dividend may amount to an act of oppression. But where the company has been making losses, the question of the company declaring dividends cannot arise.

   If the company continues to run in losses and its substratum is wiped off, it may be a good ground for winding-up the company but the non-declaration of dividend, under such circumstances, when the company is not making profit, cannot be a ground for invoking section 397 [now Section 241] .

   Likewise in *Maharani Lalita Rajya Lakshmi* v. *Indian Motor Company (Hazaribagh) Ltd.* [1962] 32 Comp. Cas. 207 (Cal.), the *Calcutta High Court* held that non-utilisation of entire profit for declaring dividend is not an oppressive act. The Court observed that the Board of directors has a discretion to declare a dividend and in recommending the rate of such dividend. There is no law which obliges the Board of directors to use up all its profits by declaring dividends. Failure to do so could not be a ground for an application for oppression. Besides, that will also not be a ground for winding-up of a company. Also *see Dr. Percy Rutton Kavasmaneck* v. *Ghardia*

Chemicals Ltd. (*supra*). In this case, among a number of allegations, payment of low dividend was pressed as an act of oppression and the court did not accept the same.

4. *Mere filing of a suit for recovery of money from an ex-director - Chenna Basappa Kothambari* v. *Multi Plast Industries (Karnataka) (P.) Ltd.* [1985] 57 Comp. Cas. 541 (Kar.) - In this case 'M' was a private limited company in which twenty-five per cent shares were held by the petitioner, 'C', and the remaining shares were held by another group and their friends. After the petitioner gave up his directorship in the company, a suit was filed for recovery of rupees eighty thousand from him. The petitioner filed a petition contending that there was oppression and it was just and equitable to wind up the company.

   Held that mere filing of a suit against him could not be said to be any oppression to him.

5. *Denial of inspection of books to a shareholder - Maharani Lalita Rajya Lakshmi* v. *Indian Motor Company (Hazaribagh) Ltd.* (*supra*).

6. *Lack of details in notice of a meeting - Maharani Lalita Rajya Lakshmi's* case (*supra*) - In case notice of a meeting is not accompanied by an 'explanatory statement', where necessary under section 173(2) [now Section 102], it cannot *ipso facto* be considered as an act of oppression in conducting the affairs of the company.

7. *Non-maintenance of records - Chander Krishan Gupta* v. *Pannalal Girdhari Lal (P.) Ltd.* (*supra*) - Delhi High Court, in this case, observed as follows :

   > "The non-maintenance of records cannot amount to acts of oppression being committed on the minority shareholders. If proper records of the company are not maintained, it may mean that the management is not working properly. The wrongful act, if committed, of not maintaining the statutory records at the registered office may attract evil consequences to the directors of the company and may also, in certain circumstances, amount to an act of mismanagement but under no circumstances can it be regarded as an act of oppression."

   Similarly, merely because an expenditure may have been *booked in the wrong year* in the books of account of the company would not amount to an act of oppression. It would not amount to manipulation of accounts which can lead one to the conclusion that there has been an act of oppression on the part of the management against the minority shareholders.

   Nor would *manipulation in the filing of balance sheet with the Registrar* without the signatures of the auditors by itself amount to an act of oppression on the minority shareholders. It may, however, show misconduct in managing the affairs of the company. If this act causes prejudice to the company's interest, it may justify action being taken under section 398 [now Section 241]

8. *Drawing of remuneration by a director to which he is not legally entitled* - If a director of a company draws remuneration to which he was not legally entitled or in excess of the remuneration to which he was legally entitled, this might no doubt cause misfeasance proceedings or proceedings for some

other kind of relief, but it would not by itself amount to oppression. Nor would the fact that the director was a majority shareholder in the company make any difference, unless he had used his majority voting powers to procure or retain or to stifle proceedings by the company or other shareholders in relation to it - *Jermyn Street Turkish Baths Ltd., In re* [1971] 41 Comp. Cas. 999 (CA).

9. *Negligence and inefficiency in managing the affairs of a company* - Minor acts of mismanagement, *e.g.*, where passengers travelling without ticket on a company's buses were not checked or where the petrol consumption by a transport company was excessive, the Calcutta High Court refused to grant relief under section 397 [now Section 241]. Negligence and inefficiency, even assuming that these are proved, do not amount to oppression or mismanagement as contemplated by the Act - *Mohta Bros.* v. *Calcutta Landing and Shipping Co. Ltd.* [1970] 40 Comp. Cas. 119 (Cal.).

10. *Where a resolution is passed by the members in a general meeting suspending operation of section 81 (now section 62) (Rights issue) - Shanti Prasad Jain* v. *Kalinga Tubes Ltd.* [1965] 35 Comp. Cas. 35 (*supra*).

11. *Increasing the voting rights of the shares held by the management* - Where there is nothing against the present management and where it can be said that it would be beneficial to maintain the present management, any attempt to increase the voting rights of the shares held by the present management cannot be construed as an act of oppression - *Rights & Issues Investment Trust Ltd.* v. *Style Shoes Ltd.* [1964] 3 All ER 628.

12. If, as on the date of petition, the person(s) complaining of oppression and mismanagement is (are) not member(s), due to prior cancellation of FCD's to comply with SEBI's Takeover Regulations, he (they) does not fulfil the conditions laid down in section 399 [now Section 244] and hence no case of oppression can be taken cognizance of. Further, the cancellation of FCDs to conform to law is not an act of oppression [*Turner Morrison Ltd.* v. *Jenson & Nicholson (India) Ltd.* [1998] 16 SCL 619 (CLB)].

13. When a share sale agreement was executed by an NRI and the scrips and transfer deed were handed over to an escrow agent as such sale was subject to RBI permission and full consideration money was received, then such a person after lapse of about 5 years, cannot raise an issue of oppression in the capacity of a member as the transfer remained in abeyance awaiting RBI permission. On fact, the sale of shares was unconditional and unrestricted and there was no clause to render the sale agreement infructuous after lapse of any stipulated time. Also, during the long intervening period neither the NRI exercised any right as shareholder nor the company treated him as a member. [*Rajiv Mehta* v. *Group 4 Securities Hindustan (P.) Ltd.*, CLB, Principal Bench, N. Delhi [1998] 18 SCL 89], *Mrs. Jameela Beevi* v. *Narmada Building Enterprises (P.) Ltd.* [2004] 50 SCL 610 (CLB).

14. As a result of a *bona fide* sale of shares of majority group, the EGM held at the instance of such majority Group, authorised the Board of directors to appoint nominees of the proposed acquirer in the Board, it was held that as on the date of the petition no such appointment was made and accordingly

allegation of violation of section 263 [now Section 162] was premature. It was also held that in the context of facts of the case the word "nominees" would mean "Proposed persons". In the absence of any preemptive clause in the articles of the company in favour of other shareholders, the sale of majority shares to the acquirer cannot be considered as oppressive, especially when the sale was for a *bona fide* need. The Bench observed that while *there is no bar to a winding up proceeding in a financially sound company as a result of deadlock in the management,* in the instant case, there existed no deadlock in the management; also SEBI's Takeover Regulations was not infringed as the seller of the shares made a public announcement inviting bids before the EGM. [*Krishna Paul* v. *Calcutta Chemical Co. Ltd.* [1999] 19 SCL 339 (CLB)].

15. Where petitioners and respondents being directors have filed various suits against each other involving financial irregularities and clandestinely selling title deed of a plot of land, the petition under section 397/398 [now Section 241] cannot be admitted and best course for them was to mutually settle the disputes. So long rights and privileges of members are not infringed, case of oppression or mismanagement cannot be said to be made out - *B.S. Choudhary* v. *Mrs. Indra Singh* [2000] 23 SCL 251 (CLB).

16. Petition made under sections 397 and 398 [now Section 241] having underlying oblique motive is to be dismissed. Also, in the absence of appropriate evidence, the charge that transmission of shares allowed by the Board of the company is a matter of oppression and mismanagement is not sustainable when the transmission was effected in accordance with the provision of the Articles of Association - *Ramesh Bhajanlal Thakur* v. *Sea Side Hotel (P.) Ltd.* [2000] 23 SCL 164 (CLB).

17. Allegations already looked into by the Court cannot be raised in a petition to CLB (now Tribunal). When newly constituted Board of directors taking into consideration the needs of the company decided to issue right shares, the same cannot be held to be motivated to create a new majority specially when the petitioner did not subscribe to the rights offered, on the plea that the rights issue is unnecessary—*Hari Kumar Rajah* v. *Sovereign Dairy Industries Ltd.* [2001] 31 SCL 112 (CLB).

18. By prejudicial conduct against the company's interest and also on grounds of waiver, estoppel and acquiescence, the petitioner had disentitled itself from being granted any equitable relief - *VLS Finance Ltd.* v. *Sunair Hotels Ltd.* [2001] 33 SCL 475 (CLB).

19. Petition under sections 397 and 398 [now Section 241] is maintainable only in respect of affairs of the respondent company and cannot extend to the affairs of individual respondents - *Smt. Namita Gupta* v. *Surma Valley Stock Ltd.* [2002] 35 SCL 700 (CLB). Similarly CLB declined to admit petition in respect of sections 397 and 398 [now Section 241], based on private agreement; also allegation brought for irregularity in allotment of shares after eight years could not be entertained - *Ms. Deepa Goyal* v. *Nanda Devi Builders (P.) Ltd.* [2002] 35 SCL 842. Also *see Radhe Shyam Tulsian* v. *Panchmukhi Investments Ltd.* [2002] 35 SCL 849 (CLB).

20. In the context of allegations of transfer of shares to an outsider to the hitherto composition of shareholding and inducting the outsider as a director in violation of articles of association and in not sending the notice of EOGM to the petitioner, the CLB [now Tribunal] found that while the allegation of violating the provisions of the articles could not be substantiated, the irregularity in holding the EOGM was there. This itself cannot be taken as oppression as in the EOGM majority of shareholders took the decision on transfer of shares in the best interest of the company. However, having regard to prejudice caused to the interest of the petitioner as shareholder, the respondent was directed to buy out the shares of the petitioner - *Cine & Supply Corpn. (P.) Ltd., In re* [2002] 35 SCL 683.

21. In a case where allegation of minority oppressing majority was brought before it, CLB [now Tribunal] ruled that mere expression of desire to gain control over the company by the minority is not an act of oppression - *Ultrafilter (India) Pvt. Ltd.* v. *Ultrafilter GmbH* [2002] 38 SCL 573.

22. Casting of vote in AGM, convened under CLB (now Tribunal) direction, by valid power of attorney holders on behalf of certain shareholders to elect directors cannot be questioned merely on the ground that RBI permission for sale of concerned shares was awaited - *S. Ashok* v. *Tamil Nadu Mercantile Bank Ltd.* [2005] 61 SCL 106 (Mad.).

23. A preference shareholder cannot allege oppression in matters of allotment of equity shares - *Hillcrest Realty Sdn. Bhd.* v. *Hotel Queen Road (P.) Ltd.* (*supra*) (para 3.2A of this edition).

24. Where the grievances of petitioners flow from share purchase agreement between them and respondents no application lie before CLB (now Tribunal) - *M. Trimme Gowda* v. *SPR Sugars (P) Ltd.* [2008] 81 SCL 30 (CLB).

25. Petitioner has to prove that conduct of majority shareholders lacked probity and was unfair so as to cause prejudice to the petitioner in exercising his legal rights and proprietary interests as a shareholder. An MoU between promoting entity and a private financer for allowing the latter to have majority shares and control over the company when not translated into effective action, the company cannot be blamed for that. It amounts to a civil dispute between two shareholders and section 397 [now Section 241] does not come into play - *Chatterjee Petrochem (I) (P.) Ltd.* v. *Haldia Petrochemicals Ltd.* [2011] 110 SCL 107 (SC).

26. *Opening multiple bank accounts without proof of diversion of funds* - In *Ajay Nagrath* v. *Rishi Ganga Power Corporation Ltd.* [2014] 44 taxmann.com 468 (CLB - New Delhi), opening of multiple bank accounts with due approval of the Board was allowed to be continue and held to be non oppressive. However the petitioners under Section 397 (now Section 241) were authorized to look into look into receipts and payments of money in bank accounts so as to ensure that there was no diversion of funds as alleged and that the funds were utilized in interest of company.

27. *Merely passing of enabling resolution to authorize board* - In *Mehool Bhuva* v. *Indo-Nippon Chemical Co. Ltd.* [2014] 43 taxmann.com 66 (CLB - Mumbai),

the respondent company proposed to dispose of Company's undertaking and manufacturing plant and sought approval from shareholders under provisions of section 293 [now section 180]. The petitioner filed a petition under Section 397 [now section 241] for oppression alleging that decision to sell unit was *mala fide* with purpose to cause wrongful gain to respondents and that explanatory statement given with notice did not meet requirements of section 173 [now section 102] as it did not indicate any detailed information relating to proposed sale of said unit. It was held that petitioner had failed to substantiate that act complained off. The resolution sought to be passed was merely an enabling resolution to authorize Board to negotiate and proceed for sale of said unit and could not said to be an oppressive act.

28. *Holding of EOGM and allotment of shares strictly not meeting the requirements of the Act* - In the case of *Rajiv Kant Laxman* v. *Bobby Electronics (P.) Ltd.* [2014] 43 taxmann.com 54 (CLB - Mumbai), the share capital of a company was increased to meet out urgent requirement of funds. The holding of extra-ordinary general meeting and allotment of shares was not strictly in accordance with the requirements of the Companies Act. It was held that as share capital was increased to meet out urgent requirement of funds, holding of EOGM and allotment of impugned shares, even if not be strictly in accordance with provisions of Companies Act, did not amount to an act of oppression and the petition under Section 397 [now section 241] was disallowed.

29. *Allegation not substantiated* - The High Court of Calcutta set aside the order of the CLB which admitted a petition under Section 397 [now section 241] in *Ganesh Commercial Co. Ltd.* v. *Arun Kumar Mohata,* [2013] 38 taxmann.com 167 (Calcutta). CLB [now Tribunal] earlier admitted the petition of the respondent for alleged acts of oppression and mismanagement. It was alleged by the respondent/petitioner that he was not given notice of the AGM, removal of his and his son from directorship and increase of share capital in that AGM was contrary to law and misappropriation of funds by another shareholder. The CLB [now Tribunal] admitted the petition. On appeal the High Court held that issue of the notice of meeting by hand and under certificate of posting and publication in newspaper was to be considered as deemed service of notice. Decision taken at AGM could not be challenged by the respondent/petitioner as he abstained from said meeting and since details of payments received and expenses incurred were furnished by the other shareholder, allegation for misappropriation of funds also could not be made out. The order of the CLB was set aside.

30. In *Gautam Bharadwaj* v. *Invest India Micro Pension Services (P.) Ltd.* [2015] 55 taxmann.com 208 (CLB - New Delhi), the petitioner was terminated from the post of MD on his failure to achieve the targets as per his employment agreement. *It was held that* he was bound by agreement he entered into and was not covered by generalized provisions earmarked as rights of promoters. Petition under section 284, read with section 397 (now section 169 and section 241) was not upheld.

31. Misuse of the digital signatures by directors of subsidiary company and hiding affairs of company form its holding company was held to be oppres-

sion and mismanagement under Section 241/242. [*Khosla Steel Industries (P.) Ltd* v. *K. Steel (P.) Ltd.* [2017] 79 taxmann.com 71 (NCLT - Kolkata)]. However, in another case the NCLT did not find the claim of director that his digital signature was misused by other where it was found that digital signature was still under his custody and he had admittedly transacted subsequent transactions with same digital signature. [*Anand Prakash Sanghi* v. *AGA Publication Ltd.* [2017] 87 taxmann.com 86 (NCLT - Hyd.)

22.3-5 Matrimonial differences

The CLB in the case of *Smt. Neelu Kohli* v. *V. Nikhil Rubber (P.) Ltd.* [2000] 28 SCL 235 took the view that as a result of serious matrimonial differences the petitioner and second respondent could not continue together (apparently charge for oppression otherwise was not conclusively proved) and having regard to the fact that the petitioner had her own separate business, it would be just and equitable to direct petitioner to sell her interest in the business to the respondent at a value to be determined by an independent valuer. CLB [now Tribunal] felt that in the peculiar circumstances of the case, this would be the most equitable solution even though somewhat unconventional. It seemed to the CLB [now Tribunal] that the matrimonial differences lie at the root of this case and perhaps neither party has come with clean hands.

In a husband and wife promoted company, the wife petitioned the CLB [now Tribunal] alleging oppression and the CLB [now Tribunal] on the basis of facts brought before it was satisfied that there is oppression and ordered the husband to buy out the shares of the wife at an appropriate price. The CLB [now Tribunal] could have passed order restoring all the rights of the wife as shareholder but did not do as the relationship between husband and wife was estranged and divorce proceedings were on and the family discord would percolate to the company concerned to affect its working - *A. Kalyani* v. *Vale Exports (P.) Ltd.* [2002] 40 SCL 732. In this case the CLB [now Tribunal] also said that even in a two member company, allotment of shares to one only amounts to oppression on the other.

22.4 Meaning of public interest

The expression 'public interest' is not capable of precise description. It has been held to be an elusive abstraction meaning general social welfare or regard for social good and predicating interest of the general public in matters where a regard for the social good is of the first moment. In the words of *Frankfurter, J.* of the United States Supreme Court, "the idea of public interest is a vague, impalpable, but all controlling consideration". A thing is said to be in public interest where it is or can be made to appear to be contributive to the general welfare rather than to the special privilege of a class, group or individual - *N.R. Murty* v. *Industrial Development Corporation of Orissa Ltd.* [1977] 47 Comp. Cas. 389 (Ori.).

The Supreme Court in *State of Bihar* v. *Kameshwar Singh* AIR 1952 SC 252 has observed that the expression 'public interest' is not capable of a precise definition and has no rigid meaning and is elastic and takes its colours from the statute in which it occurs, the concept varying with the time and state of society and its needs.

Thus, what is public interest today may not be so considered a decade later. It cannot be considered in value but must be decided on the facts and circumstances of each case. In the case of a company intended to operate in a modern welfare state, the concept of public interest takes the company outside the conventional sphere of being a concern in which the shareholders alone are interested. It emphasises the idea of the company functioning for the public good or general welfare of the community, at any rate, not in a manner detrimental to the public good.

Non-publication of a news item (in this case, regarding Bofors issue) in the newspaper was held not to be an act prejudicial to the public interest. The Madras High Court observed that a decision regarding publication of a news item would be in public interest or not, cannot be said to affect or prejudice public interest. Further, whether the interest of the public is in prejudice or not will be known only after publication but not before. The Court felt that the expression 'interest' in this context must receive a meaning different from the interest of a reader of a news item, who as the member of the public may have one or the other opinion. 'Public interest' cannot be allowed to be confused with public opinion - *G. Kasturi* v. *N. Murali* [1992] 74 Comp. Cas. 611 (Mad.).

22.5 Petition to contain all material facts

Petition under section 397 [now Section 241] must plead all material facts necessary for granting the relief prayed for. If the facts transpiring on the date of the petition and alleged in the petition are not sufficient to make out a case, facts arising subsequent to the filing of the petition cannot be relied upon. Also, subsequent affidavits are not enough - *Shanti Prasad Jain* v. *Kalinga Tubes Ltd.* [1964] 1 Comp. LJ 117. The validity of the petition will be judged on the facts alleged therein and existing at the time of its presentation. Thus, where the petitioners were not even able to prove that they were members nor could show any facts which constituted their oppression, the petition was dismissed as being without substance - *T.J. Thomas* v. *Rev. C.S. Joseph* [1988] 1 Comp. LJ 22 (Ker.).

Further, lack of essential allegation in a petition cannot be made good by leading evidence - *Re. Bengal Luxmi Cotton Mills Ltd.* [1965] 1 Comp. LJ 35.

Besides, the application under section 241 must specifically state the nature of the relief or reliefs sought. It must contain enough to leave no doubt as to what the applicant wants the Tribunal to do and should not merely seek a general relief that the Tribunal may deem just and expedient[19]. The Madras High Court in a comprehensive judgment in the case of *S. Seetharaman* v. *Stick Fast Chemicals (P.) Ltd.* [1998] 18 SCL 399 has confirmed all the points made in this Paragraph. Also, the judgment held that relief against reallotment of shares cannot be sought under sections 397 and 398 [now Section 241] (as the Companies Act then provided recourse to section 155), and continuous act of oppression must be present to establish oppression under section 397 [now Section 241] . Further, it held that the mere fact that a substantial shareholder is excluded from management does not amount to oppression. Also cases like denial of right of inspection or declaration of

19. *Antigen Laboratories Ltd., In re* [1951] 1 All ER 110 (Ch. D).

dividend at a lesser rate, etc., do not constitute oppression as separate reliefs are available.

22.5-1 True scope of section 241

In *Shanti Prasad Jain* v. *Kalinga Tubes Ltd.* (*supra*), the Supreme Court considered four important English cases[20] and quoted the following summary given in *Meyer's* case which lays down certain important considerations to be kept in view in determining the scope of section 397 [now Section 241]

- The oppression of which a petitioner complains must relate to the manner in which the affairs of the company concerned are being conducted; and the conduct complained of must be such as to oppress a minority of the members (including the petitioners) *qua* shareholders.
- It follows that the oppression complained of must be shown to be brought about by a majority of members exercising as shareholders' predominant voting power in the conduct of the company's affairs.
- Although the facts relied on by the petitioner may appear to furnish grounds for making of a winding up order under the 'just and equitable' rules, those facts must be relevant to disclose also that the making of a winding up order would unfairly prejudice the minority members *qua* shareholders.
- Although the word 'oppressive' is not defined, it is possible, by way of illustration, to figure a situation in which majority shareholders, by an abuse of their predominant voting power, are 'treating the company and its affairs as if they were their own property' to the prejudice of the minority shareholders and in which just and equitable grounds would exist for the making of a winding up order but in which the 'alternative' remedy provided by this section by way of an appropriate order might well be open to the minority shareholders with a view to bringing to an end the oppressive conduct of the majority.
- The power conferred on the court to grant a remedy in an appropriate case appears to envisage a reasonably wide discretion vested in the court in relation to the order sought by a complainant as the appropriate equitable alternative to a winding up order.
- In proceedings under section 397 [now Section 241] it is not legality or illegality of action complained of is of primary importance but whether the act(s) is oppressive is of paramount importance - *K.N. Bhargava* v. *Track Parts of India Ltd. (supra).* It is also permissible in petition under sections 397 and 398 [now Section 241] to bring further facts and grounds before the final hearing of the petition provided such facts/grounds disclose additional cause of action and the same is arguable - *Jer Rutton Kavasmaneek* v. *Gharda Chemicals Ltd.* [2000] 23 SCL 71 (Bom.).

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20. *Elder* v. *Elder & Watson Ltd.* [1952] SC 49 (SCOT), *George Meyer* v. *Scottish Co-operative Wholesale Society Ltd.* [1954] SC 81 (SCOT), *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer* [1958] 3 All ER 66 (HL) (being an appeal from *Meyer's* case [1954] SC 381) and *H.R. Harmer Ltd., In re* [1958] 3 All ER 689.

22.6 Oppression of majority

It may be noted that remedies against oppression or mismanagement are available not only to the minorities but, in an appropriate case, if the Tribunal is satisfied about the acts of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. In *Sindhri Iron Foundry (P.) Ltd., Re*[1964] 34 Comp. Cas. 510 (Cal.), the *High Court* observed that sections 397 and 398 [now Section 241] nowhere prescribe that the application under the two sections can be made only by a minority group. Nor do they prescribe that a majority group can under no circumstances come to Court for redress, whatever may be the nature and extent of the oppressive acts of the rival group and whatever may be the extent of the injury suffered by the company as a result of the activities of such a group. Justice Mitra further observed that if the Court finds that the company's interest is being seriously prejudiced by the activities of one or the other group of shareholders, that *two different registered offices at two different addresses have been set up, that two rival boards are holding meetings, that the company's business, property and assets have passed into the hands of unauthorised persons who have taken wrongful possession and who claim to be shareholders and directors, that the bank accounts of the company have been practically frozen, there is no reason why the Court should not make appropriate orders to put an end to such matters.*

Likewise, in *Dr. V. Sebastian* v. *City Hospital (P.) Ltd.* [1985] 57 Comp. Cas. 453, the Kerala High Court observed that "it is true that sections 397 and 398 [now Section 241] are intended primarily to protect the minority interests. In ordinary cases, the majority will be able to protect itself by controlling the directors at general body meetings. But, where the majority is prevented from doing so, despite the clear indication in the articles that majority rule based on the right to demand poll should operate as a correcting influence, the majority becomes an artificial minority entitled to claim protection under sections 397 and 398 [now Section 241]". The High Courts in Delhi and in Punjab & Haryana have also held that a petition against minority shareholders is maintainable under sections 397 and 398 [now Section 241] depending upon facts and circumstances of the case. [*Radhe Shyam Gupta* v. *Kamal Oil & Allied Industries Ltd.* [1999] 19 SCL 271 (Delhi)/ *Amit Gupta* v. *J.K. Gupta* [2002] 38 SCL 112 (Punj. & Har.). In *Prabir Kumar Misra* v. *Ramani Ramaswami (supra),* it has been held that in appropriate case, CLB (now Tribunal) cannot be restricted in directing majority shareholders to submit to minority shareholders.

On a question whether a petition against oppression and mismanagement under Section 397 [now section 241] should be filed only by minority it was decided in negative by the High Court of Delhi in *Gurpartap Singh* v. *Vista Hospitality (P.) Ltd.* [2013] 40 taxmann.com 18 (Delhi). The court held that if the requisite conditions of section 399 [now section 244] are satisfied, petition may be made by shareholders having a majority shareholding. It was also held that while exercising its power under Section 402 [now section 242], a petition shall not be rejected on highly technical grounds.

Mere expression of the desire by minority to gain control over the company has been held as not an act of oppression - *Ultrafilter (India) Pvt. Ltd.* v. *Ultrafilter GmbH*

case (*supra*). But when majority is denied his legitimate right and is wrongfully reduced to minority, it was held to be an act of oppression and the Calcutta High Court set aside illegal allotment of shares - *Bhagirath Agarwal* v. *Tara Properties (P.) Ltd.* [2002] 39 SCL 943. Also see *Kobian (P.) Ltd.* v. *Kobian India (P.) Ltd.* [2005] 59 SCL 608 (CLB) and *Rajendra Prasad Rungta* v. *Amber Commercial (P.) Ltd.* [2012] 114 SCL 54.

22.7 Limitation

In *Hunger Ford Investment Trust Ltd.* v. *Turner Morrison & Co. Ltd.* ILR [1972] 1 Cal. 286, it was held that Article 137 of Limitation Act, 1963, applies to application under sections 397 and 398 [now Section 241] and accordingly a petitioner cannot rely upon events (acts of oppression) more than three years prior to the date of the filing of the petition. In *Dilip Modu Timblo* v. *Sociedade De Fomento Industries (P.) Ltd.* [2013] 32 taxmann.com 123 (CLB - Mumbai), the Mumbai Bench of CLB [now Tribunal] observed that on the plea of the application of the Limitation Act to the proceedings before the CLB [now Tribunal] it has been consistently held by the CLB [now Tribunal] that the Limitation Act as applied by the Civil Court is not applicable to the proceedings before the CLB (now Tribunal), a quasi-judicial authority and not a Court in the strict sense of the term. But in this case the issue was that CLB [now Tribunal], even if a quasi-judicial body is not precluded from rejecting/dismissing a petition on account of delay/latches in appropriate cases. The Mumbai Bench held that though no limitation period is provided to make an application for rectification of Register of Members, residuary Article, namely Article 137 of the Limitation Act would apply in such cases and the limitation period starts from the date of knowledge of cause of action. However, certain authors on the subject hold a different view. Ramaiya, for instance, argues that the Schedule to Limitation Act, 1963 applies to suits and application before a Court and not before a quasi-judicial authority like CLB [now Tribunal]. Further, it is argued that if the oppression is of a continuing nature, bar of limitation cannot come in the way of admitting the petition.

Petition filed for oppression and mismanagement in 2015 for cause of action arising in years 2009, 2010 or 2011 was held to be barred by limitation as period of limitation provided under Limitation Act for complaint of oppression and mismanagement is three years. *Praveen Shankaralayam* v. *Elan Professional Appliances (P.) Ltd.* [[2016] 76 taxmann.com 290 (NCLT - New Delhi)]

Sections 242 and 243 confer certain powers on the Tribunal to deal with oppression of the minority or with mismanagement of the affairs of a company in a manner prejudicial to the interests of the company and its members. The provisions of these sections are intended to avoid recourse to the extreme step of winding up a company and at the same time protect the minority shareholders from acts of oppression and mismanagement. Under these sections, the oppressed members of the company may, subject to the conditions laid down in section 244, move the Tribunal for the protection of their rights and interests.

Instances: A study of the applications made to the courts in respect of which notices were received by the Department revealed common types of mismanagement and oppression against which complaints were filed. These were as follows:

(*a*) fraudulent transactions;

(*b*) grossly inefficient management in disregard of the best interests of companies;

(*c*) misappropriation of funds of the company;

(*d*) illegality in the conduct of board meetings and general meetings;

(*e*) absence of the proper legal authority on the part of directors to carry on the management of companies.

Nature of reliefs - While making these allegations, the parties sought the following general types of reliefs:

(*a*) a direction by the court for the proper conduct of the affairs of the company;

(*b*) removal of the existing directors or some of them from the management of the company;

(*c*) declaration that the removal of the petitioner(s) from the management of the company was invalid, and that his/their appointments or rights were to remain unaffected;

(*d*) appointment of an administrator or receiver during the interim period till final judgment of the court (now Tribunal);

(*e*) revision of the company's accounts and recovery of funds alleged to have been misappropriated by the existing management; and

(*f*) an order that the affairs of the company should be investigated - *Taxmann's Circulars & Clarifications*, 1992 edn., pp. 422-423.

22.8 Prevention of mismanagement

22.8-1 Application to Tribunal for relief in cases of mismanagement

Section 241 provides for relief in cases of mismanagement. The section provides that the requisite number of members (as laid down in section 244) of a company may apply to the Tribunal for appropriate relief on the ground of mismanagement of the company.

Similar to the case of oppression, the legal representative of the deceased shareholder acquires right to approach competent court for relief against mismanagement of the company - *Arjun Tukaram Shetaonkar* v. *Smt. Urmila Vaikunta Desai* [2001] 34 SCL 227 (Bom.).

22.8-2 Relief by the Tribunal

The Tribunal may give relief if it is of opinion—

(*a*) that the affairs of the company are being conducted in a manner prejudicial to the public interest or in a manner prejudicial to interests of the company; or

(*b*) that by reason of a material change in the management or control of the company, the affairs of the company are likely to be conducted in a manner prejudicial to the public interest or in a manner prejudicial to the interests of the company.

The change in management or control of the company may be due to an alteration in its Board of directors or Manager or in the ownership of the company's shares, or if it has no share capital, in its membership or in any other manner whatsoever. The material change in the management or control does not include a change brought about by, or in the interests of any creditors including debenture holders, or any class of shareholders, of the company.

It would, however, not be correct to say that jurisdiction of CLB (now Tribunal) is very wide and serious dispute regarding title to shares cannot necessarily be decided by the CLB (now Tribunal). Such dispute may be decided by appropriate Civil Court. CLB was held to be not a Civil Court - *Gordon Woodroffe & Co. Ltd., U.K.* v. *Gordon Woodroffe Ltd.* [1999] 20 SCL 429 (Mad.). Where principal issues of dispute between shareholders and the company are already before the High Court, the CLB (now Tribunal) loses its jurisdiction in matters of sections 397 and 398 [now Section 241] - *Indowind Energy Ltd.* v. *ICICI Bank Ltd.* (*supra*).

22.8-3 Instance of mismanagement

A very clear illustration of mismanagement contemplated under section 241 appears in *Rajahmundry Electric Corporation* v. *A. Nageshwara Rao* (*supra*)

A petition was brought against a company by certain shareholders on the ground of mismanagement by directors. The court found that the vice-chairman grossly mismanaged the affairs of the company and had drawn considerable amounts for his personal purposes, that large amounts were owing to the Government for charges for supply of electricity, that machinery was in a state of disrepair, that the directorate had become greatly attenuated and "a powerful local junta was ruling the roost" and that the shareholders outside the group of the chairman were powerless to set matters right. This was held to be sufficient evidence of mismanagement. The Court, accordingly, appointed two administrators for the management of the company for a period of six months vesting in them all the powers of the directorate.

It may be noted that expression "the affairs of the company are being conducted in a manner prejudicial to the interest of the company" in section 398 [now Section 241] will also take within its ambit the non-conduct of the affairs of the company where such non-conduct results in prejudice being caused to the company. In *Chander Krishan Gupta* v. *Pannalal Girdhari Lal (P.) Ltd.* (*supra*), the Delhi High Court observed that "section 398 [now Section 241] has two facets. The *first* is that positive acts are done by the management which results in prejudice being caused to the company. *Secondly*, section 398 [now Section 241] may be attracted even where no action at all is taken by the management and such non-action results in prejudice being caused to the company.....non-conduct may arise for a variety of reasons including serious disputes among the Board of directors of the company which results in a complete deadlock or stalemate."

In the case cited above, for quite some time the company had been incurring losses. The directors of the company were carrying on other personal businesses. The disputes amongst the directors of the company had resulted in the records of the company not being available. The management of the company had miserably failed in protecting the company's records and this failure resulted in prejudice

being caused to the company. Moreover, the constant fight amongst the directors, who were also the shareholders of the company, had an adverse effect on the conduct of the company's business with the result that the company started incurring losses. *Held* that, it was a fit case where appropriate orders under section 398 [now Section 241] should be passed.

22.8-4 Conditions precedent for obtaining relief

Section 241 can be invoked in either of the two circumstances :

1. that the affairs of the company *are* being conducted in a manner which is—
   (*a*) prejudicial to public interest; or
   (*b*) prejudicial to the interest of the company.

   OR

2. it is likely that the affairs of the company *will be* conducted in a manner—
   (*a*) prejudicial to public interest; or
   (*b*) prejudicial to the interest of the company.

   due to a material change that has taken place in the management or control of the company. Such change may take place due to alteration in the company's Board of directors or Manager or in ownership of its shares or membership or in any other manner whatsoever. (Such change not being a change brought about or in the interests of any creditors including debenture holders or any class of shareholders of the company).

In *Suresh Kumar Sanghi* v. *Supreme Motors Ltd.* [1988] 54 Comp. Cas. 235 (Delhi), the Delhi High Court observed that "relief under section 398 [now Section 241] can be obtained only if (*i*) the affairs of the company are being conducted in a manner prejudicial to public interest, (*ii*) if the affairs are being conducted in a manner prejudicial to the interest of the company, or (*iii*) if there is material change which has taken place in the management or control of the company in the manner set out in the said section, and that by reason of such change it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest or in a manner prejudicial to the interest of the company." It was further observed that section 398 [now section 241] comes into play only when there is actual mismanagement or apprehension of mismanagement of the affairs of the company.

22.8-5 Acts held as mismanagement

The following acts have been held as amounting to mismanagement under section 398 [now Section 241] :

1. Where there is serious infighting between directors resulting in serious prejudice being caused to the company - *Suresh Kumar Sanghi* v. *Supreme Motors Ltd.* (*supra*). In a family centered company if shares are allotted to one group to the exclusion of the other and additional directors are appointed to control the Board, taking advantage of temporary absence of a director belonging to the other group - *Ms. Pushpa Prabhudas Vora* v. *Vora Exclusive Tools (P.) Ltd.* [2000] 24 SCL 111 (CLB).

2. Where Board of directors is not legal and the illegality is being continued, it will amount to mismanagement, prejudicial to public interest - *Sishu Ranjan Dutta* v. *Bholanath Paper House Ltd.* [1988] 53 Comp. Cas. 888 (Cal.).
3. Gross neglect of interest of the company by sale of its only assets and total inattention thereafter to the affairs of the company - *M. Moorthy* v. *Drivers and Conductors Bus Service (P.) Ltd.* [1991] 71 Comp. Cas. 136 (Mad.).
4. Diversion of funds of the company for the benefit of majority group - *Bhaskar Stoneware Pipes (P.) Ltd.* v. *Rajindernath Bhaskar* [1988] 63 Comp. Cas. 184 (Delhi); diversion of public money for unknown/unwanted purposes affecting grossly financial state of the company - (held gross act of mismanagement) *KRS Mani* v. *Anugraha Jewellers Ltd.* (*supra*).
5. Where bank account was operated by unauthorised persons - *Col. Kuldip Singh Dhillon* v. *Paragaon Utility Financiers (P.) Ltd.* [1988] 64 Comp. Cas. 19 (Punj. & Har.). In this case, a certified copy of a resolution had been sent to the bank authorising certain persons to operate the account. No such resolution was found recorded in the minutes book; rather the resolutions passed on the particular date and recorded in the minutes book were different.
6. Advance of loans without execution of a document which is not repaid and even interest is not realised - *Col. Kuldip Singh Dhillon's* case (*supra*).
7. Where directors take no serious action to recover amounts embezzled - *Col. Kuldip Singh Dhillon's* case (*supra*).
8. Continuation in office after expiry of term and infighting among directors. - Where the managing directors of a company continued in office after their terms had expired, without a meeting being held to re-appoint them prior to making a fresh application to the Central Government under section 269 [now Section 203], the continuation in office under these conditions was held to be mismanagement within the purview of this section - *Sishu Ranjan Dutta* v. *Bhola Nath Paper House Ltd.* (*supra*). So also infighting among the directors resulting in serious prejudice to the company constitutes mismanagement under section 398 [now Section 241] - *Suresh Kumar Sanghi* v. *Supreme Motors Ltd.* (*supra*).
9. *Sale of assets at low price and without compliance with the Act* - One of the estates of a tea and rubber plantation company was sold by the directors at a low price to another tea plantation company without complying with the requirements of section 293(1) [now Section 180] which demands approval by shareholders and without giving adequate notice under section 173 [now Section 102] and relevant information, giving delivery of possession before general body meeting and accepting consideration in instalment. It was held that all these acts constituted mismanagement of affairs and the sale was set aside.

   The Board of directors and the purchasers were held liable for the company's losses and were required to submit an account of the income of the estate from the date of delivery of possession to the date of its actual return to the company - *Malayalam Plantation (India) Ltd., Re* [1991] 5 Corpt. LA 361 (Ker.).

10. *Collusive sale of assets by lending institutions.* - Where the assets of the borrower company were disposed of by the lending institution to the brother-in-law of the managing director in a collusive sale and the member-directors of the company were not able to pay out the buyer to recover back the assets, the CLB (now Tribunal) ordered the managing director to take steps to put the company on winding up or to have its name struck off the register. In the meantime the lending institution was instructed not to seek any recovery from the company and to release the directors from their personal guarantees - *Mittal Dal Mills Ltd., Re* [1992] 8 Corpt. LA 104 (CLB).
11. *Company doomed to trade unprofitably.* - In a *Company, Re ex p. Burr* [1992] BCLC 724 (Ch. D.). Vinelott J. stated (at 731): "There can be no doubt that if the directors of a company continue to trade when the company is making losses and when it should have been apparent that there was no real prospect that the company would return to profitability, the court may draw the inference that the directors' decision was improperly influenced by their desire to continue in office and remain in control of the company and to draw remuneration and other benefits for themselves and others connected with them. So also if the company is trading at a profit which yields a return which does not reflect the value of the assets employed and which would be available for distribution in a winding up, and if there is no real prospect that the profits will ever represent a reasonable return on the capital employed. If that inference is drawn, the court may conclude that the affairs of the company are being conducted in a way which is unfairly prejudicial to the members or to members other than the directors and those who obtain such benefit".
12. *Violation of statutory provisions and those of articles* - Transferring shares without first offering them to the existing members in accordance with their rights under the articles, holding meetings without sending notice to members; issue of shares for a consideration other than cash not represented by corresponding assets and burdening the company with additional rental by shifting the company's office - *Akbarali A. Kalvert* v. *Konkan Chemicals (P.) Ltd.* [1994] 3 Comp. LJ 102 : [1994] 15 Corpt. LA 170 (CLB).
13. *Erosion of company's substratum.* - Where neither the duly constituted Board of directors nor the petitioner who was allowed a trial to run the company was able to make any headway towards improving the lot of the company and there were also many irregularities in the conduct of affairs which had eroded the substratum of the company, the CLB (now Tribunal) asked the Central Government to consider taking appropriate action under section 433/439 [now Section 271/272] in case the newly constituted Board of directors also failed in reviving the company within a reasonable time - *AIR Asiatic Ltd., Re* [1994] 3 Comp. LJ 294 : [1994] 15 Corpt. LA 189 (CLB) and *Thomas George* v. *KCG Verghese* [1994] 3 Comp. LJ 294 : [1994] 15 Corpt. LA 189 (CLB).
14. *Violation of memorandum.* - Violation of the conditions of the company's memorandum by those who are in charge of company's management - *S.M. Ramakrishna Rao* v. *Bangalore Race Club Ltd.* [1970] 40 Comp. Cas. 674 (Mys.).

15. Non-existence of names of petitioners in the register of members on the face of existence of valid share certificates, communication in the matter of the AGM to the petitioners and other supporting facts—*Banford Investment Ltd.* v. *Magadh Spun Pipe Ltd.* [1998] 17 SCL 166 (CLB).
16. When the respondent managing director does not comply with the terms of consent order and does not appear at hearings, he would be deemed to have abandoned his interest in the company and the petitioner will be entitled to manage and control the company - *Mrs. Pooja Joshi* v. *Century Gases & Petro Chemicals Ltd.* [2004] 50 SCL 556 (CLB - New Delhi)
17. When controlling group in a company takes away the company's significant business by incorporating another company without the knowledge of the other group or of the company, amounts to mismanagement of the company concerned - *Vaishnav Shorilal Puri* v. *Kishore Kundanlal Sippy* [2004] 53 SCL 469 (Bom.).
18. When the managing director of a closely held company transferred his shares to his son and no evidence could be produced that the transfer was in accordance with the Articles, the transfer is ordered to be cancelled as it amounted to oppression and mismanagement - *S. Rehana Rao* v. *Balaji Fabricators (P.) Ltd.* [2004] 55 SCL 400 (CLB).
19. Providing false information to statutory authorities, anti-dating of notice for general meeting and related documents and manipulating the process of conversion of a public company into a private company, amount not only to mismanagement but also to oppression on minority shareholders - *Suresh Kumar Rungta* v. *Roadco (I) Pvt. Ltd.* [2008] 84 SCL 407 (CLB).
20. Powers of CLB (now Tribunal) under sections 397 and 398 [now Section 241] are primarily intended for preventive purposes and not for raking up past but to redeem future. The respondents were ordered to indemnify the company for funds, if found diverted, on verification by a chartered accountant - *A.M. Gopalan* v. *Panchami Pack (Kerala) Pvt. Ltd.* [2008] 84 SCL 279 (CLB).
21. In the absence of evidence to prove that the meeting stated to have been held on a particular day to appoint certain respondents as directors, in compliance with applicable provisions of the law and so confirmed by two out of three directors, the same cannot be acceptable, as a majority cannot turn black into white. The removal of the petitioner from directorship illegally and issue of further shares by the respondents constitute acts of continuous oppression. It was a composite case under sections 397 and 398 [now Section 241] - *Sanjay Paliwal* v. *Paliwal Hotels Pvt. Ltd.* [2008] 84 SCL 329 (CLB).
22. When signatures of alleged transferors (petitioners in the case) on the transfer deed lodged with the company on the strength of which, transfer of shares was recorded by the company, appeared to be different from admitted signatures of the petitioners, the transfers become a nullity and the company was directed to replace the names of transferors in and remove the names of transferees from the Register of shareholders. However, in view of long inaction on the part of the petitioners in the affairs of the company as directors and not bringing action in time for their alleged irregular removal

from directorship, the petitioners cannot be granted relief under section 397 or 398 [now Section 241]. The order also required appointment of a chartered accountant to verify the correctness or otherwise of the allegations of financial irregularity in the company - *G. Ramana Reddy* v. *Vijaya Durga Estates (P.) Ltd.* [2008] 84 SCL 95 (CLB).

23. A refusal to reconstitute the board of directors subsequent to increase in the shareholding of the petitioner in the company was an act of oppression and mismanagement [*Yusuf Kagzi* v. *Avigo Trustee Co. (P.) Ltd.* [2016] 66 taxmann.com 219 (Bombay)]. In *Girdharlal Nathubhai Dalal* v. *Star Grain & Shipping (P.) Ltd.* [2015] 60 taxmann.com 390 (CLB - Mumbai) the petitioner had been removed as director of company without following due process of law. The respondent company also passed resolution to increase authorised share capital of company and further allotment of shares. It was held by the CLB, Mumbai that removal as director without following the due process was a gross act of mismanagement. Further allotment and subsequent transfer of shares was found to have been done to gain control over company and to oust petitioner from company and hence such transfer of shares was to be cancelled.

24. Removal of a director from the Board of company in violation of the provision of Section 169 of the Act was held to be an act of mismanagement. [*Basudev Bagchi* v. *Shasi Kumar Tea Co. (P.) Ltd.* [2017] 79 taxmann.com 406 (NCLT - Guwahati)]

Scope of power under section 241 is not subject to any limitation—In a significant judgment the Madras High Court held that where a company committed large number of irregularities including allotment of share against illusory consideration, accounts not audited since 1977, AGM not convened, annual returns not filed and prosecution launched against persons concerned in the company for failure to comply with provision of the Companies Act, it appears to be a straightforward case under sections 397 and 398 [now Section 241]. It was held that not only the company was mismanaged, certain actions of the company were prejudicial to the interests of the company and of the other shareholders. It was further held that the scope of power of the Court (now Tribunal) is not subject to any limitation in the matters of sections 397 and 398 [now Section 241] and relief seeking members need not be sent elsewhere for getting the reliefs. The all pervasive power in these matters include the power to alter articles without a resolution of the company and without being placed before the general meeting and to order rectification of the register of members without recourse to laid down procedure. The court, *inter alia*, ordered supersession of the Board of directors, declared allotment of shares to two of the respondents illegal and appointed a receiver to convene and hold AGM without audited accounts. It also ordered constitution of a new Board of directors - *Harikumar Rajah* v. *Sovereign Dairy Industries Ltd.* [1999] 19 SCL 391 (Mad.). In *KRS Mani* v. *Anugraha Jewellers Ltd. (supra)*, it was held by the CLB Bench (now Tribunal) that on facts and circumstances of this case, it is not justified to wind up the company but revamping of the management is a necessity and accordingly, it ordered supersession of the Board and appointment of administrator. The Court, however, has to act judicially. Approval of a scheme of reconstruction of the company and the related family settlement without involving all the shareholders

and creditors and without hearing relevant parties is simply erroneous. The matter arose out of a charge of mismanagement - *Mahendra Kumar Sanghi* v. *Ratan Kumar Sanghi* [2003] 44 SCL 592 (Raj.). However, where CLB's (now Tribunal's) own finding in respect of respondent's petition under section 397/398 [now Section 241] was that no case of oppression was proved, then to order the company concerned to purchase shares held by the respondent was just abuse of the process of CLB and not sustainable - *Vardhaman Dye Stuff Industries (P) Ltd.* v. *M.R. Shah* [2008] 82 SCL 220 (Bom.).

CLB (now Tribunal) in a petition under sections 397 and 398 [now Section 241] can appoint an auditor to conduct an investigative audit u/s 237(*b*) [now Section 213] as CLB (now Tribunal) has power in the nature of administrative power under that section and it can exercise that power *suo motu* - *Muthusamy* v. *S. Balasubramanian* [2012] 114 SCL 252 (Mad.). This judgment also held that strict rules of pleading and proof as required in Civil Courts are not applicable to proceedings before CLB (now Tribunal).

22.8-6 Acts held as not mismanagement

1. Building up of reserves, or non-declaration of dividend especially when it does not result in devaluation of shares - *V.J. Thomas Vettom* v. *Kuttanad Rubber Co. Ltd.* [1984] 56 Comp. Cas. 284 (Ker.).
2. Merely because company incurs loss, it cannot be said that it is mismanaged - *Chennabasappa Kothambari* v. *Multiplast Industries (Karnataka) (P.) Ltd.* [1985] 57 Comp. Cas. 541 (Kar.).
3. Removal of Secretary by majority decision of Board of directors unless it is shown that the removal has prejudicially affected the interest of the company or the public interest - *Dr. V. Sebastian* v. *City Hospital (P.) Ltd.* (*supra*).
4. The mere keeping of the moneys of the company in a Term Deposit is not bad business practice or in any case such mismanagement as would warrant interference under section 398 [now Section 241].

   The single act of letting out the premises of the company is not sufficient to attract this section.

   Allegations that properties of the company have been let out at low rents without any proof as to what higher rents were available as also an unsubstantiated allegation that premium amounts were misappropriated were held to be not sufficient in invoking the provisions regarding mismanagement - *Jaladhar Chakraborty* v. *Power Tools and Appliances Co. Ltd.* [1994] 79 Comp. Cas. 505 (Cal.).
5. *Arrangement with creditors in company's* bona fide *interest.* - Where the directors of a company in financial difficulties arrange with the company's creditors that the creditors may become shareholders and directors instead of remaining as creditors, was not an act of mismanagement or oppression so far as the existing shareholders are concerned but done *bona fide* in the best interests of the company - *Suresh Chandra Marwaha* v. *Lauls (P.) Ltd.* [1978] 48 Comp. Cas. 110 (DB) (P & H).

6. *Removal of director and termination of works manager's services* - Termination of the services of a works manager who held only ten shares was not in itself an act of mismanagement - *Modern Furnishers (Interior Designers) (P.) Ltd., In re* [1985] 58 Comp. Cas. 858 (Cal.). Removal of some of the directors from office which was found to be valid was held to be not a state of mismanagement of the company's affairs - *Siddaramappa Bapurao Patil* v. *Ratna Cements (Yadwad) Ltd.* [1991] 70 Comp. Cas. 27 (Kar.).
7. Mismanagement cannot be alleged in pre-production stage - *S. Seetharaman* v. *Stick Fast Chemicals (P.) Ltd. (supra).*
8. Mere breach of fiduciary duty resulting in suffering of interest of company or public interest is not a ground for interference by CLB (now Tribunal) under section 398(1)(*b*) [now Section 241]; there must be material change in management or control of company - *Gordon Woodroffe & Co. Ltd.* v. *U.K. Gordon Woodroffe Ltd. (supra).*

Removal of existing directors and appointment of new directors cannot be challenged in a petition under section 398 [now Section 241]. It is only when the new directors misconduct the affairs of the company that it may be said that they had been working to the prejudice of the company - *Rai Saheb Vishwamitra* v. *Amar Nath Mehrotra* 1983 Tax LR 2600 : [1986] 59 Comp. Cas. 854 (All.).

Winding up order declined when basic complaint was of mismanagement - The petitioner sought winding up order as just and equitable under section 433(*f*) [now Section 271] alleging mismanagement of the company as the company did not recover sale proceeds of six flats. The Court declined to pass the order as specific remedy against mismanagement is available under section 398 [now Section 241]. The petitioner has to establish circumstances justifying winding up of the company and show that no alternative remedy is available to him. Petitioner cannot just come to the Court without first exercising his rights as shareholder in the given circumstances - *Kiritbhai R. Patel* v. *Lavina Constructions & Finance Ltd.* [1999] 20 SCL 158 (Guj.).

22.8-7 Private agreement for investment and section 241

The CLB, in *Allianz Securities Ltd.* v. *Regal Industries Ltd.* [2000] 25 SCL 349 has held that disputes arising out of private agreements for investment in shares have to be agitated in civil suit and the same cannot be dealt with in petition under sections 397 and 398 [now Section 241].

A dispute arising out of MoU relating to right of applicant to obtain petitioners shares in company was held to be a private dispute under an independent contract between shareholder and prospective purchaser. Such a dispute is not covered Section 241/242 of the Act. [*Adbhut Vincom (P.) Ltd.* v. *Hotel Birsa (P.) Ltd.* [2016] 74 taxmann.com 82 (NCLT - Kolkata)]. Similarly, the NCLT, New Delhi refused to pass restrain orders under Section 241 over a property which was subject matter of a dispute pending before a civil Court. [*Vinod Muktinath Sharma* v. *Sharma Realty (P.) Ltd.* [2016] 71 taxmann.com 144 (NCLT - New Delhi)]

Wrong and imprudent decisions in management - It is one of the settled principles in deciding on petition under sections 397 and 398 [now Section 241] that wrong/

imprudent decision *alone* cannot constitute oppression or mismanagement unless the same is motivated one or in breach of fiduciary responsibilities - *Ramaiya Electronics Ltd.* v. *Gujarat Trans Receivers Ltd.* [2002] 35 SCL 704 (CLB). The Madras High Court in *KRS Mani* v. *Anugraha Jewellers Ltd.* (*supra*) has pronounced that courts should recognise corporate democracy of a company in managing its affairs and should not restrict powers of the Board of directors of the company and should not interfere in day-to-day affairs of the company. This pronouncement, it appears, is not intended for a situation where management of affairs of a company is palpably wrong.

22.8-8 Oppression and mismanagement and family centred Companies

A review of cases on oppression and mismanagement reveal that a sizeable proportion of such cases arise in family centred companies and often involve private disputes among the family members bringing complexities in the concerned company's affairs. It has been held in various decisions:

1. Family arrangement of equality in shares not being a part of articles of association cannot bind the company.
2. Any attempt to block company from complying with directions of the Courts on the basis of shareholding strength is contrary to company's interest.
3. Raising resources by further issue of shares by the group in management is not oppressive to the other group so long the issue is in *bona fide* need of the company and articles do not prohibit such course of action.
4. Where articles provide that shares in the company are to be allotted equally/proportionately and that no new member could be inducted without approval of majority of members, equity demands, that in making allotments requirement of articles should be followed and any allotment of shares to outsiders without offering the proportionate shares to those who are entitled thereto is oppression. [*Vide V.B. Gopalakrishnan* v. *New Theatres (P.) Ltd.* [2001] 30 SCL 197 (CLB)]

   Also *see Mrs. Najma M. Saiyed* v. *Mehboob Productions (P.) Ltd.* [2005] 62 SCL 468 (CLB). In this case issue was development of the business property of the family held company. Decision of Board of directors to mobilise funds for the benefit of the company was not held oppressive. In fact, the CLB (now Tribunal) was of the view that the petitioner had oblique motive.
5. Private agreement among sisters regarding pre-emption right for transfer of shares, not being a part of the articles was not binding. An act to be construed as oppressive has to be burdensome or wrongful or it should have an element of lack of probity and fair dealing in matters of proprietary rights as shareholders. However, allotment of fresh shares to newly inducted shareholding group on a preferential basis without approval of general body, even though for a *bona fide* purpose, has to be held as oppression, more so when petitioner was a promoter shareholder/director. However, as the fund so brought it has been already utilised for the benefit of the company, instead of cancelling the issue of shares, petitioner should be offered fresh shares to bring her holding to the pre-issue proportion. It was also held that petitioner

being the only remaining founding family member in the company, she should continue to remain as a non-rotational director of the company so long she retains her shareholding as allowed in the order [*vide Ms. Pushpa Katoch* v. *Manu Maharani Hotels Ltd.* [2001] 31 SCL 97 (CLB)].

6. When a new majority is created or an existing majority is reduced to minority by allotment of new shares without complying with statutory provisions, it is an act of oppression as it marginalises a group by a wrong means even though fund was necessary for the purpose of the company. However, cancellation of irregular allotment was not resorted to as the funds were already utilised for the purpose of the company and the respondent was ready and willing to restore original shareholding percentage of the petitioner. In an interlocutory stage, suitable directions can be issued to preserve assets of the company but at the final stage no blanket order either permitting or restraining dealings in properties of the company should be given as that lies within realm of management/shareholders. Petitioners, being in minority, cannot seek a direction to wind up the company which the majority, did not desire. Having regard to the ceaseless conflict between the groups, it was held to be in the interest of the respondents to purchase petitioner's shares at a fair price to be determined by the statutory auditors—*Suryakant Gupta* v. *Rajaram Corn Products (Punjab) Ltd.* [2001] 31 SCL 120 (CLB). Also see *Arati Dutta Gupta* v. *Unit Construction Co. Ltd.* [2004] 52 SCL 679 (CLB); *T. Ramesh U. Pai* v. *Canara Land Investments Ltd.* [2004] 55 SCL 616; *Navin B. Patel* v. *Bhoomi Builders (P.) Ltd.* [2005] 60 SCL 209 (CLB). In this case 33% shareholding of petitioner group was reduced to less than 10% by clandestine issue of further shares. The act of respondent group was held to be oppressive.

7. Sale of properties owned jointly by two factions of a family and sold by one of the factions, where leave of court was necessary to effect the sale was held to be an act of oppression, when no leave of court was taken - *Bajrang Prasad Jalan* v. *Raigarh Jute & Textile Mills Ltd.* [2001] 32 SCL 583 (Cal.)

8. Board of directors, acting in fiduciary capacity, had no right to register irregular transmission of shares. Articles of Association provided for transmission only to holder of succession certificate and there was no evidence to show that the Board in effecting the transmission had regard to the relevant provision of the Articles. The registration of shares of the deceased in favour of one who did not hold the succession certificate was held as an act of oppression and therefore set aside - *A.J. Coelho* v. *South India Tea and Coffee Estates Ltd.* [2001] 33 SCL 503 (CLB).

9. In cases of family companies wherein equal shareholding and equal participation were in vogue, strict principles of company law need not be applied and equitable principle should be given equal weightage. Petitioners' grievance that they had been deliberately excluded from allotment of further shares was upheld and the CLB (now Tribunal) granted the petitioners' prayer for proportionate allotment of shares. While granting this, the CLB (now Tribunal), having regard to strained relationship between parties, did not pass any order on the other grievance involving non-election of one of the petitioners as a director - *V.G. Coelho* v. *Silver Cloud Estates (P.) Ltd.*

[2001] 33 SCL 662. The principle of equity was also upheld in a company which was of a nature of partnership - *Deepak C. Shriram General Sales Ltd. (supra).* Also see *Hansraj Gokuldas Ved* v. *Nitin Dyeing & Bleaching Mills (P.) Ltd.* [2004] 55 SCL 600 (CLB); *Navin Ramji Shah* v. *Simplex Engineering and Foundry Works (P) Ltd.* [2007] 75 SCL 336 (CLB). This case also upheld that in family companies and companies in nature of quasi-partnerships, directorial complaints can be entertained. In *Anant Ram Sarangal* v. *Balwant Bros. (P) Ltd.* [2007] 75 SCL 97 (CLB), a complaint contained composite matters *i.e.* issues on shareholding and directorial rights. The petition under sections 397 and 398 [now Section 241] was admitted. Also *see Nagesh Kumar* v. *Nagesh Hosiery Exports Ltd.* [2009] 93 SCL 238 (CLB).

10. In a family based company in the nature of quasi-partnership, admission of new members should be with the consent of existing members. Though a number of irregular and improper acts were allegedly committed by respondents to reduce the shareholding of the petitioners from 50% to less than 10% on record and to remove them from management of the company, the CLB (now Tribunal) ordered that the petitioners should sell their shares to the respondents/company on receipt of fair value in view of the fact that bringing back the parity in shareholding and management would bring deadlock in the company. This order was to safeguard the interest of the company - *S. Ajit Singh* v. *DSS Enterprises (P.) Ltd.* [2001] 34 SCL 547.

11. Directors of a company cannot use their fiduciary powers over the shares of the company for destroying an existing majority. They cannot gain total control of the company by use of improper means. The right to refuse transmission of shares cannot be invoked against the legal heir/successor of the deceased shareholder - *Smt. Shanta Devi Pratap Singh Gaekwad* v. *Sangramsinh P. Gaekwad* [2002] 37 SCL 339 (Guj.).

12. A party to a decision can never allege mismanagement - A family/private agreement between shareholders in the instant case, as a reference point before CLB (now Tribunal), has become redundant in view of the agreement between parties to implement the family settlement - *Prakash Nath* v. *Ashoka Mfg. Co. (P.) Ltd.* [2002] 38 SCL 747 (CLB).

13. In a partnership in the guise of a company (a family company), removing a director by dubious means and methods from directorship, siphoning of funds, not serving notice etc. constitute oppression. The CLB (now Tribunal) allowed compensation for loss of office as a director to the petitioner and directed the company and the respondents to purchase the shares of the petitioner at fair value - *V. Natarajan* v. *Nilesh Industrial Products (P) Ltd.* [2003] 41 SCL 237 (CLB).

14. Petitioner complaining that a majority group in the family company has been reduced to minority has to establish that all the family members involved have recognized creation and existence of groups in the company. However, any disturbance in shareholding of members disproportionately is an act of oppression - *Mrs. Shyamali Dey* v. *Homco Engg. Works (P.) Ltd.* [2003] 41 SCL 223 (CLB); also *Dilip Kumar Chandra* v. *Chandra & Sons (P.) Ltd.* [2003] 45 SCL 408 (CLB - Delhi).

15. The CLB [now Tribunal], in *Brij Mohan Bansal* v. *Bansal Gems (P) Ltd.* [2002] 38 SCL 1 has held that in the absence of cogent evidence from petitioner to support his contention, it is impossible to accept that concerned documents were fabricated/manipulated to oust him from management. Also, it was found unbelievable that petitioner could remain silent for over three years without raising the matter with the respondent.
16. Transfer of shares by certain members of the family in the family owned private limited company in full compliance of the requirements of the Articles of Association is not an act of oppression; also alternative use of land for earning revenue when normal business of the company has been closed is not an act of mismanagement - *Devaraj Dhanram* v. *Firebricks & Potteries (P.) Ltd.* [2002] 38 SCL 13 (CLB - Chennai).
17. Lack of mutual confidence between petitioner and respondent was taken into consideration by the CLB [now Tribunal] which gave option to the petitioner to take over the company after paying to the respondents their investments in share capital and share application money in the company and all other dues to them even though the petitioner might have got relief through order of the CLB (now Tribunal) to end oppression/mismanagement - *Arun Kejriwal* v. *A.R. Corrugated Containers (P) Ltd.* [2002] 38 SCL 52; in *Chandrakant Kantilal Shah* v. *National Refinery (P.) Ltd.* [2004] 51 SCL 387. The CLB, having regard to unreconcilable state of relations between warring groups in the family company directed sale of shares of the minority group to the majority.
18. When Chartered Accountants failed to find out from records of the company, the correct contribution towards shares of the company made by the petitioner, the CLB (now Tribunal) took into consideration the total project cost and total resources recorded for the same and attributed the difference to be the unrecorded contribution of the petitioner and ordered issue of shares to the petitioner, representing the difference - *S. Swamiyappan* v. *Andipalayam Common Effluent Treatment Plant (P.) Ltd.* [2002] 38 SCL 58.
19. Since petitioners had continued as directors even without attending Board meetings regularly and were getting remuneration for a long-time on the premise that all the branches of the family get some source of income from the company, stopping of that source of income on ground of vacation of office for irregular attending of the Board meetings is oppression - *M.G. Subrahmanyan* v. *Mannariah & Sons (P.) Ltd.* [2003] 45 SCL 8 (CLB).
20. Non-sending of notice of Board meeting to allot further shares to Petitioner's Group so as to render it minority as also appointing directors in exclusion of petitioner's group and removing existing director of petitioner's group resulting in loss of parity in the Board, amount to oppression and mismanagement - *T.O. Aleyas* v. *St. Mary's Hotels (P.) Ltd.* [2004] 56 SCL 177 (CLB).
21. In a family based company having activities in Jallandhar, Ambala, Jaipur and Delhi, where the participating family streams reached a stage of total deadlock in management despite existence of family agreement and shareholders agreement, the CLB (now Tribunal) by virtue of provisions of section 402 [now Section 242] and terms of agreements referred above on the

question of deadlock, can direct either purchase of one stream's shareholdings by another or division of the operating units which were all independent of each other, amongst the streams - *Vijay Kr. Chopra* v. *Hind Samachar Ltd.* [2005] 58 SCL 131 (CLB).

22. Reclassification of shares made in AGM for which notice was not served on the petitioner—the memorandum and articles were also correspondingly amended in that meeting. Further, no notice was served on the petitioner who was also a director for the board meeting in which additional shares were allotted. The respondent company could not produce any evidence of either notice being served on the petitioner or the family agreement relevant to the case. Held that all these acts of the respondent company are nullities and the allotment of shares was struck down - *Navin R. Shah* v. *Simshah Estates & Trading (P.) Ltd.* [2005] 59 SCL 282 (CLB).

23. Unanimous decision to give 40% shares of the company to the petitioner and to make him an NRI director of the company, taken at the Board meeting held in June 1988 remained to be implemented, inspite of reminders of the petitioner, who in 2003 filed petition for oppression and mismanagement. The objection of the respondent that the petition is time-barred was not accepted as the CLB Bench (now Tribunal) felt that the respondent should not be allowed to take advantage of its failure - *Harish Kumar Berry* v. *Berry's Automotive Udyog (P.) Ltd.* [2005] 59 SCL 659.

24. When a material change is brought about in management to the detriment of interest of main promoter, it is squarely covered under section 398(1)(*b*) [now Section 241]. Also where a company was floated by elder brother who was its managing director but company was run and managed by younger brother, in absence of elder brother (an NRI) ousting of managing director and cornering of substantial shares so as to have full control of that company by younger brother was oppression, being squarely covered by section 397(1) [now Section 241]. - *Kamal Kr. Dutta* v. *Ruby General Hospital Ltd.* [2006] 70 SCL 222 (SC). In a case where a close relative of the promoter (entrusted with management of the company) betrayed him and misappropriated huge amount that led the promoter to commit suicide, the CLB (now Tribunal) ordered the respondents to buy out the shares of the petitioner (wife of the deceased) who jointly held the shares with the deceased on payment of the investment made by the deceased together with interest @ 10% from the date of the investment - *Smt. Nita Raj Mirani* v. *Raj Auto Diagnostic Centre (P) Ltd.* [2007] 80 SCL 145.

25. In an allegation of allotment of shares being detrimental to the interest of petitioner, the primary thing to be seen is whether the allotment was valid in all respects. Here, petitioner was not allotted shares while others were, it was held as oppressive - *A. Ravishankar Prasad* v. *Prasad Productions (P.) Ltd.* [2006] 71 SCL 83. In this case the improper act of allotment to others in exclusion of the petitioner, though was a single act at that time, it had the potential of harming the interest of the petitioner on a continuing basis.

26. In closely held family companies or companies in the nature of quasi-partnership, if circumstances so warrant, even employment, directorial

complaints of shareholders can be entertained - *Dr. Vimal K. Jain* v. *BSI (India) Pvt. Ltd.* [2008] 85 SCL 212 (CLB).

27. In case of a closely held company, removal of any shareholder from Board by a process of manipulation, specially when such shareholder was associated with the company for a long period is an act of oppression - *Naginar Singh Siena* v. *R.S. Infrastructure Ltd.* [2008] 86 SCL 90 (CLB).

28. Where the petitioner has grievances comprised of civil matters as also matters falling within the scope of section 397 or 398 [now Section 241], he cannot be asked to first exhaust remedies available in Civil Court before coming for redressal of grievances falling within the ambit of section 397 or section 398 [now Section 241] [2008] 87 SCL 314 (Delhi), *Dayagen (P.) Ltd.* v. *Rajendra Darian Punj.*

29. A couple owned all the shares of a company, wife holding 90% and the husband 10%. Upon their divorce, dispute arose between them. By a consent order of CLB [now Tribunal], the wife's share was reduced to 50%. While she was mentally depressed, she was made to sign a paper accepting only Rs.7.5 lakhs for the shares given up as against Rs.90 lakhs determined by a valuer. On her realizing the fraud and misrepresentation, she appealed to the High Court. The High Court set aside the CLB order as also the effect of her signing the consent document as the same was obtained by fraud and misrepresentation - *Mrs. Neelu Kohli* v. *Nikhil Rubbers (P.) Ltd.* [2009] 91 SCL 202 (All.)

In a petition for oppression and mismanagement a right must exist against a third party respondent - The Allahabad High Court in *Banaras Bank* v. *Bhagwan Das* AIR 1947 All. 18 had laid down two tests to decide whether a certain person is a necessary party. These tests are—

(*i*) there must be a right to relief against such party in respect of the matter in complaint, and

(*ii*) it should not be possible to pass an effective decree in the absence of such a party.

Interested third party in proceedings u/s 241 - When *prima facie* any third party is found to be involved in carrying out oppression and mismanagement in the affairs of a company and named in the petition as respondent, his prayer for deleting his name as respondent cannot be granted - *Das Lagerwey Wind Turbines Ltd., In re* [2004] 55 SCL 378 (CLB).

22.8-9 Affairs of a company include affairs of its subsidiary(ies) in appropriate cases

Section 241 of the Act focus on "affairs of the company" in the context of oppression and mismanagement - where the respondent, primarily being a family based company, is also a dominant member of the family group companies, the expression "affairs of the company" as above would include affairs of its subsidiaries and the chain of subsidiaries where a clear nexus of operational control can be discerned on the respondent; this will be specially so, if further the true character of the shareholding in various companies in the group is of partnership and the group working is as one single economic unit. If facts and circumstances of a case so

warrant, after going into the allegations, the affairs of the subsidiary(ies) would get merged in the affairs of the respondent company. From the above, it should not be construed that without going into the allegation and ascertaining the facts, the subsidiaries can be taken out of the scope of the expression "affairs of the company" or be included in it. Therefore, it is necessary, when the plaint connects up the affairs of the holding company and the subsidiary, the CLB (now Tribunal) has to go into the grievances and consider the evidence and their relevance to subsidiary. If they are relevant, the affairs of the subsidiary come within the scope of affairs of the holding company - *Shankar Sundaram* v. *Amalgamations Ltd.* [2002] 38 SCL 777 (Mad.), *Life Insurance Corporation of India* v. *Hari Das Mundhra* [1966] 36 Comp. Cas. 371 (All.), *Bajrang Prasad Jalan* v. *Mahabir Prasad Jalan* AIR 1999 Cal. 156; Debonair Agencies Ltd. - Company Petition No. 494 of 1989 before the Calcutta High Court. However, the affairs of an independent firm do not come within purview of the expression "affairs of a company" - *Sanjeev Joy* v. *Pereira & Rochi (P.) Ltd.* [2002] 39 SCL 176 (CLB). This case also relates to a family based company. As the CLB (now Tribunal) found affairs of a subsidiary was independent of the holding company, the petition of the petitioner to include the subsidiary also in his original petition under sections 397 and 398 [now Section 241] against the holding company was turned down - *P. Govindarajan* v. *Tiruppur Transports (P.) Ltd.* [2004] 55 SCL 453.

22.8-10 Waiver, estoppel or acquiescence by a shareholder holding 10% or more of shares in the company

The Madras High Court upheld the rejection of the appeal questioning maintainability of a petition filed against the appellant company on preliminary consideration as according to the appellant company, the respondent was a party to the relevant decisions now being questioned. The Court held that as the basic requisite for making the petition has been met, the petitioner cannot be disentitled from claiming reliefs on merit - *Amalgamations Ltd.* v. *Shankar Sundaram* [2002] 38 SCL 803 (Mad.).

22.8-11 Interim Order

Section 242(4) has a right to make an interim order on the application of any party to the proceedings for regulating the conduct of the company's affairs. It may by order impose such terms and conditions as may be just and equitable. The normal principles to be applied for grant of interim relief are - (*i*) there exists a serious dispute in question to be tried, (*ii*) court's interference is necessary to protect the parties from injury and (*iii*) a *prima facie* case has been established and the balance of convenience is in favour of the petitioner for interim relief. A joint venture (J.V.) agreement was entered into by a hotelier with a State Government for incorporation of a company to develop and manage a five star hotel (resort) proposed in the joint venture, for which the property belonged to the State Government. The joint venture provided for a time-frame for development and operation of the property into the stipulated hotel, reference of any dispute on the joint venture to arbitration and taking over of the shares of the hotelier in the incorporated company by the State Government when the hotel would fail to come to the stage of commercial operation within the time frame. Although the construction of the hotel was complete and it started commercial operation in a limited scale within the extended

time frame as per J.V., the State Government invoked the provision in the joint venture to take over the shares of the hotelier in the company. The hotelier applied to CLB (now Tribunal) for interim relief claiming, *inter alia*, that it has done its part under the joint venture and has incurred huge financial liability in developing the property into the hotel, and it is unfair for the State Government to take over its shares. The hotelier, however, did not, at this stage, refer the matter to arbitration under section 8 of the Arbitration and Conciliation Act, 1996. The State Government sought a stay on the interim proceeding and the same was not granted based on the aforesaid principles. The CLB [now Tribunal] also observed that where the factors appear to be evenly balanced, it is a counsel of prudence to take such measures as are calculated to preserve the *status quo* - *EIH Ltd.* v. *Mashobra Resort Ltd.* [2002] 38 SCL 562.

22.8-12 Amalgamation of transferor company after filing of petition under section 241

The transferee company would step into the shoes of transferor company when the High Court order sanctioning the scheme of amalgamation specifically stated that all legal proceedings pending by or against transferor company should be continued by or against transferee company. This decision also held that maintainability of petition under sections 397 and 398 [now Section 241] was to be seen when it was presented and substitution of transferor by transferee was to be allowed when petition was made prior to amalgamation - *RFB Latex Ltd.* v. *Union of India* [2005] 63 SCL 539 (Delhi)

22.9 Effect of 'Arbitration clause' in the Articles/Separate Agreement

Merely because there is an article in the Articles of Association of a company to the effect that any dispute between the company on the one hand and its members on the other will be referred to arbitration, the Tribunal will not stay a petition under section 241 for relief against oppression or mismanagement in the affairs of the company. The provisions of sections 397 and 398 [now Section 241] give exclusive jurisdiction to the CLB (now Tribunal) and the matters dealt with thereby cannot be referred to arbitration - *O.P. Gupta* v. *Shiv General Finance (Pvt.) Ltd.* [1977] 47 Comp. Cas. 297 (Delhi). However, when a dispute arises out of an agreement to settle the dispute by arbitration and no further development has taken place to novate the agreement on arbitration and in the circumstances of the case it is not improper or incapable of being arbitrated, the matter has to go for arbitration, especially in view of mandatory nature of section 45 of Arbitration and Conciliation Act - *Naveen Kedia* v. *Chennai Power Generation Ltd.* [1998] 17 SCL 327 (CLB). The distinguishing point may be the specific agreement as against a general clause in the Articles of Association.

When an agreement for arbitration of dispute subsists and the party has already submitted his statement in response to the proceeding under section 397/398 [now Section 241] on the substance of the dispute, he is debarred from invoking the arbitration agreement - *Suresh Kumar Jain* v. *Hindustan Ferro Industries Ltd.* [1998] 17 SCL 444 (CLB). Also *see VLS Finance Ltd.* v. *Sunair Hotels Ltd.* [2000] 28 SCL 253 (CLB). Where an alternative remedy was available to parties under joint

venture agreement (JVA) by way of Arbitration and Arbitrator had already been appointed by Supreme Court, approaching NCLT under Section 241/242 for issues arising out of violation of JVA were not at all tenable. [*Demerara Distillers (P.) Ltd.* v. *Demerara Distillers Ltd., Guyana* [2017] 77 taxmann.com 291 (NCLT - Hyd.)]

Where the company itself is not a party to the arbitration agreement [*i.e.,* the agreement is between the individual members (promoters)], then matters related to company affairs finding place in the petition under section 397/398 [now Section 241] cannot be referred to arbitrator - *Bhadresh Kantilal Shah* v. *Aia Magotteaux International* [2000] 24 SCL 270. Also *see Premier Automobiles Ltd.* v. *Fiat India (P.) Ltd.* [2004] 56 SCL 59 (CLB). However, where the subject-matter of the dispute is such that it can be adjudicated under section 397/98 [now Section 241] without reference to arbitration agreement the matter cannot be referred for arbitration even though the same is covered by arbitration agreement - *Sporting Pastime India Ltd.* v. *Kasturi & Sons Ltd.* [2006] 70 SCL 391 (CLB).

Where serious allegations of diversion of money, misappropriation and breach of trust are alleged and issues are already before the various law Courts and CLB (now Tribunal), the arbitration agreement between the Joint Venture partners, one being a foreign entity (financing partner) cannot be invoked as the arbitration proceedings cannot do justice to the complexities involved - *C.G. Holdings (P.) Ltd.* v. *Ramasamy Athappan* (supra – *vide* Para 2.4 of this Edition).

Jurisdiction of Civil Court in matters of oppression and mismanagement when a petition for oppression and mismanagement is pending before the Tribunal - The Punjab & Haryana High Court ruled that the Civil Court has no jurisdiction in the above circumstances as its jurisdiction is implicitly barred because the Companies Act itself has provided a complete machinery for redressal of grievances involving oppression and mismanagement - *Anil Gupta* v. *J.K. Gupta* [2002] 38 SCL 112. In this case majority shareholding group filed the petition alleging oppression and mismanagement against the minority group.

However, the CLB (now Tribunal) cannot pass any order on the same issue on which an order of the Civil Court was in force - *Dr. V.J.S. Vohra* v. *Mrs. Hardavin Johl* [2002] 37 SCL 784 (CLB).

Civil proceedings filed before filing petition with Tribunal - Proceedings before CLB (now Tribunal) have to be stayed till disposal of civil suit - *Guljarilal Kanoria* v. *Loptchu Tea Co. Ltd.* [2000] 24 SCL 101 (CLB).

22.10 Appeals against the orders of the Tribunal and variation of the order of Tribunal

As per Section 430 any suit of proceedings in respect of any matter which the Tribunal or Appellate Tribunal is empowered to determine under this Act or any other law, no civil court shall have jurisdiction to entertain such suits or proceedings. Under Section 421 any person aggrieved by the order or decision of the Tribunal may prefer an appeal to the Appellate Tribunal within forty-five days of the date of receipt by him of the copy of the order or decision. The appeal is to be made in such form and accompanied by such fee as may be prescribed. However, no appeal can be made in respect of an order or decision of the Tribunal made with

consent of the parties. If the Appellate Tribunal is satisfied that there was sufficient cause that prevented the appellant from filing the appeal within the period stipulated, it may allow an appellant to file the appeal even after expiry of aforesaid forty-five days but within a further period not exceeding forty five days. An appeal against the order of the Appellate Tribunal shall have to be made to the Supreme Court of India.

The Appellate Tribunal shall give a reasonable opportunity to the parties to the appeal of being heard before confirming, modifying or setting aside the order of the Tribunal appealed against. A copy of the order made by the Appellate Tribunal is required to be sent to the Tribunal and the parties concerned.

Allahabad High Court, in *Scientific Instruments Co. Ltd.* v. *Rajendra Prasad Gupta* [1999] 19 SCL 451 has held that when the CLB (now Tribunal) finding on matters of sections 397 and 398 [now Section 241] was based on no evidence or on surmise, conjecture and assumption, then the reference under section 10F [now Section 465] assumes the presence of question of law. The Court set aside the CLB (now Tribunal) order and directed hearing of the petition on merits including maintainability of petition afresh, on basis of documentary evidence and materials placed by parties.[21] Any person, not being a direct party, may prefer appeal against CLB's (now Tribunal's) order under section 402 (now Section 242), if he is affected by the order - *IDBI Ltd.* v. *CLB* [2007] 80 SCL 138 (Delhi).

Variation of the order of the Tribunal passed earlier - In a case where the CLB (now Tribunal) earlier ordered for appointment of four directors by the Central Government under section 402 (now Section 242), in the Board of a company presumably with a view to create a sense of confidence among creditors, shareholders and public in the working of the company, on a direction by the Supreme Court, an application was subsequently moved before the CLB (now Tribunal) to vary that order. The CLB (now Tribunal), being satisfied that considerable improvement has taken place in the working and affairs of the company, ruled that its earlier order is not required to be implemented. It was observed that the provisions of section 398 (now Section 241) are curative and/or preventive in nature and not punitive. Therefore, when the very basis for issuance of the earlier order is no more present, it will not be proper to stick to the earlier order. - *All India Shaw Wallace Employees Federation* v. *Shaw Wallace & Co. Ltd.* [2002] 40 SCL 393 (CLB).

22.11 Difference between winding up proceedings and proceedings under sections 241 and 242

Sections 241and 242 are intended to avoid winding up of a company, if possible, and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Relief, under sections 241 and 242, is perhaps, in fact, a better alternative to the winding up.

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21. Also *see Dale & Carrington Investment (P.) Ltd.* v. *P.K. Prathapan* [2004] 54 SCL 601 (SC) - Where the CLB finding of facts was held to be perverse and therefore appeal to the High Court was maintainable.

Thus, a shareholder aggrieved by oppression and mismanagement has two alternative remedies – to apply to the Tribunal under Section 241 for relief against oppression or mismanagement or to apply for the winding up on the grounds of mentioned under clause (*g*) of Section 271(1) suggesting that it is 'proper' that the company be wound up.

Between a winding up petition under section 271(1)(*g*) (*i.e.,* when it is 'just and equitable ' to wind up the company for reasons cited therein) and a petition under section 241, there are following distinguishable features :

Petition under section 241	*Petition for winding up under section 271(1)*(g)
1. Share qualification is required for an application *vide* section 244 unless otherwise allowed by the Central Government. As an alternative, a minimum number of members have been specified for a company having share capital. In respect of a company not having share capital a minimum proportion of membership as valid applicants has been specified.	1. No minimum share qualification is required.
2. Under section 241(2), the Central Government may itself apply if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to the public interest .	2. Any person authorized by the Central Government, the company itself, creditors or contributory may apply.
3. Nature of relief is much wider, *vide* section 242	3. Nature of relief is narrower vide Section 271
4. Remedy is of preventive nature and thus helps the continuity of company	4. Winding up results in the civil death of the company.

22.12 Composite/simultaneous petition under sections 241 and 271 - Whether maintainable

In view of the distinctions highlighted above, the Madhya Pradesh High Court in *Kilpest (P.) Ltd.* v. *Shekhar Mehra* (*supra*) held that the petition, if initially made under sections 397 and 398 (now Section 241), cannot be converted into a winding up petition under section 433(*f*) [now Section 271(1)(*e*) and even no composite petition can be filed].

But, the aforesaid decision of the Madhya Pradesh High Court was overruled by the Supreme Court in *Worldwide Agencies (P.) Ltd.* v. *Mrs. Margaret T. Desor* [1990] 67 Comp. Cas. 607. The Supreme Court in this case observed that "though there may be some differences in the procedure to be adopted, it is not such which is irreconcilable and cannot simultaneously be gone into". It further observed that "it

has to be borne in mind that a discretion is conferred on the Court and it is only when the court is satisfied that the facts justify the making of the winding up order on the ground that it is just and equitable that the company should be wound up, but if the court is further of the opinion that it would be a remedy worse than the disease, then the court can examine whether the alternative relief by way of a direction under section 397 [now Section 241] can be granted. This is a well accepted remedy exercised by the court". Thus, the Supreme Court held that "a composite petition under sections 397, 398 and 433(*f*) [now Sections 241 and 271(1)(*e*)] is maintainable".

Again, in *A.K. Puri* v. *Devi Dass Gopal Kishan Ltd.* [1995] 17 C.L.A 1, the J & K High Court held that there was no conflict of jurisdiction with respect to sections 397 and 398 and section 433 [now Section 241 and Section 271]. The Court observed that there is no statutory provision in the Companies Act which provides for stay of the winding up proceedings under section 433 [now Section 271] (while the CLB (now Tribunal) was seized of a petition between the same parties under section 397/398 [now Section 241]. Nor is there a precedent on this aspect. This should be distinguished from 'forum shopping' discussed earlier in the Chapter as the objectives of two petitions are dissimilar. According to the Supreme Court, when a petition under section 397/398 [now Section 241] is pending before CLB (now Tribunal), no writ petition on the same matter before a Court is ordinarily admissible.

The Supreme Court in *Kilpest Pvt. Ltd.* v. *Shekhar Mehra* (*supra*) has held that when the promoters of a company whether or not they were hitherto partners, elect to avail of the advantages of forming a limited company, they voluntarily and knowingly bound themselves by the provisions of the Companies Act. The submission that a limited company should be treated as a quasi-partnership should, therefore, not be easily accepted. Having regard to the wide powers under section 402 [now Section 242], very rarely would it be necessary to wind up any company in a petition filed under sections 397 and 398 [now Section 241].

Winding up petition as a creditor on ground of inability to pay debts is not a bar to admission of a composite petition under sections 397 and 398 [now Section 241] by the same party in the capacity of a member - *MMTC Ltd.* v. *Indo-French Bio-Tech Enterprise Ltd.* [2000] 23 SCL 192 (CLB).

22.13 Powers of the Tribunal [Section 242]

Whereas section 242(1) confer general powers on the Tribunal[22] to pass necessary orders to bring an end to matters concerning oppression and mismanagement, section 242(2) empowers it to grant certain specific reliefs. The reliefs contemplated under sub-section (2) are :

(*a*) *The regulation of the conduct of company's affairs in future [Section 242(2)(*a*)]* - In *M.R. Harmer Ltd., In re* [1958] 3 All EQ 689 (CA), a father held a majority of votes in the company. By virtue of a weighted shareholding he exercised his control irregularly without regard to the wishes of the Board.

22. However, the CLB (now Tribunal) should act in consonance with the requirement of the principle of natural justice while passing any order - *Garib Ram Sharma* v. *Daulat Ram Kashyap* [1994] 80 Comp. Cas. 267 (Raj.).

The Court ordered that he should be employed as consultant only, and that he should not further interfere in the affairs of the company except in accordance with the decision of the Board. Again, in *Bennet Coleman & Co.* v. *Union of India* [1977] 47 Comp. Cas. 92 (Bom.), the Bombay High Court ordered for the incorporation of a new regulation in the articles providing for retirement of the shareholders' directors every year. Further, it held that the regulation was valid even if it was contrary to the provisions of section 255 [now Section 152] . In *Richardson and Cruddas Ltd., In re* [1959] 29 Comp. Cas. 549, the Calcutta High Court ordered for the appointment of a Board of advisers to assist the special officer already appointed in managing the business of the company, subject to the terms and conditions laid down in the order.

It may be noted that the CLB's [now Tribunal] power under section 242(1) in regulating the management of the company can be exercised even during the pendency of petition under section 397/398 [now Section 241] - *B.R. Kundra* v. *Motion Pictures Association* [1978] 48 Comp. Cas. 564 (Delhi).

However, under section 402 [now Section 242] directions only for administration and management of affairs of company can be given; questions relating to debts due to third parties are outside its scope - *T.P. Sokkalal Ram Sait Factory (P.) Ltd., In re* [1978] 48 Comp. Cas. 503 (Mad.).

It may be noted that a committee of management appointed by Court (now Tribunal) is not board of directors, nor even a special officer or receiver, and its powers are not subject to those limitations which apply to board, special officer and receiver - *Pramod Kumar Mittal* v. *Andhra Steel Corpn. Ltd.* [1985] 58 Comp. Cas. 772 (Cal.).

(*b*) *Purchase of the shares or interest of any members of the company by other members thereof or by the company [Section 242(2)(*b*)]* - In *Suresh Kumar Sanghi* v. *Supreme Motors Ltd.* (*supra*), the Delhi High Court granted the group in actual control the opportunity to purchase the shares of the other group at a price to be fixed by a judge. Also *see Bajrang Prasad Jalan* v. *Raigarh Jute & Textile Mills Ltd. (supra); Suresh Arora* v. *Grevlon Textile Mills (P) Ltd.* [2007] 80 SCL 228 (CLB) and *H.S.D.C. Radharamanam* v. *M.S.D. Chandra Sekara Raja* [2007] 80 SCL 254 (Mad.). In this case, though oppression was not proved but to remove the deadlock in the management, the father was asked to sell his shares to his son at an independently obtained value. In this case, father and son were the only shareholders and directors.

An order requiring one party to sell the shares to others should be an appropriate order spelling out the person who should sell and who should purchase and at what price. There could be no final order under this section unless these very pertinent matters are appropriately decided. Thus, an order referring the disputes between parties to an arbitrator should show that the court contemplated passing of final or appropriate order after receiving the award of the arbitrator. Such an order cannot be considered as a final order under this section - *Shree Sadul Textile Ltd.* v. *Raza Textiles Ltd.* 1973 Tax LR 2119 (Raj.) (DB). A mere agreement between the parties

that there should be sale by one to the other cannot be treated as a proper and valid order in terms of this section - *Shree Sadul Textile's* case (*supra*).

In one case, the petition filed by an aggrieved shareholder for winding up the company was dismissed by the High Court. On an application filed by him subsequently for relief under sections 397 and 398 [now Section 241], the CLB (now Tribunal) directed the majority shareholders to purchase the shares of the aggrieved shareholder at a specified price - *Shree Daulat Makanmmal Luthra* v. *Keshav Naik* [1992] 9 CLA 72. It may, however, be noted that section 402 [now Section 242] does not contain any stipulation that it is the minority, which should be directed to sell their shares to the majority - *Girdhar Gopal Dalmia* v. *Bateli Tea Co. Ltd.* (*supra*). When petitioner and respondent, both are found not to have come with clean hands and they both lack *bona fide*, the CLB (now Tribunal) is competent to dismiss the petition but may order certain remedial steps while dismissing the petition - *Sunil Kalra* v. *Bawa Shoes Leather Guild (P) Ltd.* [2008] 80 SCL 1 (CLB).

Valuation of shares - The overwhelming requirement in valuing shares is that the price should be fair. What is fair will depend upon the facts of the particular case - *Bird Precision Bellows Ltd.* (*supra*). There is no general rule as to the date by reference to which the valuation of shares should be made. Date of valuation of shares may be the date of the petition, or a date prior to the petition or the date of the order. Generally, it is the date of the petition that is favoured because it is the date on which the members chose to complain about oppression or mismanagement - *Cumana Ltd., In re* [1986] BCLC 430 (CA). In appropriate cases, however, fairness may sometimes require that the shares be valued at a date earlier than the petition - *O.C. Transport Services Ltd., In re* [1984] BCLC 251; Re, a Company [1983] 1 WLR 927 and *London School of Electronics Ltd., In re* [1986] Ch. 211. Nourse, J., thought that, *prima facie*, an interest in a going concern ought to be valued at the date of the order for purchase.

Valuation of shares can be directed to be done both on assets basis and on maintainable profits basis so as to enable the court to decide at what price the shares should be offered to the purchasing group. As to what should be the value of the shares to be so offered is to be decided after the receipt of the report of the valuers - *Omni India (P.) Ltd.* v. *Balbir Singh* [1989] 2 Comp. LJ 216 (Delhi); *Rakhra Sports (P.) Ltd.* v. *Khairatilal Rakhra* [1993] 10 CLA 96 (Kar.) (DB).

The Kerala High Court in *Kanthimathy Plantations (P.) Ltd.* v. *S. Veera Subramonia Sarma* [2004] 54 SCL 360 has held that value of a company has to be assessed not by valuing land but considering fixed assets, loss and liabilities. The court set aside the valuation approved by CLB (now Tribunal).

CLB in *Gurmit Singh* v. *Polymer Papers Ltd.* [2003] 45 SCL 251 has held that section 77A [now Section 68] relating to buy-back of shares has nothing to do when the CLB [now Tribunal] passes an order under section 402 [now Section 242] directing buying of shares of the company by the company itself.

It was held by the NCLAT, New Delhi that where option to purchase shares was given to those who had been found by NCLT to be oppressed, valuation of shares was to be done on date of decision of oppression and mismanagement petition. [*K.J. Paul* v. *Seaqueen Builders (P.) Ltd.* [2019] 102 taxmann.com 155 (NCL-AT)]

(*c*) *Reduction of share capital [Section 242(2)*(c)*]* - The order of the Tribunal relating to purchase of its own shares by the company as per clause (*b*) may also provide for the consequent reduction of its share capital. However, before granting such reduction, it is not necessary to give notice of the consequent reduction of share capital to the creditors of the company. No such requirement is laid down by the Act. The procedure prescribed for reduction of share capital (including resolution of the shareholders confirming the reduction of capital) in sections 100 to 104 [now Section 66] need not be followed in respect of a reduction of share capital affected pursuant to the order under this section - *Cosmosteels (P.) Ltd.* v. *Jairam Das* AIR 1978 SC 375. Nevertheless, before giving directions for purchase of shares of members by the company, the court should keep in view all the relevant facts and circumstances, including the interests of the creditors. Even if the petition is being disposed of on a compromise between the parties, the court should certainly satisfy itself that the direction proposed to be given by it pursuant to the consent terms would not adversely affect or jeopardise the interests of the creditors - *Cosmosteels'* case (*supra*).

(*d*) *Restriction on transfer or allotment of shares [Section 242(2)*(d)*]* – The Tribunal may impose such conditions on the transfer or allotment of shares by the company, as it may deem fit.

(*e*) *Termination, setting aside or modification of any agreement between the company and the managing director/director/manager [Section 242(2)*(e)*]* – Tribunal may, in its order, direct the termination, setting aside or modification of any agreement, howsoever arrived at, between the company on the one hand, and any of the following persons, on the other, namely :

(*i*) Managing director,

(*ii*) Any other director, and

(*iii*) the Manager,

upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in all the circumstances of the case.

In *Shoe Specialities Ltd.* v. *Standard Distilleries & Breweries (P.) Ltd.*[23], it was held that when a case of oppression is made out, it is within the powers of CLB (now Tribunal) to end the matter and make such orders as it thinks fit. While considering to end the matters complained of and when given the power to make any such order as it thinks fit to rectify the same, the CLB (Tribunal) is empowered to remove the Board of directors so that the affairs of the company could be set right.

23. Reported in Chartered Accountant, March, 1997.

(*f*) *Termination, setting aside or modification of any agreement between the company and any third person [Section 242(2)*(f)*]* - Again, Tribunal may, in its order, direct the termination, setting aside or modification of any agreement between the company and any third person provided due notice to the party concerned has been given and his consent obtained for the modification.

(*g*) *Setting aside of any transfer, delivery of goods, payment, execution or other act relating to property [Section 242(2)*(g)*]* - The Tribunal may, in its order, direct the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under section 241, which would if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference.

The period of three months should be a clear period of three months between the date of transfer and that of application - *Roshan Lal Aggarwal* v. *Sheoram* [1980] 50 Comp. Cas. 243 (Pat.).

(*h*) *Removal of the managing director, manager or any of the directors of the company [Section 242(2)*(h)*]* - The Tribunal may by order remove the managing director, manager or any of the directors of the company.

(*i*) *Recovery of undue gains made by any managing director, manager or director [Section 242(2)*(i)*)* - The Tribunal may order for recovery of undue gains made by the managing director, manager or director removed under clause (*h*). The Tribunal may also prescribe the manner in which the amount recovered shall be used including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(*j*) *Manner of appointment of managing director or manager of the company [Section 242(2)*(j)*]* - If an order removing the existing managing director or manager of the company made under clause (*h*) has been passed, the Tribunal may also prescribe the manner of appointment of managing director or manager to fill the vacancy so caused.

(*k*) *Appointment of directors on the Board [Section 242(2)*(k)*]*- The Tribunal may appoint such number of directors and direct them to report to the Tribunal on such matters as the Tribunal may direct.

(*l*) *Imposition of costs* as may be deemed fit by the Tribunal *[Section (242(2)*(l)*]*

(*m*) *Any other matter [Section 242(2)*(m)*]* - The Tribunal is conferred with the residual powers of granting relief in respect of any other matter for which, it is just and equitable that provision should be made.

Thus, the Tribunal has power to make the order in regard to convening and holding of meetings, filing of proxies or nominations or in regard to any other matter for the purpose of conducting the affairs of a company, which might be contrary to the provisions of the articles of the company or of the Act, *e.g.*, order for reduction of capital - where otherwise procedure in sections 100-104 [now Section 66] need not be followed—*Debi Jhora Tea Co. Ltd.* v. *Barendra Krishna Bhowmick* [1980] 50 Comp. Cas. 771 (Cal.) (DB).

The residuary provision of clause (*m*) has, however, to be construed in the light of the object with which this section has been enacted, namely, to give directions regarding internal management of the company. This section, therefore, cannot be utilised for agitating disputes about liabilities like debts due to third parties or for staying tax liability of the company - *T.P. Sokkalal Ram Sait Factory (P.) Ltd., In re* (*supra*).

In *Tushar Clothing (P.) Ltd.* v. *Ramesh D. Shah* [2015] 59 taxmann.com 300 (CLB - Mumbai). It was held that even if no case of oppression and mismanagement was made out under section 241 yet CLB could pass an order directing one party to sell its shareholdings to other group. Since in the instant case it was clear that both groups could not run management of company together and company could not function smoothly by these two rival groups, it would be just and proper that majority shareholders be directed to buyout shares held by petitioners in company at a fair price to be determined by an independent valuer.

In *Prakash Timbers (P.) Ltd.* v. *Shushma Shingla* [1996] 1 Comp. L.J. 133 (All.), the issue was *whether the CLB (now Tribunal), in proceedings under sections 397 and 398* [now Section 241], *has powers to order transfer of property* when a transfer of property can only be done by execution of a proper deed of conveyance and registering the same. It was held that sections 397 and 398 [now Section 241] read with section 402 (now Section 242) empower the CLB (now Tribunal) to make such orders as it thinks fit with a view to bring to an end the matters complained of.

In *Desin (P.) Ltd.* v. *Electrim (I) Ltd.* [2001] 32 SCL 393, the CLB ordered for inspection of the books of account of the company having regard to the facts of the case which, *inter alia*, involved serious allegations on accounting. The inquiry order was to be issued by the Central Government under section 209A [now Section 207]. Depending upon facts of the case, even where oppression is not established, the CLB (now Tribunal) can pass appropriate order on equitable jurisdiction conferred by section 397 [now Section 241] - *Delstar Commercial & Financial Ltd.* v. *Sarvottam Vinijaya Ltd.* [2001] 32 SCL 416.

In *Bajrang Prasad Jalan* v. *Raigarh Jute & Textile Mills Ltd. (supra)* the Calcutta High Court ruled that the power to order investigation (sections 235 and 237*) in proceedings under sections 397 and 398 [now Section 241] can cover related entities as well like the holding company and the subsidiary company

The Madras High Court in *Prabir Kumar Misra* v. *Ramani Ramaswamy (supra)* has, *inter alia*, held that even where charge of oppression is not established, powers of CLB (now Tribunal) wide enough for enforcing equitable jurisdiction.

22.13-1 Removal of directors, etc.

The Central Government may request the Tribunal to enquire whether the person concerned with the management of a company is fit and proper person to hold the office of the director or any other officer connected with the conduct and management of the company. [Section 241(3)]. The Tribunal on such application shall record its decision specifically stating whether such person is fit and proper person to hold such office of any company. [Section 242(4A)]. A person determined to be not a fit and proper person as aforesaid and removed from the office, shall not be entitled to or be paid any compensation for the loss of the office. Further, such person shall not hold the office of the director or any other officer connected with

*Now sections 210 and 213.

the conduct and management of any company for a period of five years from the date of the order by the Tribunal. However, the Central Government, with the leave of the Tribunal may permit such person to hold any such office before the expiry of the said period of five years. [Section 243(1A) and (1B)].*

22.13-2 Whether the provisions of the Evidence Act and Code of Civil Procedure are applicable to proceedings under section 241

In *Rajinder Kumar Malhotra* v. *Harbanslal Malhotra & Sons Ltd.* (CP 57 of 1992 decided on 18-1-1996), the issue involved was whether the provisions of the Evidence Act and Code of Civil Procedure are applicable to proceedings under sections 397 and 398 [now Section 241] before the CLB (now Tribunal) and whether recording of oral evidence and cross-examinations can be pressed for.

As a general principle, the Supreme Court has laid down that the Evidence Act had no application to enquiries conducted by Tribunals, even though they might be judicial in character. The Tribunals should observe rules of natural justice (AIR 1957 SC 882); (1995) 4 SCC 132.

As per section 424(1) of the Companies Act, the Tribunal shall be guided by the principles of natural justice and shall act in its discretion to regulate its own procedure.

Interim Order by the Tribunal [Section 242(4)] - Under section 242, the Tribunal may make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable. The Tribunal may pass such an order on the application of any party to the proceedings.

Before making an interim order it is necessary first to test whether a *prima facie* case for an order under section 241 has been made out by the person invoking the Tribunal's jurisdiction or not. The words "for regulating the conduct of the affairs upon such terms and conditions as appear to it to be just and equitable" clarify that the CLB (now Tribunal) is required to take for the purpose of interim order only such step which is necessary for regulating the conduct of the affairs and upon such terms and conditions as appear to it to be just and equitable - *G. Kasturi* v. *N. Murali* [1991] 5 CLA 269/[1992] 74 Comp. Cas. 661 (Mad.).

As already noted, the CLB (now Tribunal) has powers to enable the regulation of the company during the pendency of a petition under section 397 or 398 [now Section 241] in order to protect the interest of the company during the hearing of the petition and to prevent a complete deadlock in the running of the company - *B.R. Kundra* v. *Motion Pictures Association* (*supra*). Where there is complete lack of confidence between the warring groups resulting in the company's plant and machinery lying idle, interim order may be passed to permit the working of the company but without causing any hardship to either of the groups and without entailing further financial liability on either of the groups - *Anil Kumar* v. *Bedla Flour Mills & Allied Industries (P.) Ltd.* 1978 Tax LR 1663 (Raj.).

Similarly, the CLB (now Tribunal) allowed further issue of shares by the respondent, when proceedings under section 397 [now Section 241] were on, as the same was decided by the Board in the interest of the company and petitioner was

*Section 241(3), Section 242(4A), Sections 243(1A) and 243(1B) inserted *vide* the Companies (Amendment) Act, 2019.

not excluded from the issue - *Girish Gupta* v. *Tirupati Roller Flour Mills (P) Ltd.* [2007] 79 SCL 282. However, Chennai Bench of CLB (now Tribunal) has held that where rival groups were competing for control of company and interim order was passed in section 397 [now Section 241] petition for buying out of shares, an application for increase in share capital and allotment of shares cannot be permitted without documentary proof of financial requirement in interest of company- *Sharvani Energy (P.) Ltd.* v. *N. Venkateshwar Rao* [2013] 31 taxmann.com 172 (CLB - Chennai).

An applicant for an interim relief must satisfy the CLB (now Tribunal) that he would be entitled to a similar or a greater relief if he succeeds in the action. If, on the other hand, the relief cannot be granted in the action itself or in the main petition, an interim relief which is always granted by the CLB (now Tribunal) in aid of the relief in the action itself should be refused - *Bengal Luxmi Cotton Mills Ltd., In re* (*supra*).

The Delhi High Court in *R.F. Wood & Co. Ltd., In re* [2002] 39 SCL 378 has stated that the relief sought under section 402 (now Section 242) has to flow from the petition under sections 397 and 398 [now Section 241].

An interim order made upon the consent of all parties concerned cannot be revoked, recalled or cancelled when it has been acted upon by the parties concerned - *Parvesh Kumar Basu* v. *Special Officer, New Standard Coal Co. Pvt. Ltd., In re* [1964] 2 Comp. LJ 184 (Cal.).

Interlocutory order - An interlocutory order passed by CLB (now Tribunal) is open to final adjustment if nature of proceedings and the order do not appear as impediment - *Tara Properties Ltd.* v. *Bhagirathi Agarwala* [2004] 52 SCL 158 (Cal.)

Limitation on inherent power of the Tribunal in the matters of oppression and mismanagement—In *Shaw Wallace & Co. Ltd.* v. *Union of India* [1998] 4 CLJ 299 (Cal.), the High Court held that inherent powers stipulated under regulation 44 of the CLB (now Tribunal) Regulations have to be exercised in aid of and within the provisions of the concerned statute. There are provisions in the Act enabling CLB (now Tribunal) to pass interim order in specific circumstances and not in general terms. It may be observed that the Tribunal's power to pass interim order under section 242 is restricted to matters of oppression and mismanagement under section 241 only.

Effect of alteration of Memorandum of Association or Articles of Association of Company by order under section 241 [Section 242] - Where an order under section 241 results in an alteration in the Memorandum or Articles, the company shall not have power to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order of the Tribunal. The alteration made in the Memorandum or Articles shall within thirty days be filed by the company with the ROC who shall register the same. The order of the Tribunal will have the same effect as is obtained by following the required procedure for alteration of the Memorandum or the Articles.

Consequences of termination or modification of certain agreements [Section 243] - Where an order made under section 241 terminates, sets aside or modifies an agreement between the company and the managing director/director/manager or any other person [as referred to in clause (*e*), (*f*) or (*g*) of section 242(2)], no compensation shall be payable for loss of office or in any other respect resulting therefrom. Further, a person *i.e.* a managing director or a director or a manager,

whose agreement or office has been terminated by the order of the Tribunal shall not act for the company for five years thereafter without the leave of the Tribunal. Any person who knowingly acts as a managing director, or other director, or manager in contravention of this provision and every other director of the company who is knowingly a party to this contravention, shall be punishable with imprisonment up to one year, or with fine up to rupees five lakh, or with both.

Estoppel - After making a petition under sections 397 and 398 [now Section 241], the parties arrived at a settlement and the same was placed before the CLB (now Tribunal), which in turn, passed a consent order embodying facts and terms of settlement. Eventually, valuation of shares made by a valuer was rejected by both the parties and at that stage the respondent raised question on maintainability of the petition and the same was rejected is with the passing of the consent order the parties have been estopped from contending otherwise than the terms of settlement even though no finality was then there on the valuation of shares - *K.K. Framji* v. *Consulting Engg. Services (P.) Ltd.* [2002] 38 SCL 1118 (CLB).

Does Tribunal possess power to review its own order? - Under Section 420(2), the Tribunal has a right to amend an order passed by it amend. Such an amendment may be made at any time within two years from the date of the order, with a view to rectifying any mistake apparent from the record, if the mistake is brought to its notice by the parties. However if an appeal has been made in respect of any order, no such amendment shall be made.

22.13-3 Some more cases on oppression and mismanagement—

1. Where validity of petitioner's status as wife of the deceased shareholder is under challenge in a civil suit, the company's insistence on receiving of succession certificate for effecting transmission of shares of the deceased, is not oppressive. Claim for rent etc. receivable by the petitioner arising out of contractual rights and obligations between the petitioner and the company does not fall within the ambit of sections 397 and 398 [now Section 241] - *Smt. Prameela Ravindran* v. *Vital Instruments (P.) Ltd.* [2003] 45 SCL 46 (CLB - Chennai).
2. The management of the company has passed on to a group and the group holding 16.5% shares in the company, being the group formerly managing the affairs of the company, accuses the present management of mismanagement on various counts while facing charges of mismanagement by the present management group. This matter cannot be adjudicated under section 397/398 [now Section 241]. However, the former management group has to be relieved from the liability of personal guarantee given for the company as it is now not in the management and has also a substantially lesser stake in the shares of the company - *M.K. Dhir* v. *Givo Ltd.* [2003] 45 SCL 55 (CLB - New Delhi).
3. Sale of property agreement entered into by the company before petition under section 397/398 [now Section 241] was filed and partly remaining to be executed has to be allowed as the sale is *prima facie* not below market price - *Vijayawada Share Brokers Ltd.* v. *D. Ramkishore* [2003] 45 SCL 1 (CLB - Chennai).
4. When the Articles provided for consensus on important matters amongst almost equal shareholding blocks and one block unilaterally decides on an

issue on which despite earlier discussions with other block, consensus was not reached, such block cannot complain of oppression or deadlock. The other block also cannot succeed in its charge of mismanagement against the former block as minutes revealed that the company's loss was due to bad market condition and not mismanagement. In view of lack of trust for each other, it would be appropriate that either block goes out of the company. Since ordering either to go out would be unfair in view of valuable contributions made by both the groups to the company in the past, preferred course was to order both the blocks to value the shares of the company and the block arriving at a higher value being asked to buy the shares held by the other block at that value - *Tenneco Mauritius Ltd.* v. *Bangalore Union Services Ltd.* [2003] 45 SCL 205 (CLB - Chennai).

5. Petitioners alleged oppression and mismanagement by the respondents on account of non-convening of meetings of the Board and the members, removal of petitioners from directorship, illegal allotment of shares and induction of persons in the Board of directors, siphoning of the company's funds and encumbering company's properties without any benefit to the company and all these were denied by the respondents. It was held that mere production of certificate of posting of notices of the meetings in the absence of any other corroborative evidence shows an effort on the part of respondents to marginalise the petitioners. Therefore, induction of directors could not be held valid. Also, as the respondents could not produce any documentary proof of having brought funds for the allotment of shares made or having utilised any such fund for the company, the allotment of shares made in exclusion of petitioners was oppressive. The order directed for allotment of shares to the petitioners as per their entitlements - *M.M. Subrahmanyam* v. *Gulf Olefines (P.) Ltd.* [2003] 45 SCL 240 (CLB - Chennai). Also *see M.M. Subrahmanyam* v. *Prasanna Investments (P.) Ltd.* [2003] 47 SCL 161 (CLB - Chennai).

6. With a view not to destabilise the control of the plaintiff and defendant on the company and not to upset existing MOU between them and to prevent any third party gaining control over the company the court allowed the purchase of the block of shares (offered to a single party by UPSIDC), by the plaintiff on condition that 50% of the consideration payable would be on account of the defendant as aforesaid, who was running short of cash, so that their *inter se* relation is maintained - *K.K. Modi* v. *K.N. Modi* [2003] 45 SCL 509 (Delhi).

7. The rule against interference by court with internal management of a company is not applicable in cases of infringement of individual membership rights. Since there was no evidence of notice of the meeting being sent to the plaintiffs and the plaintiffs did not attend the meeting, the meeting should be deemed as not having been held and accordingly all the decisions purportedly passed thereat should be treated as null and void - *Dr. Dilip Makhija* v. *Arun Mittal* [2003] 47 SCL 241 (Delhi).

8. In *Maharashtra Power Development Corpn. Ltd.* v. *Dhabol Power Company* the Bombay High Court, held - (*i*) if effects of a single act is burdensome, wrongful and oppressive and of continuing impact, which deprives a member of his membership rights and privileges for all times to come, then a petition under section 397 [now Section 241] is maintainable, (*ii*) a petition

by shareholder(s) who are not minority shareholders, while the alleged oppressors are also not majority shareholders is also maintainable, (*iii*) a shareholder in the status of a shareholder is not entitled to be served with notice for the Board meeting, (*iv*) since Reg. 75 of Table A formed part of the articles of the company, two continuing directors could validly hold Board meeting for co-option/appointment of one more director to constitute valid quorum for Board meeting to be held in future, (*v*) in the absence of nomination to the Board by financial institutions, shareholders can appoint directors by majority vote, (*vi*) the mere fact that the holding company of the appellant would be loser in a different capacity and some other members would be beneficiaries in their concurrent capacity of creditors, cannot bar the Board from proceeding with the arbitration proceedings started by the respondent against such holding company, (*vii*) exercise of contractual rights against Government cannot be considered as against public interest, (*viii*) the fact that an arbitration proceeding against the Government or its instrumentality is also not against public interest merely for the fact that an adverse award by the arbitrator may lead to payment from public exchequer. This decision further held that where there was no lack of probity or fair dealing and no violation of proprietary rights of appellants as a shareholder and also the shareholder could not establish that it is just and equitable to wind up the respondent, the petition under section 397 [now section 241] lacks the essential elements required to maintain the petition. The Court added an *Obiter Dicta* - Even after appointment of a provisional liquidator, the Board of directors has a power to make a reference to BIFR and also the power to propose a scheme of arrangement under sections 391-394 [now Sections 230-234] to rehabilitate the company [2003] 48 SCL 180. On appeal, a Division Bench of the High Court upheld the judgment. Also it clearly stated that at the time of petition filing with CLB (now Tribunal), the petitioner was only a shareholder and it had no director on the Board, therefore there was no question of serving it with notice of Board meeting. No case of oppression on shareholders was also established [2004] 52 SCL 224.

9. Non-issue of further shares, to petitioner-applicants, offered by the respondent company, taking a plea that a joint application by several shareholders is not in conformity with provisions of section 41(2) [now Section 2(*55*)], was held as an act of oppression as provision of section 41(2) [now Section 2(*55*)] is inapplicable to issue of shares subsequent to first allotment of shares by the company - *Vijay Kumar Narang* v. *Prakash Coach Builders (P.) Ltd.* [2004] 56 SCL 274 (CLB).

10. Clandestine issue of further shares by the company to reduce the shareholding proportion of petitioner, not acknowledging the petitioner as shareholder and denial of right to the petitioner to nominate directors on the Board of the company were held as acts of oppression. The change of name of the petitioner, though intimated to the company, was not recorded to render the new name of the petitioner under which the petition was made, as a non-shareholder to deprive it of the right to redressal of oppression. The CLB (now Tribunal) ordered that petitioner could exercise all the rights that the entity could exercise as shareholder in its previous name - *Pearson Education Inc.* v. *Prentice Hall of India (P.) Ltd.* [2004] 56 SCL 365.

11. A petition under section 397 or 398 [now Section 241] must stand on its own footing and it should be complete with all the required details. Except any development arising subsequent to the petition, no other matters/fact can be entertained in deciding on the petition. Commercial misjudgement cannot be treated as oppression/mismanagement. Similarly, fluctuation in share price in the stock market without any evidence of manipulation cannot be so treated - *Central Government* v. *Kopran Ltd.* [2004] 56 SCL 428 (CLB).
12. CLB in *Gian Gupta* v. *Siel Ltd.* [2004] 56 SCL 560 has held that a petition written in English for which consent support signature of some of the consent givers was in Hindi, is not maintainable as the consents of those who signed in Hindi have to be ignored as it is to be presumed that they did not understand the writings in the Petition. When signatures in Hindi are ignored the number of petitioners along with consent givers fell below 100 and the aggregate shareholding also did not reach 10% of the subscribed share capital.
13. Allegation of non-compliance of the provisions of the Articles of Association that amount to oppression or mismanagement can only be considered by the CLB (now Tribunal) notwithstanding existence of an Arbitration Agreement between parties, the terms whereof were incorporated in the Articles - *Geriesheim GMBH* v. *Goyal M. Gases (P.) Ltd.* [2004] 56 SCL 593 (CLB).
14. When equal participation in day-to-day management of a domestic company exists among the petitioner and the respondent, there cannot arise a case of oppression. What can be there is only deadlock in management and relief can be by letting either party buying off the shares of the other - *MSD Chandrasekhar Raja* v. *Shree Bhaarathi Cotton Mills (P.) Ltd.* [2005] 57 SCL 72 (CLB).
15. On the issue of substitution of one of the original petitioners by another shareholder, it was held that proceeding under section 397/398 [now Section 241] is a representative proceeding and can continue even if one of the original petitioners withdraw, provided the petition is on merit. Substitution of one of the original petitioners by another shareholder is permissible even without the support of any enabling provision like section 405 of the Act - *Renuka A. Kattar* v. *Gees Marine Products (P.) Ltd.* [2005] 57 SCL 68 (CLB). This decision has two distinct parts:
    (*i*) continuity of the proceedings if petition was valid at the time of making, with or without any withdrawal - substitution syndrome. If the petition can stand on merit, it survives even if one of the petitioners go out;
    (*ii*) there can be a substitution of petitioner, provided the substituting person is otherwise eligible to be a petitioner under section 399 (now section 244) of the Act.
16. A company which originally started with three directors, removed one of such directors after another one voluntarily resigned. The directors remaining after resignation mentioned above, had equal shareholdings and they were the only shareholders. Held, it was a case of oppression as in a two directors - two members company no board meeting or AGM can be held without participation of both and it was established that no notice of board meeting was sent of the director who was removed - *Rohit Churamani* v. *Disha Research & Marketing Services (P.) Ltd.* [2005] 57 SCL 353 (CLB).

17. When letter of resignation from directorship is duly signed by the concerned person and it could not be shown that the signature is not that of the person concerned, then the position that the director has resigned is acceptable. It is necessary for the company to inform the concerned Bench of the CLB (now Tribunal) when AGM is held during the pendency of the proceedings before CLB (now Tribunal). Sending notice of the AGM through UPC when notice was to be sent through Registered A.D. post is not in order - *Ms. Hardeep Kaur* v. *Thinlac Enterprises (P.) Ltd.* [2005] 57 SCL 459 (CLB).

18. Not an oppression - Non-declaration of dividend or giving interest-free loan to sister concerns by itself do not constitute oppression as these are management decisions - *Shankarlal Gilada* v. *Kapricon Sleepers Works (P.) Ltd.* [2005] 63 SCL 609 (CLB).

19. CLB (now Tribunal) in *Girdhar Gopal Dalmia* v. *Bateli Tea Co. Ltd.* (*supra*) has held that (*i*) mere incurring of losses and/or existence of huge liabilities do not necessarily mean mismanagement; it may, at most reflect in efficient management (*ii*) actions taken by the group in control of a company to prevent diversion of funds, even if same are in violation of the provisions of the Act, cannot be held to be mismanagement/oppression and (*iii*) but attempt to stripping of one group of directors of their powers enjoyed by them for a long period is definitely an act of oppression.

20. The CLB (now Tribunal) held the manipulative issue of shares by the respondent, on whom the petitioner reposed great faith, as an act of oppression. The properties of the company were entirely given by the petitioner, who had to live abroad after setting up the company along with the respondent - *Dr. Mrs. Usha Chopra* v. *Chopra Hospital (P.) Ltd.* [2005] 63 SCL 625.

    On appeal, the Delhi High Court upheld the CLB (now Tribunal) decision as the same was based on facts then submitted by parties and on Principle of Preponderance of possibility. There is no ground for interference by the court [2007] 79 SCL 299. Also, the court held that in a situation of fiduciary relationship, the burden of proving that actions by the party enjoying confidence is devoid of fraud and manipulation, rests on that party.

21. The petitioner inherited certain shares of two companies on demise of his father. In the context of the companies deciding not to allot further shares to the petitioner, the petitioner is entitled to benefits that accrued to the company at the time of his father's death in proportion to the shares held at that point of time in respective companies ignoring the alteration of shareholding structures that arose on further issue of shares - *Kaikhosrou K. Tramgi* v. *Consulting Engg. Services (India) Ltd.* [2007] 80 SCL 53 (CLB).

22. Illegal appointments of additional directors and filing relevant Form with the R.O.C. with forged signature and creating a majority by illegal means are acts of oppression and mismanagement. Getting certified copy of filed fabricated form with stamp of the ROC does not render the document as genuine. Selling of the company assets to relatives of respondent directors at the back of petitioners for inadequate consideration constitute breach of fiduciary duties and the shortfall in the consideration has to be brought back to the company - *J.K. Paliwal* v. *Paliwal Steels Ltd.* [2008] 81 SCL 121 (CLB).

23. As petitioner himself did not take due care of the company, when in control of the company and the petition is aimed at to relieve him from liabilities for actions taken during the period of his control, the petition was dismissed *in limine*. However, since the respondent too was not out of blame, the respondent was ordered to buy out petitioner's share at a fair value - *Surendra Goyal* v. *Nile Aqua Faucets (P.) Ltd.* [2008] 88 SCL 224 (CLB).
24. Since the contention of respondents as regards submitting the dispute to arbitration was not sustainable in view of the company concerned not being a party to the shareholders' agreement which contained the arbitration clause, the CLB (now Tribunal) in an interim order required the parties to maintain *status quo* subject to appointment of a nominee of petitioner company as Joint Managing Director to safeguard the interest of petitioner - *Enercon GMBH* v. *Enercon (I) Ltd.* [2009] 91 SCL 60.
25. When a director has sold off certain company properties without obtaining the consent of shareholders/Board at a price not beneficial to the company, it constitutes oppression and the sale has to be set aside - *T. Balan* v. *Unicentre Agencies & Engineering (P.) Ltd.* [2009] 96 SCL 71 (CLB).
26. On the basis of an investigation into the affairs of the company under section 235(1) [now Section 210], the Central Government, after suspension of the entire Board of the respondent, petitioned for interim relief under section 403 [now Section 242] to implead the C.F.O. of the company among other consequential matters. The CLB (now Tribunal), in the interests of the company concerned, its stakeholders and the public allowed inclusion of the C.F.O. as one of the respondent as *ex parte* decision as the C.F.O. was legally and directly interested in respect of alleged wrong doings - *Union of India* v. *Satyam Computer Services Ltd.* [2009] 96 SCL 367 (CLB).
27. The proposed action of P.F. authorities to proceed against the government appointed Board of directors after CLB (now Tribunal) suspended the entire Board of the company under section 403 [now Section 242] was not sustainable as the defaults occurred during the tenure of the suspended Board and the government appointed Board was there to render a public service - *Union of India* v. *Satyam Computer Services Ltd.* [2010] 97 SCL 49 (CLB).
28. Interim Relief denied - In *Union of India* v. *Maytas Infra Ltd.* [2010] 97 SCL 318, the CLB (now Tribunal) allowed Part of the prayer by ordering appointment of four nominee directors in the Board of the company instead of ten asked for but declined to accede to the prayer that the then members of the Board be restrained from acting as directors of the company and from dealing with company assets. This was done by the CLB (now Tribunal) by taking into account facts and circumstances of the case, specially the fact of public interest involved in carrying out large infrastructural projects.
29. In a family centred company which was functioning in a manner akin to a partnership, the petition of the appellant to CLB (now Tribunal) carrying charges of oppression and mismanagement was dismissed without adequate regard to facts. The High Court found the inadequacy in CLB's appreciation of the case as also the fact that the conclusion of CLB was based

more on surmises and accordingly set aside the order of the CLB - *Vijayan Rajesh* v. *MSP Plantations (P.) Ltd.* [2010] 98 SCL 383 (Kar.)

30. Petitioner shareholder and respondent No. 2 entered into a Memorandum of Understanding (MoU) as regards shareholding and management of a company (Respondent No. 1) and to refer disputes to arbitration. The petitioner, in his petition under sections 397 and 398 [now Section 241] alleged oppression and mismanagement in the affairs of the company, making the persons in management as respondents. Respondent No. 2 opposed the petition on the ground that the allegations should be referred to arbitration in terms of MoU. The MoU related to the matters of two private parties but the allegations under sections 397 and 398 [now Section 241] related to the company and other respondents, in the petition who are not signatories to the MoU. Since, the allegations related to company management, as a whole, the MOU signed by the petitioner and Respondent No. 2 has no applicability and the opposition by respondent No. 2 had no merit - *Dr. S.S. Agarwal* v. *Rajasthan Hospitals Ltd.* [2011] 109 SCL 507 (CLB).

31. When petitioner alleged that his signatures have been fabricated by respondent in reducing his shareholding from 60% to 9.6% and to record his resignation as a director, the plea of getting the signatures verified by Forensic Science Deptt. is to be allowed - *C. Ramachandran* v. *Sreenivasa Balaji Papers (P.) Ltd.* [2012] 112 SCL 124 (CLB).

32. In *Nagesh Kumar* v. *Nagesh Hosiery Exports Ltd.* [2013] 32 taxmann.com 154 (Delhi), appellants were shareholders of a family company along with the respondents. They had filed a petition under section 397 [now Section 241] alleging certain acts of oppression and mismanagement on part of respondents. CLB (now Tribunal) by impugned order held that allegations of acts of oppression and mismanagement of affairs of respondent company resulting in depletion of its reserves remained uncontroverted. CLB (now Tribunal) directed appellants to go out of respondent company on receipt of fair value of their shares at rate of Rs. 706.73 being admitted value per share. CLB had arrived at value of shares on basis of purported admissions. The Delhi High Court held that there ought to have been a proper valuation by approved valuer for arriving at fair market value of shares and CLB was not correct in its approach in arriving at value of shares on basis of purported admission and the impugned order of CLB was, therefore, to be set aside.

33. A piece of land was sold by a director of the company to a person on January 5, 2006. The land was held in the personal name of the director concerned. The buyer of the land, in turn, entered into an agreement to sell for the same land on 16.10.2006. In the meantime the shareholders of the company moved CLB u/ss 397 and 398 [now Section 241] to set aside the sale by the director as well as the agreement to sell of October 2006. The CLB (now Tribunal), on the understanding that the land was purchased by use of company fund set aside the sale by the director and restored the land to the company. The company, however, never came to possess the land or own it on records and documents. On appeal, the order of the CLB was set aside as the original sale by the director was legally valid sale. Also, the original acquisition of land by

the director in his name had become time barred. Exercise of power by CLB u/s 402 [now Tribunal u/s 242] was held unsustainable - *T. Vinayaka Perumal* v. *T. Balan* [2012] 115 SCL 260 (Mad.)

34. *Separation of family ownership and management* - The Editorial directors of reputed newspaper group 'The Hindu' in their meeting formulated a succession plan on retirement of directors and to bring in corporate governance in the management of the company. This was resisted by directors belonging to the family owning and managing the group. They applied to CLB (now Tribunal) u/ss 397 and 398 [now Section 241] . CLB (now Tribunal), in turn ordered for Board meeting to discuss the issue. The Board agreed with the decision of the Editorial directors and decided to convene EGM for its approval. The family directors again sought CLB (now Tribunal) intervention, which allowed the EGM to be called but decision, if any, to be kept pending. As no finding had been recorded by CLB that the matter to be placed before EGM is against public interest/interest (now Tribunal) of the company, the CLB order for non-implementation of EGM decision was set aside—*N. Ram* v. *N. Ravi* [2012] 115 SCL 274 (Mad.).

22.14 Class Action

Section 245 provides an alternate remedy to the members or depositors of a company or any class of them by way of class action before the Tribunal. Class action refers to a law suit where one or several person join together and sue on behalf of a larger group of persons. A class action is suitable where the issues in question are common to all affected and the number of persons affected is very large making it impractical for all of them to join hands. Section 245 (1) permits class action to be brought by the prescribed number of member or members, depositor or depositors or any class of them before the Tribunal on behalf of members or depositors. Such an application may be filed if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interest of the company or its members or depositors. Remedy under Section 245 is not available in case of a banking company.

22.14-1 Who may file an application

An application may be made by in the case of a company having a share capital, by not less than one hundred members of the company or not less than such percentage of the total number of its members as may be prescribed, whichever is less, or any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed. Only those members who have paid all the calls and other sums due are eligible to join the application. In case of a company not having a share capital, application may be made by not less than one fifth of the total number of its members [Section 245(3)(i)]

An application on behalf of the depositor may be made by not less than one hundred depositors or not less than such percentage of the total number of depositors as may be prescribed, whichever is less. Alternatively any depositor or depositors to whom the company owes prescribed percentage of total deposits of the company may apply [Section 245(3)(ii)].

An application on behalf of members can be made, in case of company having share capital by not less than one hundred members of the company or not less than ten per cent of the total number of its members, whichever is less, or any member or members singly or jointly holding not less than ten per cent of the issued share capital of the company, subject to the condition that the applicant or applicants have paid all calls and other sums due on his or their shares. An application on behalf of depositors may be made by not less than one hundred depositors or not less than ten per cent of the total number of depositors, whichever is less or any depositor or depositors singly or jointly holding not less than ten per cent of the total value of outstanding deposits of the company. An application once made cannot be withdrawn without the leave of the Tribunal.

The application needs to be made in Form No. NCLT-9 of the NCLT Rules alongwith the requisite documents and fees. A copy of the application is required to be served on the company, other respondents and other persons as directed by the Tribunal (Rule 84 of NCLT Rules)

22.14-2 Against whom an application may be filed

A class action application may be filed with the Tribunal against the company, its directors, auditor or any expert or advisor or consultant or any other person who has made any incorrect or misleading statement to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part.

22.14-3 Relief under a class action

Under Section 245(1) the application may be made to the Tribunal as aforesaid for an order for seeking all or any of the following:

(*a*) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;

(*b*) to restrain the company from committing breach of any provision of the company's memorandum or articles;

(*c*) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

(*d*) to restrain the company and its directors from acting on such resolution;

(*e*) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(*f*) to restrain the company from taking action contrary to any resolution passed by the members;

(*g*) to claim damages or compensation or demand any other suitable action from or against—

(*i*) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

(*ii*) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

(*iii*) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

(*h*) to seek any other remedy as the Tribunal may deem fit.

It may be noted that the remedies mentioned in the sub-clauses (a) to (f) above are for preventing or restraining the company or its directors from acting against the provisions of any law or memorandum or articles of association. The remedy in sub-clause (g) provides for damages from any fraudulent, unlawful or wrongful act committed by the company or its directors. Damages may be sought for any improper or misleading statement etc. made by the auditors or any other expert or advisor of consultant or any other person. The class action is permitted under Section 245 (1) not only against the company but also against the auditors and other experts or advisors as mentioned. Section 245(2) provides that in a class action against an audit firm, both the firm and each partner involved in making the alleged improper or misleading statement in the audit report or who acted in a fraudulent, unlawful or wrongful manner shall be liable.

The tribunal while considering the application shall take into account the following aspects [Section 245(4)] —

(*a*) The applicant is acting in good faith for seeking an order. For example if the application has been made to pressurize the company to derive some personal benefits for the applicants, it will not be considered an application in good faith.

(*b*) Any evidence suggesting the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (*a*) to (*f*) of sub-section (1).

(*c*) Possibility of the member or depositors pursuing the cause of action in his own right rather than through an order under this section. If the former is considered as a better alternative, class action may not be tenable.

(*d*) Views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section. View of such members is likely to add objectivity to the proceedings.

(*e*) Where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be authorised by the company before it occurs; or ratified by the company after it occurs. If the company is well within its rights to authorize and regularize the act or omission alleged, the class action may not be tenable.

(*f*) Where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would likely to be, ratified by the company. Again if the act or omission that is the subject matter of the application is likely to be ratified by the company, the application would lose its purpose.

22.14-4 Procedure to be followed by the Tribunal -

Section 245(5) prescribes the procedure to be followed by the Tribunal once the application under sub-section (1) has been admitted :

(*a*) Service of a public notice on admission of the application to all the members or depositors of the class in such manner as may be prescribed. As the class action is on behalf of all the members or depositors or class of them, they need to be informed about the admission of application by way of a public notice.

(*b*) If there are more than one applications prevalent in any jurisdiction, they should be consolidated into a single application. Upon such consolidation the class members or depositors would choose the lead applicant. If the members or depositors of the class are not able to choose a lead applicant, the Tribunal shall have the power to appoint a lead applicant to be in charge of the proceedings.

(*c*) Two class action applications for the same cause of action shall not be allowed;

(*d*) The cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

It may be noted that as the class action is on behalf of all the members or depositors, having more than one application for the same cause will defeat the purpose of the class action.

Section 246 further provides that the provisions of Sections 337 to 341 shall apply *mutatis mutandis* in relation to an application for a class action.

Rule 87 of the National Company Law Tribunal Rules, 2016 prescribe the manner in which the notice shall be served as aforesaid. Accordingly –

(*i*) The notice shall be published within seven days of admission of the application by the Tribunal at least once in a vernacular newspaper in the principal vernacular language of the state in which the registered office of the company is situated and circulating in that state and at least once in English in an English newspaper circulating in that State;

(*ii*) The date on which the notice is published in the newspapers shall be taken as the date of serving the public notice;

(*iii*) The notice shall also be placed on the website of such company, if any, in addition to publication of such public notice in newspaper. Additionally such notice shall also be placed on the website of the Tribunal, on the website of Ministry of Corporate Affairs, on the website, of the concerned Registrar of Companies and in respect of a listed company on the website of the concerned stock exchange(s) where the company has any of its securities listed. The notice shall remain posted as such till the application is disposed of by the Tribunal;

(*iv*) The public notice shall *inter alia* contain the following —

(*a*) name of the lead applicant;

(*b*) brief particulars of the grounds of application;

(*c*) relief sought by such application;

(*d*) statement to the effect that application has been made by the requisite number of members/depositors;

(*e*) statement to the effect that the application has been admitted by the Tribunal after considering the matters stated under sub-section (4) of section 245 and it is satisfied that the application may be admitted;

(*f*) Informing other members or depositors that they can also join the applicant, if they so wish;

(*g*) date and time of the hearing of the said application;

(*h*) time within which any representation may be filed with the Tribunal on the application; and

(*i*) such other particulars as the Tribunal thinks fit.

(*v*) The applicant shall initially bear the cost or expenses connected with the publication of the public notice. The same shall be defrayed by the company or any other person responsible for any oppressive act.

22.14-5 Order of the Tribunal

Under Section 245(6) any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company. If an application made under sub-section (1) is found to be frivolous or vexatious the same is liable to be rejected by the Tribunal. The Tribunal shall by order require the applicant to pay the cost, not exceeding rupees one lakh to the opposite party.

Any failure to comply with the order of the Tribunal would make the company punishable with fine which shall not be less than rupees five lakh but which may extend to rupees twenty-five lakh. Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than rupees twenty-five thousand but which may extend to rupees one lakh.

22.14-6 Differences between application under Section 241/244 and class action under Section 245

The key difference between the two remedies are set out below:

	Application under Section 241/244	Application under Section 245
Who can apply	Members of the company; Central Government	Members and Depositors of the company
Against whom	Company and its management (managing director, manager or any of the directors)	Company, Directors, Auditors, Experts or advisors or consultants or any other person as mentioned

	Application under Section 241/244	Application under Section 245
Public Notice	Not required	Required in the prescribed manner
Matters for which relief may be requested	Oppression, mismanagement, prejudicial to any member, members or interest of the company or prejudicial to public interest , both past and continuing	Acts involving violation of law, *ultra vires* the articles or memorandum. Fraudulent, unlawful or wrongful act or omission or improper or misleading statements Cover past, present and future activities as well.

22.15 Valuation by registered valuers

There may be occasions that require valuation of any property, stocks, bonds, debentures, securities or goodwill or any other asset or net worth of a company or its liabilities. The valuation in such cases shall be carried out by a registered valuer, which is appointed by the audit committee or the Board of Directors of the company (Section 247). The Central Government has delegated powers regarding qualification and registration of valuers to the Insolvency and Bankruptcy Board of India. The Companies (Registered Valuers & Valuation) Rules, 2017 lay down the eligibility, qualification and registration of valuers, valuation standards and model code of conduct for registered valuers.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (INTER)/ PE-II/FINAL, C.S. (INTER)/FINAL, ICWA (INTER)]

1. Comment on the following statement : " A mere dissatisfaction of the minority does not constitute oppression".
2. "It is an elementary principle of law relating to joint stock companies that the court will not interfere with the internal management of companies acting within their powers and in fact has no jurisdiction to do so." Elucidate.
3. (*a*) What are the powers of the Tribunal to prevent oppression and mismanagement?

   (*b*) Under what circumstances can these powers be exercised?
4. (*a*) When can the oppression or mismanagement be complained of in a company ?

   (*b*) Who can apply to the Tribunal for relief in case of oppression and mismanagement?

   (*c*) State the procedure for applying to the Tribunal regarding prevention of oppression and mismanagement.
5. An order has been passed by the Tribunal under section 241 against your company which is considered inappropriate by the management. What action would you take in such a situation?

6. Legal representative of a deceased member of a company alleged oppression and mismanagement. He made a complaint to the Tribunal for relief. The management of the company is of the opinion that he has no *locus standi* since he is not a member. The register of members still shows the name of the deceased as member. Will the complaint of representative of the deceased member be entertained by the Tribunal?

[**Hint :** *See* para 22.1-2.]

7. Law intends relieving minority shareholders from oppression and mismanagement without resorting to winding up of the company. Discuss.

8. Explain the nature of relief that may be granted in a class action.

9. What is meant by 'oppression'? State whether the aggrieved party would succeed in obtaining relief from Tribunal on the ground of oppression in the following cases:

(*i*) The majority of the Board of Directors override the minority directors and the minority directors apply to the Tribunal complaining oppression by majority directors.

(*ii*) A petition by majority shareholders complaining oppression by minority shareholders.

10. Discuss the powers of the Tribunal to pass the following orders on applications seeking reliefs for oppression and mismanagement :

(*i*) Termination or modification of any agreement between the company on the one hand, and the Managing Director or Director or any other person, on the other.

(*ii*) Alteration in the memorandum or articles of the company.

11. What are the considerations before the Tribunal before admitting an application of class action under Section 245?

12. A petition (in English) is filed by the required number of members alleging oppression and mismanagement against a company and directors, accompanied by consent letters of some members in Hindi. Discuss whether the petition is maintainable.

[**Hint :** *See* item 12 of para 22.13-2.]

13. Petitions under sections 241 and 271 are not simultaneously maintainable. Comment.

[**Hint :** Maintainable - *See* para 22.12.]

14. Can the Tribunal order reduction of share capital in a proceeding under section 241 relating to oppression of shareholders?

15. Describe the procedure for filing and withdrawing a petition in the matter of oppression and mismanagement.

16. In a public limited company, some group of rich people joined and have acquired by paying very high prices of shares, a controlling interest. The company is well managed showing very good profits in the last three years. They want to appoint their own nominees as directors of this prosperous company. It is considered that this change in the Board of directors would prejudicially affect the affairs of the company. Discuss whether this change in the composition of Board of directors can be prevented.

17. In a situation where winding up order for a company has been made by the Tribunal and the liquidator has been appointed, is it still permissible to propose a scheme of compromise under section 230? Answer with reason.

[*See* item 8 of para 22.13-2.]

18. State whether non-declaration of dividend, resulting in non-devaluation of the shares, constitutes mismanagement.

Ans. Not an act of mismanagement *vide V.J. Thomas Vettom* v. *Kuttanad Rubber Company Ltd.* [1984] 56 Comp. Cas. 284 (Ker.).

19. Explain the concept of Class Action as an alternate remedy. State the key differences between application under Section 241/244 and class action under Section 245.

PRACTICAL PROBLEMS

1. X, Y and Z, directors of a company were the major shareholders of the company. X was the chairman of the company. At a meeting of the Board of Directors, it was decided to increase the share capital. Y and Z did not have the money to take up additional shares and feared that in consequence, X would corner all shares and become predominant in the company. So a general meeting was called and it was resolved that the present members alone should not benefit from the prosperity of the company, but others also should share, and a special resolution was passed that the new shares may be offered to about a dozen persons who were not members of the company.

X rushed to the Tribunal, complaining of oppression, saying that Y and Z wanted to throw him out as director and chairman of the company and they had passed a special resolution to bring about a change in the management.

(*i*) Define what amounts to oppression?

(*ii*) Discuss fully the chances, if any, of X succeeding in the proceeding.

Hint : The person claiming oppression has to prove on the part of majority :

- lack of probity
- unfair conduct
- prejudice to him in the exercise of legal and proprietary rights as a shareholder - [*Shanti Prasad Jain* v. *Kalinga Tubes Ltd.* AIR 1965 SC 1535; *Needle Industries (India) Ltd.* v. *Needle Industries Newey (India) Holdings Ltd.* [1981] Comp. Cas. 743].

The facts in the case do not point to the conduct of majority falling under any of the aforesaid grounds. Seeking change of management does not, *prima facie,* amount to oppression. Accordingly, X would not succeed.

2. A company was required under a directive issued by the Reserve Bank of India to reduce its foreign shareholding from 60 per cent to 40 per cent. It made an offer of right shares to all existing shareholders, but issued shares only to its Indian shareholders. The foreign company, which was a shareholder, contended that non-issue of shares to it amounted to 'oppression'.

Considering the provisions of the Companies Act in this regard :

(*i*) Explain the meaning of the term 'oppression'.

(*ii*) Decide whether the contention of the foreign company is maintainable.

Hint : (*i*) For meaning please *see* Text.

(*ii*) Relief may be granted under section 397 (corresponding to Section 241/242 of the Act) only against continuous acts on the part of majority shareholders who are oppressive to the minority. Mere isolated acts do not amount to oppression - *V.M. Rao* v. *Rajeshwari Rama Krishnan* [1986] 1 Comp. LJ.

Again, in the case of *Needle Industries (India) Ltd.*, the Supreme Court held it not amounting to oppression [Facts are based on this case].

3. A group of shareholders consisting of 25 members decides to file a petition before the Tribunal for relief against oppression and mismanagement by the Board of Directors of M/s Fly By Night Operators Ltd. The company has a total of 300 members and the group of 25 members holds one-tenth of the total paid-up share capital accounting for one-fifteenth of the issued share capital. The main grievance of the group is that due to mismanagement by the Board of directors, the company is incurring losses and the company has not declared any dividends even when profits were available in the past years for declaration of dividend.

Advise the group of shareholders regarding the success of (*i*) getting the petition admitted and (*ii*) obtaining relief from the Tribunal.

Hint : (i) *Since the group of shareholders do not number 100 or hold 1/10 of the issued share capital or 1/10 of the total number of members, they have no right to approach the Tribunal for relief.* However, the Tribunal, if it is of the view that circumstances exist which make it just and equitable so to do, may authorise any member(s) to apply to the Tribunal [Section 244]. So members may approach Tribunal to waive the requirement.

(*ii*) As regards obtaining relief from Tribunal continuous losses cannot, by itself, be regarded as oppression. [*Ashok Betelnut Co. (P.) Ltd.* v. *M.K. Chandrakanth*].

Similarly, failure to declare dividends or payments of low dividends also does not amount to oppression (*Thomas Vekkon* v. *Kuttanand Rubber Co. Ltd.*). Thus, the shareholders may not succeed in getting any relief from Tribunal.

4. (*a*) ABC Private Limited is a company in which there are eight shareholders. Can a member holding less than one-tenth of the share capital of the company apply to the Tribunal for relief against oppression and mismanagement?

(*b*) It is alleged by the said member that the directors of the company have misused their position in making certain inter-corporate deposits which are against the interests of the company. Will the Tribunal entertain application containing such allegation in the case of a private company?

Hint : (*a*) Section 244 provides for the persons who can make a valid application to the Tribunal for relief against oppression and mismanagement. With respect to the members/shareholders who can apply, section 244 states that in the case of a company having share capital a valid application may be made by 100 members or 10 per cent of its total members, whichever is less. In the alternative, application may be made by members holding 10 per cent of the issued share capital. Thus in the present case, since ABC Private Limited has only 8 shareholders, 1/10 thereof will mean one or more member. The requirement of such member being the holder of 1/10 of the issued share capital is not relevant.

Accordingly, application by even one member holding less than 1/10 of the share capital of the company shall be valid, in the given case.

(*b*) For a petition under section 241, the complainant members are required to establish that the company's affairs are being conducted in a manner prejudicial of the public interest or in a manner prejudicial to the interest of the company.

Thus in the present case, the Tribunal may entertain the application if complainant member is able to *prima facie* establish that the directors have misused their position in making certain inter-corporate deposits which are against the interest of the company.

5. A group of shareholders of M/s High Profile Engineering Company Ltd. has filed a petition before the Tribunal alleging various Acts of oppression and mismanagement by the majority shareholders. The petitioner group holds 15% of the issued share capital of the company. During the course of hearing before Tribunal, some of the petitioner group of shareholders holding about 6% of the issued share capital of the company have withdrawn their consent by stating that they were misled by the group to sign the petition and after coming to know of the facts they have disassociated themselves from the petition and they along with the other majority shareholders have submitted that the petition should be dismissed on the ground of non-maintainability. Examine their contention having regard to the provisions of the Companies Act.

Hint : The contention of the majority shareholders is not correct and the Tribunal will continue to proceed with the petition filed for oppression and mismanagement. It has been held by the Supreme Court in *Rajahmundry Electric Corporation* v. *A. Nageshwara Rao* that if some of the consenting members have subsequent to the presentation of the application, withdrawn their consent, it would not affect the right of the applicant to proceed with the

application. Thus, the validity of the petition must be judged on the facts as they were at the time of its presentation. Neither the right of the applicant to proceed with the application, nor the jurisdiction of the CLB (now Tribunal) to dispose it off on its own merits can be affected by events happening subsequent to the presentation. Also *see* Madras High Court case of *L. Rama Subbu* v. *Madura College.*

6. A group of shareholders of Deceptive Duplicating Machines Ltd. filed an application before the Tribunal alleging various acts of fraud and mismanagement by Mr. Unscrupulous, the Managing Director, and his associates. During the course of hearings before the Tribunal, it was contended on behalf of the company that the alleged transactions had taken place long ago and that the Managing Director, who was responsible for such actions had already been removed and that there is no case before the Tribunal to interfere in the working of the company. The contention of the Applicants on the other hand is that though the fraudulent nature of the transactions is a thing of the past and though the Managing Director had been removed, yet the management of the company is still controlled by the henchmen of Mr. Unscrupulous. Discuss the powers of the Tribunal in support of your answer.

Hint : The power available to the shareholders to seek relief or remedy from the acts of oppression and mismanagement as stated in section 241 of Act can be invoked when the affairs of the company 'have been' or 'are being' conducted in a manner oppressive to shareholders or prejudicial to the interest of the company. Thus, at the time of making an application, it is not necessary that there must be a continuous course or conduct of the affairs of the company, which is oppressive to any shareholder or shareholders or prejudicial to the interest of the company.

7. To convert a well run proprietary business into a private company, Mrs. Agnihotri admitted her husband as a nominal shareholder and the business prospered well. Later on, differences started showing up and Mrs. Agnihotri complained that her husband was behaving oppressively, though she held 95% shares. She filed a petition before the Tribunal for winding up of the company under section 241. Her husband contended that though she contributed capital, he has contributed his skill and expertise. Comment.

Hint : The facts of given problem are based on the case of *Neelu Kohli* v. *Nikhil Rubber (P.) Ltd.* [2002] 108 Comp. Cas. 422 (CLB) wherein it was held that the claim of the petitioner that she had held 95% of the share capital and the respondent was taken into company merely to satisfy the legal requirement etc. carried no conviction. In as much as mere capital alone would not ensure prosperity and her husband contributed much by going abroad, introduced new technology, booked lucrative orders. All these had resulted in the quick phenomenal growth of the company. Considering all these aspects in the said case, in a proceeding under section 397/398 (now Section 241), the petitioner was directed by the Company Law Board (now Tribunal) to sell out 50% share to her husband at the rate to be determined by an independent valuer.

Thus, in the instant case Mrs. Agnihotri will be directed to sell her 50% share to her husband at the rate to be determined by independent valuer.

8. The Tribunal has the power to order the purchase of shares of any members of the company by other members thereof or by the company itself under section 242.

Since section 68 deals with the matter of buy back of the company's own shares, do you think that the implementation of the order of the Tribunal by the company to buy its shares from certain shareholders will need compliance with requirements of section 68 of the Act?

Hint : Power of Tribunal under section 242 is independent of section 68 - *See Gurmit Singh's* case in para 22.13(b).

23 Compromises, Arrangements, Reconstruction and Amalgamation

23.1 Meaning of compromise

'Compromise' means an amicable settlement of differences by mutual concessions by the parties to dispute or difference by agreeing not to try it out. In *Sneath* v. *Valley Gold Ltd.* [1893] 1 Ch. 447, 'compromise', was described as an agreement terminating a dispute between parties as to the rights of one or more of them, or modifying the undoubted rights of a party which he has difficulty in enforcing.

The result of this case and others[1] is that there can be no compromise unless there is some dispute, *e.g.*, as to the power to enforce rights or as to what those rights are.

23.2 Meaning of arrangement

An 'arrangement', as the expression is used in the Act, embraces a far wider class of agreements than a 'compromise'. It includes agreements which modify rights about which there is no dispute. Thus, 'arrangement' includes a reorganisation of the share capital of the company by the consolidation of shares of different classes, or by division of shares into shares of different classes or by both these methods. It also includes re-organisation of the share capital of the company by exchange of the company's assets for shares of a newly formed company[2]. An arrangement may also involve : (*i*) Debentureholders being given an extension of time for payment, releasing their security in whole or in part or changing their debenture for equity shares in a new company; (*ii*) the creditors agreeing to receive cash in part payment

1. *Mercantile Investment and General Trust Co.* v. *International Co. of Mexico* [1893] 1 Ch. 484; *Mercantile Investment and General Trust Co.* v. *River Plate Trust, Loan and Agency Co.* [1894] 1 Ch. 578; *In re N.F.U. Development Trust Ltd.* [1971] 1 WLR 1548.
2. *Sandwell Park Colliery Co., In re* [1914] 1 Ch. 431. The expression 'arrangement' would also cover acquisition of shares of a subsidiary by the dominant shareholder of the holding company (virtually the sole owner) by surrendering his shares in the holding company in lieu of the shares of the subsidiary, transferred by the holding company to that shareholder. However, the holding company has to do this by complying with provisions of section 77(1) read with section 100 [now Sections 67 and 66].

of the claims and the balance in shares or debentures of the company; (*iii*) the preference shareholders giving up their rights to arrears of dividends, further agreeing to accept a reduced rate of dividend in the future, and so on.

Thus, when a company has a dispute with a member or a class of members or with a creditor or a class of them, a scheme of compromise may be drawn up. But, where there is no dispute but there is need for readjusting the rights or liabilities of a member or a class of them or of a creditor or a class of them, the company may resort to a scheme of arrangement with them. Section 230 provides that "the expression 'arrangement' includes a reorganisation of the share capital of the company by the consolidation of shares of different classes, or by the division of shares into shares of different classes, or by both these methods".

It is not, however, appropriate to use the expression 'arrangement' where membership rights are proposed to be surrendered or otherwise terminated or confiscated without compensation - *N.F.V. Development Trust Ltd., In re* [1973] 1 All ER 135 (Ch. D).

Celebrated author Palmer has viewed 'arrangement' and 'reconstruction' as any form of internal reorganization of the company and its affairs as well as schemes for the merger of two or more companies or for the division of one company into two or more companies - (*Palmer's Company Law, Vol. II. Part 8 - Page 12009-1994 Edition*). However, unitary process of revaluation of assets of a company does not require any approval of the Company Court [*VXL Technologies Ltd., In re* [2010] 103 SCL 507 (Punj. & Har.)].

Implied power to compromise/arrangement - Companies may need to enter into agreements compromising claims or modifying rights which other persons have against them, or which they have against other persons. A company has an implied power to compromise disputes in which it is involved with outsiders or with its own members - *Re Norwich Provident Insurance Society, Bath's* case [1878] 8 Ch. D 384, and it probably also has implied power to enter into arrangements with such persons modifying the undoubted rights which they or the company has.[3] In any case, the express power to do these things is usually inserted in objects clause of its Memorandum of association as one of the standard provisions. The reason why the subject of compromises and arrangements is deserving a separate treatment is that rights enforceable against companies are often vested in large classes of persons with whom it would be practically impossible to negotiate individually, and in such cases a machinery is required by which the claims of the classes collectively may be compromised or their rights modified with the assent of a majority of their number given at meetings called for the purpose.[4]

This machinery may be provided by the original agreements between the company and the classes of persons entitled to the rights, but whether such machinery is provided by agreement or not, it is provided by the Companies Act, 2013.

Arrangement to close down a company - A company, because of unending financial difficulties, was closed down without being wound-up, under sections 391 to 394 [now Sections 230 to 232] and all the assets and properties and only some liabilities

3. *Pennington's Company Law,* 5th Edition, page 583.
4. *Pennington's Company Law,* 5th Edition, page 583.

passed on to a transferee corporation. It was held that arrangements of closing down the loss making company and taking over of its assets and some of the liabilities were separate arrangements. The successor corporation was neither liable to pay compensation nor to re-employ those employees whose services stood automatically terminated because of the closing down of the company, as the arrangement was not for transfer of the undertaking. However, the court held that the labour court would be entitled to examine the compensation issue under section 25FFF of the Industrial Disputes Act, payable by the Union of India and in that the Union of India and the erstwhile company would be parties - *Inland Steam Navigation Workers' Union* v. *Union of India* [2001] 32 SCL 431 (SC).

Compromise and arrangement vis-a-vis guarantor of loan to the company concerned—When a lender has accepted a compromise arrangement which included the loan given by it and also accepted the settlement money in regard to that loan, it cannot proceed further against the guarantor for balance amount of the loan - *Kundanmal Dapriwah* v. *Haryana Fin. Corporation* [2012] 114 SCL 609 (P & H).

23.3 Statutory provisions regarding compromise or arrangement

The Companies Act, 2013 empowers a company to make compromise or arrangement with its creditors (or any class of them) or members (or any class of them) and makes suitable provisions under sections 230 to 232.

Section 230 provides:

1. *Where a compromise or arrangement is proposed,*

   (*a*) between a company and its creditors or any class of them; or

   (*b*) between a company and its members or any class of them;

   the Tribunal may, on the application of the company or any creditor[5] or member or of the class involved, or liquidator, order that a meeting of the creditors or members (or any class of them) be called and held in the manner directed by the Tribunal [Sub-section (1)]. Clubbing of secured creditors and unsecured creditors in a meeting for approval of a scheme was held impermissible as not in conformity with court's order under section 391(1) [now Section 230(1)]. Also a meeting originally held under the order of the court is not capable of being adjourned without a fresh order of the court under section 391(1) [now Section 230(1)]. *Hindustan Development Corpn. Ltd.* v. *Shaw Wallace & Co.* [2000] 25 SCL 187 (Cal.). However, unless a separate and different type of compromise is offered to a sub-class of a class of creditors, otherwise equally circumscribed by the class, no separate meeting of sub-class of main class of creditors would be allowed to be convened - *Commerz Bank AG* v. *Arvind Mills Ltd.* [2002] 39 SCL 9 (Guj.). Where a class of creditors/shareholders consisting of a very small number voluntarily gives consent to the scheme in writing, there would not arise any need to require members of such class to come to the meeting and take part

5. The expression 'creditor' shall include a contingent or prospective creditor – *Chittaranjan (Benode) Guha* v. *M. Ameen* [1948] 18 Comp. Cas. 228.

in voting on the scheme.[6] In a proceeding under section 391 [now Section 230], the Court (now Tribunal) cannot hold enquiry and go into question of entitlement of brands, names, trademarks etc. These are matters for a civil court or other appropriate forum to decide. The Court's (now Tribunal's) sanction of a scheme based on fulfilment of requirements of section 391 [now Section 230] will not prove to be fetters to the Civil Court or other appropriate forum in this regard - *In re, Kirloskar Electric Co. Ltd.* [2003] 43 SCL 186 (Kar.).

Application by liquidator or creditor in case of a company in liquidation - The application to the Tribunal under section 230(1) may be made *in the case of a company in liquidation,* not only by the liquidator but also by a creditor or a member. This right of a creditor or member is not taken away by reason of the company being wound up - *Rajendra Prasad Aggarwal* v. *Official Liquidator* [1978] 48 Comp. Cas. 476.

When a company is under winding up proceedings, then application under section 230(1) can be maintained by the liquidator alone - *RBI* v. *Himachal Grameen Sanchayaka Ltd.* [2003] 47 SCL. In this case the Court ruled that RBI was competent to apply for winding up of the non-banking financial company in view of provisions of sections 45MC (inability to payback depositor's, money) and 451A (the company becoming disqualified to carry on the business of the NBFC) of the RBI Act, and accordingly its petition for winding up of the NBFC is not violative of any law. In the context of the affairs of the company being vested with the liquidator, an application on behalf of the company to convene meeting of its members and creditors lies exclusively with the liquidator.

The above decision of the H.P. High Court is based upon specific facts of the case and it is to be distinguished from the aforesaid case of *Rajendra Prasad Agarwal* where applicant under section 391 [now Section 230] was not the company. A finality on this situation has been reached with the Supreme Court's verdict in *Meghal Homes (P.) Ltd.* v. *Shreeniwas Girni K.K. Sanity* [2007] 78 SCL 482, wherein it has been stated that contributory and creditor of the company in liquidation are not debarred from making petition to the Court (now Tribunal) under section 391[now Section 230] .

Can the meetings of creditors and shareholders be dispensed with? - The Delhi High Court agreed to dispense with the requirement of convening a

6. The Karnataka High Court, has, however held that the purpose of the meeting under section 391 [now section 230] is to enable members/creditors to discuss and deliberate on the scheme and accordingly any written consent from them to the scheme cannot be taken as approval of the scheme in a meeting. A letter of consent is not a substitute for approval in a meeting - *Anysys Software (P.) Ltd., In re* [2005] 57 SCL 356. It seems that the rule is to hold the meeting and dispensing with the meeting on the basis of consent letters is an exception, based on facts of the case. The Rajasthan High Court in *Shyam Basic Infrastructure Projects (P.) Ltd., In re* [2006] 66 SCL 99 has ordered for meetings of members and creditors of the transferee company, to be held in larger interest of the company even though consent for dispensing with the meetings of the members and creditors were obtained by the company. However, the same Court, in *Rajasthan Fasteners (P.) Ltd., In re* held otherwise having regard to facts of the case [2006] 66 SCL 102.

meeting of creditors and equity shareholders of transferee Company and unsecured creditors of transferor company. In this case the transferor company was wholly owned subsidiary of transferee company and transferee company had given its written consent to proposed scheme. Moreover, all existing liability, debts, duties, obligations, *inter alia*, of transferor company were proposed to be transferred to transferee company. The court observed that no variation in rights of creditors and equity shareholders of transferee company or unsecured creditors of transferor company was proposed. In effect, it could not be said that any 'compromise or arrangement' was being offered by way of proposed scheme to creditors or shareholders of transferee company, or unsecured creditors of transferor company. [*Adobe Properties (P.) Ltd., In re* [2017] 78 taxmann.com 95 (Delhi)]. However in another case the Delhi bench of NCLT held that in compromise and arrangement, Tribunal is not empowered to dispense meeting of shareholders/members; but it may dispense with calling of meeting of creditors against affidavit of creditors having 90 per cent value [*JVA Trading (P.) Ltd.,* In re [2017] 77 taxmann.com 210 (NCLT - New Delhi)

Application by transferees of shares and financiers: Transferees of shares and financiers may apply with the leave of the court (now Tribunal) - *A.K. Mishra* v. *Wearwell Cycle Co. (India) Ltd.* [1993] 78 Comp. Cas. 252 (Delhi). In this case, two persons (one of whom was the managing director) proposed to provide funds to the company for its revival. The court directed the Official Liquidator to register them as members in pursuance of transfer of shares to them and also to treat them as creditors in lieu of specified creditors who were to be paid with their money. They, thus, became competent to file a petition for leave of the court (now Tribunal) for confirmation of the scheme.

Section 230(1) hearing shall only be ex-parte - The Supreme Court in *Chembra Orchard Produce Ltd.* v. *Regional Director* [2009] 89 SCL 109 has held that if hearing is allowed at very threshold to contributories, creditors etc. then entire scheme of rules and section 391 [now Section 230] would become unworkable.

Consolidation or division of shares to be treated as arrangement – The explanation to Section 230(1) for the sake of clarification states that for the purpose of this section the expression arrangement includes reorganization of company's share capital by way of consolidation of shares of different classes or division of shares into shares of different classes or both.

2. If at the meeting, a majority of the number representing in value 3/4ths of the creditors or members (or any class of them) present in person or by proxy or by postal ballot agree to the compromise or arrangement, then the compromise or arrangement will be binding on :

   (*a*) all the creditors or creditors of the class or all the members or members of the class, and

   (*b*) the company or, if the company is being wound up, on the liquidator or contributories of the company.

Creditors of transferee-company would, however, have no right to intervene in petition filed by transferor company under section 391 [now Section 230] - *Innovatherm GmbH* v. *Sesa Goa Ltd.* [2013] 30 taxmann.com 425 (Bombay)

In *NDDS Worldwide Ltd., In re* [2001] 32 SCL 491 (Mad.), it was held that when in a shareholders' meeting to consider the scheme, the scheme is agreed to unanimously even though shareholders holding only 46.21% of the entire share capital were present, the scheme is approved, having regard to the fact that no objection to the scheme was received even though the same was advertised.

Similarly, it was held by the Delhi High Court that once the scheme of arrangement providing for demerger has been confirmed and made binding, it would bind all of the creditors whether or not they might have specifically consented to such scheme. [*Lotus Nikko Hotels Travel (P.) Ltd.* v. *Ashok Chopra & Co.* [2017] 79 taxmann.com 69 (Delhi)]

Again, in *Tony Electronics Ltd., In re* [2013] 29 taxmann.com 292 (Delhi), applicant sought recall of order sanctioning scheme of merger of petitioner-transferor company with transferee-company 'S'. Applicant claiming to be 52.47 per cent stakeholder in transferor company stated that scheme was liable to be set aside as same was sanctioned without notice to him. Applicant stated that 52,470 equity shares of company were transferred in his name by respondent pursuant to an agreement. However, it was found that the transfer forms relied upon by applicant were neither stamped nor completed, *i.e.*, requirement of section 108 [now Section 56] was not fulfilled. The Hon'ble Delhi High Court held that since applicant had taken no steps to get himself on register of members, he was not a member of company when notice of meeting for sanction of scheme was issued and, therefore, no right had accrued in his favour to entitle him to a notice of meeting. Further, it was observed that since there was no other objection to scheme which was already sanctioned by majority and, thus, objection raised by applicant being devoid of merit, the same was to be dismissed.

Section 230 requires dual majority of shareholders/creditors in the meeting for approval of the scheme - It should be noted that the majority is dual, in number and in value; a simple majority of those who are voting is adequate whereas the 'three-fourths' requirement relates to voting value. The illustration given below covering various situations will make this matter clear -

Situation I - All 1000 members holding 10,000 shares of Rs.10 each attend the meeting and vote; of these, one member holds 3,000 shares and he votes against approval of the scheme and the remaining 999 members holding 7,000 shares vote in favour - approval not granted because even though all but one member vote in favour, their aggregate share value falls short of 3/4th of the total share value of Rs.1,00,000.

Situation II - The member holding 3,000 shares abstains from voting; when the votes are counted 500 members holding 5250 shares are found to be in favour while remaining 499 members holding 1750 shares are opposed. The scheme is approved as, the dual majority of members voting is established. In members 500 is more than 499 and 5250 shares equal to 3/4th of 7,000 shares involved in voting.

Situation III - The member holding 3,000 shares abstains but instead of 500 members voting in favour, 499 members holding 5249 shares vote in favour and 500

members holding 1751 shares oppose, the scheme is not approved as majority in number of members oppose the scheme; also the value of shares of those voting in favour is less than 3/4th of the total value of shares.

Situation IV - The member holding 3000 shares vote in favour of the scheme along with 499 members totalling to an aggregate holding of 8249 shares and remaining 500 members with 1751 shares oppose it. The scheme is not approved as though the value of shares voting in favour is significantly more, the number of members voting in favour do not exceed the number of members voting against.

Scope of section 230[7] - The aid of the section may be invoked when it is not otherwise possible to make some arrangement or compromise which would be in the interests of the company and the other party or parties to the arrangement. It can be used whether the company is a going concern or is in the course of winding up. Even where a sick industrial company prepares a scheme for revival of the company when its appeal before the Appellate Authority is pending in respect of the order of the BIFR for winding up, the same can be considered by the court (now Tribunal) when overwhelming majority of creditors has approved it, although some financial institutions/banks have opposed it - *Pharmaceutical Products of India Ltd., In re* [2006] 70 SCL 93 (Bom.). In the context of proceedings under sections 397 and 398 [now Section 241] (oppression and mismanagement) the court considering a scheme in respect of the subject company cannot wait for CLB's (now Tribunal's) decisions on the issue of oppression and mismanagement - *Banaras Beads Ltd., In re* [2006] 72 SCL 178 (All.)

Particulars of creditors - Where an amalgamation of two subsidiaries of the same parent company was approved in accordance with law, the pleas of one creditor that he had received the notice of the 'first motion' and there should have been specific mention of details of the names of all creditors and the amounts respectively owed to them were rejected by the Court. The Court held that it is not mandatory to provide full particulars of creditors in the application under section 391[now Section 230] and also court notice need not be given, in respect of first or second motion to individual creditors. Once amount due to a creditor has been deposited in the court, the creditor losses *locus standi* to participate further in the proceedings - *L.G. Electronics System (I) Ltd., In re* [2003] 43 SCL 554 (Delhi).

The New Delhi Bench of NCLT held that once public notice inviting objections to Scheme of Arrangement, having been published in press and if creditor did not attend meeting or raise objections, he could not have been heard subsequently. Once the list of creditors have been accepted and passed orders to call meeting, subsequently, adding or deducting names of creditors would not be permissible. [*Statesman Ltd.* v. *Emaar MGF Land Ltd.* [2018] 96 taxmann.com 302 (NCL-AT)].

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7. As per the decision of the Gujarat High Court in *ICICI Bank Ltd., In re* [2003] 42 SCL 5, the provisions of section 391 [now Section 230] constitute a complete code and parties are not to be subjected to avoidable and unnecessary procedure for making repeated applications for matters to be done to give effect to the sanctioned scheme.

   The Rajasthan High Court in *Modern Syntax (India) Ltd., In re* [2007] 76 SCL 157 has held that section 391 [now Section 230] does not empower the Court to interfere in matters of a sick industrial company's rehabilitation scheme before the BIFR, where an arrangement is proposed for the company under section 391.

23.4 Exercise of the Tribunal's discretion

Basically in considering a petition for sanction of a scheme, the Tribunal has to act in supervisory capacity, even though all the conditions specified in the Act have been fulfilled.

Before the Tribunal sanctions a scheme, it will normally need to be satisfied on the following matters[8]:

1. *The statutory provisions must have been complied with* - The Tribunal must see that the resolutions are passed by the statutory majority in value and number in accordance with the legislation at a meeting or meetings duly convened and held. In this regard, it may be noted that section 230 contemplates a scheme between a company and its creditors or any class of them or between the company and its members or any class of them. Thus, where a scheme was agreed to by the company and its ordinary shareholders only, without interfering with the rights of the preference shareholders, the scheme was held to be valid even though a meeting of the preference shareholders was not called to ascertain their views - *Mcleod & Co.* v. *S.K. Ganguly* [1975] 45 Comp. Cas. 563. In *Noida Toll Bridge Co. Ltd.* v. *Secured Creditors of Noida Toll Bridge Co. Ltd.* [2007] 79 SCL 565 (All.), the Court sanctioned a scheme under which the interest liability of the company on its deep discount bonds was sought to be reduced inspite of objection by a section of secured creditors as the same was approved by majority of members and such bond-holders as the scheme was not found to be prejudicial to the interests of members and creditors nor was it against public interest.

   In re Krita Engineering (P.) Ltd., [2013] 36 taxmann.com 432 (Karnataka), none of the secured creditors attended the meeting convened by the transferor company. The company subsequently obtained 'no objection' from the secured creditors for the sanction of the scheme. The Karnataka High Court held that the 'no objection' so obtained was a sufficient compliance of the mandatory provisions of Section 391(2) [now Section 230(6)].

   The Tribunal shall not make any order sanctioning the compromise or arrangement unless it is satisfied that the company or any other party making the application has disclosed to the Tribunal, by affidavit, the following information:

   (*a*) all material facts relating to the company including the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;

   (*b*) reduction of share capital of the company included in the compromise or arrangement;

   (*c*) any scheme of corporate debt restructuring consented to by not less than seventy-five per cent of the secured creditors in value, including—

8. List of such matters was drawn in the case of *Sakamari Steel & Alloys Ltd., In re* [1981] 51 Comp. Cas. 267.

(*i*) a creditor's responsibility statement in the prescribed form;

(*ii*) safeguards for the protection of other secured and unsecured creditors;

(*iii*) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(*iv*) if the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

(*v*) valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer [sub-section (2) of Section 230].

The Court (now Tribunal) would see whether the proposals contained in the scheme have been made in good faith and there is no misrepresentation or concealment - *Calcutta Industrial Bank Ltd., In re* [1948] 18 Comp. Cas. 144 (Cal.). The material interests of the directors, managing director or managers as such and/or as shareholders or creditors or lenders must be stated in the scheme/notice calling the meeting. The effect of these interests on the scheme should be adequately explained stating if and how they are different from the like interests of other persons. A bland statement that the directors have no interest in the scheme other than as members along with other members of the company is not a sufficient compliance - *Rankin & Blackmore, In re* AIR 1950 SC 218.

In *Trio Mercantile & Trading Ltd.,* In re [2016] 68 taxmann.com 175 (Bombay), in a scheme of amalgamation it was found by the Court that an expert valuer had carried out valuation exercise and same had not been questioned by any stakeholders and it was approved by SEBI approved merchant banker and there was no demonstrable unfairness in determination of value of transferee company's shares. As there was no bad faith *vis-a-vis* any stakeholder and scheme was just, fair and reasonable and same had to be sanctioned. Similar views were expressed by the Rajasthan High Court in *Suruchi Holdings (P.) Ltd., In re* [2016] 65 taxmann.com 183 (Rajasthan). It was held that as there was nothing prejudicial to interest of creditors, members of both transferor and transferee Company or to public interest and all required procedures had been followed, scheme of amalgamation so proposed had to be sanctioned.

Non-disclosure of the relevant facts will lead to rejection of application by the Tribunal. In *Morepen Laboratories Ltd.,* In re [2018] 92 taxmann.com 296 (NCLT - Chd.), the applicant did not disclose investigation by Serious Fraud Investigation Office (SFIO) or pendency of various criminal proceedings against it. The proposed scheme of arrangement with fixed deposit holders was dismissed.

Further, an order made by the Tribunal sanctioning the compromise or arrangement shall be filed with the R.O.C. by the company within thirty days

of the receipt of the order [Section 230(8)]. When in a scheme of amalgamation there is change in the share capital, if the court's [now Tribunal's] order sanctioning the scheme is filed with the R.O.C., it would obviate the need of separate notice to R.O.C. under section 95 or 97 [now Section 64] - *Nokia Siemens Network India (P.) Ltd., In re* [2010] 103 SCL 193 (Kar.).

2. *The class must have been fairly represented* - The Tribunal must be satisfied that those who attended the meeting are fairly representatives of the class and that the statutory majority did not coerce the minority in order to promote interests adverse to those of the class whom they purport to represent. The Tribunal also reviews the manner in which the meeting has been held and will not sanction the scheme if the meeting was held irregularly. The Court (now Tribunal) cannot turn a blind eye on irregular voting or irregular conduct of the meeting. In an arrangement of demerger, the company cannot exclude an unsecured creditor on the plea that the concerned unsecured creditor is a creditor for another unit of the same company - *Birla VXL Ltd., In re* [2006] 66 SCL 69 (Guj.). The role of the court (now Tribunal) is inquisitional and supervisory - *Bihari Mills Ltd., In re* [1985] 58 Comp. Cas. 6 (Guj.). The Court (now Tribunal) can pierce corporate veil and if the scheme is found to be fraudulent and intended for a purpose other than the purpose stated, it may be rejected even at the outset - *Bedrock Ltd., In re* [1998] 17 SCL 385 (Bom.). Also see *St. Mary's Finance Ltd.* v. *R.G. Jaya Prakash* [1999] 22 SCL 337 (Ker.).

   The question what constitute a class of shareholder came up before the Delhi High Court in *Ram Kohli v. Indrama Investment (P.) Ltd., [2013] 35 taxmann.com 281 (Delhi).* As per the proposed scheme each 500 shares held in transferee company was to be replaced with one share in new company and shares below 50 in number were to be treated as fractional shares and to be sold by trustee through private placement. It was contended that shareholders whose shareholding was being treated as fraction should be treated as separate class. It was held that the decisive factor for determining class of shareholder is not shareholding pattern but category of shares that one holds and merely because individual held small fraction of shares would not make them a separate class. It was also held that if the scheme is found to be fair and reasonable, same would be sanctioned.

   In *Mather & Platt Fire Systems Ltd., In re,* the Bombay High Court has held that if a subsidiary of the company is a member of the class for which a meeting has been directed to be called, such a member is not in any way different from other members of that class. No plea to consider such a member separately can be entertained [2007] 74 SCL 432.

   This requirement is, in part, an off-shoot of the first. As regards the majority, there are two requirements. The majority who vote in favour of the scheme must be first a majority in number of those members of the class (whether of creditors or shareholders) who are present and voting; and, second, it must be 3/4th in value.

   Thus, if there are 100 members voting, of whom (to take an extreme example) one member holds 901 shares and the remainder hold one each, the 99 shareholders holding one share each cannot force a scheme against

the vote of the holder of the 901 shares, because they do not muster 3/4th in value. Conversely, that shareholder and 49 of the others cannot force a scheme against the votes of the remaining fifty because there would not be a majority in number. The same principle applies to creditors. Also *see* Para 23.3 for a comprehensive illustration on this aspect of majority.

It may be noted that the majorities are of those voting and not of those entitled to vote nor of those who are present - *Re Bessemer Steel & Ordnance Co.* [1875] 1 Ch. D 251. Thus, shareholders who are not present in person or by proxy, or who, although present, do not vote, may be ignored. However, the Tribunal will seek to find the underlying interest of the majority voting in favour of the scheme and satisfy that nothing clandestine exits in this regard. The majority has to act *bona fide* and for the benefit of the company.

In a case where there was no objection to a scheme from members or employees but two of the four secured creditors claiming more than three-fourths of total secured debts did not consent, it was held to be the duty of the court (now Tribunal) to examine whether the consent is unreasonably withheld as well whether the scheme would prejudicially affect those who have withheld consent - *Vishnu Chemicals (P.) Ltd., In re* [2002] 35 SCL 459 (AP).

However, this is not the whole requirement because, in addition, the Tribunal is required to be satisfied that the class is fairly represented. If, *for instance,* there were altogether one thousand shareholders holding ten thousand shares in all, the Tribunal, it is unlikely, would be satisfied by the statutory majority at a meeting at which ten members holding hundred shares in all were present and voted [*Palmer's Company Law,* 24th Edition, page 1146].

Petition of majority in guarantee companies - Problems in computing the percentage are likely to arise in case of guarantee companies and others not having share capital. In such cases, it will be assumed that each member holds one share in the company and the percentage is calculated accordingly.[9]

The principle is that, expressed in another connection by *Justice Lindley, M.R.* in *Allen* v. *Gold Reefs of West Africa Ltd*[10]. [1900] 1 Ch. 565 : ". . . . power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied and are seldom, if ever expressed".

3. *The scheme should be fair and reasonable* - Even on the face of the fact that a scheme of compromise or arrangement was approved by the requisite majority and without coercion on minority, the Tribunal is not bound to confirm the scheme[11].

9. Ramaiya, Guide to the Companies Act, 12th Edition, page 1613
10. Quoted by Palmer in this regard (*supra*).
11. Also refer to point 8 of Para 23.5 of this edition

Objection by the Regional Director: Though the wishes of the shareholders and creditors are the most important while sanctioning a scheme of amalgamation, the Regional Director has both right as well as duty to raise any concern regarding violation of any law etc. In *Prayas Engineering Ltd., In re* [2013] 32 taxmann.com 227 (Gujarat), scheme of arrangement had been approved by equity shareholders and creditors. Regional Director stated that accounting treatment proposed to treat reserves arising under scheme as General Reserve and to treat same as free reserves was contrary to the provisions of section 205 [now section 123] . Gujarat High Court held that since shareholders, secured creditors, unsecured creditors and even concerned stock exchanges had approved scheme with said treatment, objections raised by Regional Director did not survive. Moreover, since scheme of arrangement was in interest of its shareholders and creditors as well as in public interest, proposed scheme was sanctioned.

Once it is established that the petition seeking sanction of scheme of arrangement was in interest of shareholders, creditors as well as in public interest and all objection raised by Regional Director were addressed, same was to be sanctioned [*Ajanta (P.) Ltd.,* In re [2017] 77 taxmann.com 232 (Gujarat); also *Aditya Birla Money Mart Ltd.,* In re [2016] 76 taxmann.com 270 (Gujarat)]. Also see *Cello Pens (P.) Ltd.,* In re [2017] 83 taxmann.com 399 (NCLT - Ahd.)

In a more recent case the Bombay High Court acknowledged the role of the Regional Director while sanctioning a scheme of amalgamation. The petitioners *i.e.,* transferor and transferee companies sought sanction of their proposed scheme of amalgamation where under the entire business and the whole of the undertaking of the transferor shall stand transferred to and vest in the transferee with effect from the appointed date in terms of the scheme proposed by the petitioners. The Regional Director objected to the scheme stating that the idea of the petitioners behind propounding the above scheme was *inter alia* to obtain sanction of the Court to the scheme with the appointed date of 1-4-2008, and thereafter to file revised Income-tax returns in violation of section 139(5) of the Income-tax Act. It was alleged that the whole purpose of fixing a retrospective appointed date was to defeat the Income-tax demands and assessment proceedings either in progress or completed and the retrospective appointed date was nothing but a device to defeat the provisions of the Income-tax Act, particularly section 139(5), and the scheme, therefore, needs to be rejected.

It was held by the Bombay High Court that since Court (now Tribunal) is required to ensure that a scheme of amalgamation does not contravene any provision of law, Regional Director is not only entitled to but is duty bound to bring to attention of Court (now Tribunal) any provision in scheme which may contravene/circumvent provisions of any law including law pertaining to Income-tax. The court also held that the legislature intended that Regional Director will examine a scheme from all aspects and place his observations and views before Court and that the same would be considered before sanctioning scheme. [*Casby CFS (P.) Ltd.,* In re [2015] 56 taxmann.com 262 (Bombay)].

The High Court of Rajasthan rejected objections by the Regional Director to a scheme of arrangement. As the income tax department had not raised any objection to scheme of arrangement, objection of Regional Director that evasion of tax of upto Rs. 690 crores would result by transferor company if scheme was sanctioned was rejected. The court observed that the proposed scheme was just, fair, reasonable, and fully compliant with prescribed statutory provisions for its approval, not opposed in any manner to law or public policy and the same was to be allowed. [*Sistema Shyam Teleservices Ltd.,* In re [2016] 74 taxmann.com 261]

In a more recent case, the Supreme Court of India has laid down a set of guidelines for consideration of the court (now Tribunal) in the matter of sanction of a scheme under sections 391 and 394 [now Sections 230 and 232] - *Miheer H. Mafatlal* v. *Mafatlal Industries* AIR 1997 SC 506. These guidelines are as under:

1. The sanctioning court (now Tribunal) has to see to it that all the requisite statutory procedure for supporting such a scheme has been complied with and that the requisite meetings as contemplated by section 391(1)(*a*) [now Section 230(1)(a)] have been held.
2. That the scheme put up for sanction of the court is backed up by the requisite majority vote as required by section 391(2) [now Section 230(6)] .
3. That the concerned meetings of the creditors or members or any class of them had the relevant material to enable the voters to arrive at the informed decision for approving the scheme in question and that the majority decision of the concerned class of voters is just and fair to the class as a whole so as to legitimately bind even the dissenting members of that class.
4. That all necessary material indicated by section 393(1)(*a*) [now Section 230(3)] is placed before the voters at the concerned meetings as contemplated by section 391(1) [now Section 230(1)].
5. That all the requisite material contemplated by the proviso to sub-section (2) of section 391 [now Section 230(2)] is placed before the Court (now Tribunal) by the concerned applicant seeking sanction for such a scheme and the court gets satisfied about the same.
6. That the proposed scheme of compromise and arrangement is not found to be violative of any provision of law, and is not contrary to public policy. For ascertaining the real purpose underlying the scheme with a view to be satisfied on this aspect, the court (now Tribunal), if necessary, can pierce the veil of apparent corporate purpose underlying the scheme and can judiciously x-ray the same.
7. That the company court (now Tribunal) has also to satisfy itself that members or class of members or creditors or class of creditors, as the case may be, were acting *bona fide* and in good faith and were not coercing the minority in order to promote any interest adverse to that of the latter comprising of the same class whom they purported to represent.
8. That the scheme as a whole is also found to be just, fair and reasonable from the point of view of prudent men of business taking a commercial decision beneficial to the class represented by them for whom the scheme is meant. [*See Indus Ind Bank Ltd., In re* [2004] 54 SCL 37 (Bom.)]

9. Once the aforesaid broad parameters about the requirements of a scheme for getting sanction of the court (now Tribunal) are found to have been met, the court (now Tribunal) will have no further jurisdiction to sit in appeal over the commercial wisdom of the majority of the class of persons, who with their open eyes have given their approval to the scheme, even if in the view of the court, there would be a better scheme for the company and its members or creditors for whom the scheme is framed. The court (now Tribunal) cannot refuse to sanction such a scheme on that ground as it would otherwise amount to the court exercising appellate jurisdiction over the scheme rather than its supervisory jurisdiction.

These considerations guided the decision in many other cases including *Pramod Foods (P.) Ltd., In re* [2009] 94 SCL 110 (Kar.).

There is no doubt that the Court (now Tribunal) will be strongly influenced by a big majority vote[12] provided the scheme is fair and equitable. The Court (now Tribunal) will not itself judge the commercial merits of the compromise or arrangement, which is the function of the class itself. Even in a situation where the Court (now Tribunal) may be of the view that there can be a better scheme, it cannot sit as an appellate court and it will go by fulfilment of the condition of the law - *Alembic Ltd.* v. *Dipak K. J. Shah* [2003] 41 SCL 145 (Guj.)[13]. But, the court (now Tribunal) should not be taken to be a mere rubber stamp. The Madras High Court in *Calicut Bank Ltd.* v. *Devani Ammal* AIR 1940 Mad. 621 observed "that the court (now Tribunal) does not sit merely to see that the requirements of law have been complied with, nor does it simply register a resolution passed by the majority of shareholders or creditors. The court (now Tribunal) is bound to consider the proposal and decide whether they are fair and reasonable taking everything into consideration".

Thus, if the Court (now Tribunal) concludes that there is "such an objection to it as that any reasonable man might say that he could not approve it"[14], then the court may refuse to confirm the scheme. In a case where income-tax or sales tax or similar other tax liability has arisen and has crystallised, the Court (now Tribunal) will not interfere in such a case so far as the incidence of tax on the company is concerned. Justice Brightman *In re, N.F.V. Development Trust Ltd.* [1972] 1 WLR 1548 rejected as unreasonable a scheme under which it was proposed that the members of a company limited by guarantee and not having a share capital should be expropriated without compensation. The Bombay High Court in *Sandvik Asia Ltd., In re* [2004] 50 SCL 413 has gone by the principle and held that when the scheme is highly inequitable and unjust, even a single minority shareholder is entitled to oppose the scheme. The same High Court in *Bhilosa Synthetics (P.) Ltd., In re* [2004] 53 SCL 400 has held that the scope of the High court for judicial review of a scheme is very limited and definitely is not as that of an appellate jurisdiction unless whole scheme is unfair, unreasonable and contrary to law and public policy.

The scheme of amalgamation cannot be allowed as a tool to legalize an illegal entity. In the case of *Avenir Finvest & Leasing (P.) Ltd.* v. *Regional Director (Northern Region)* [2017] 88 taxmann.com 151 (NCL-AT), the transferee company was illegally carrying NBFC's activities without obtaining permission of Reserve Bank

12. *Re. Empire Mining Co.* (1840) 44 Ch.D.
13. Also *see Jaquar Steels (P.) Ltd., In re* [2004] 50 SCL 87 (AP).
14. Per Lindley, L.J. *In re, Alabama, New Orleans, Texas and Pacific Junctionary* [1891] 1 Ch. 213.

of India. The proposed scheme of amalgamation of transferor companies with transferee company was rejected.

Objection to a scheme – Proviso to Section 230(4) provides that only persons holding not less than ten per cent of the shareholding or holding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement are entitled to raise any objection to the scheme proposed.

Scheme of arrangement between Tata Teleservices, Bharti Airtel and Bharti Hexacom (Petitioner companies) was sanctioned as the members and creditors have accorded their approval and there was no objection to the scheme by Regional Director, Northern Region, Ministry of Corporate Affairs, Income Tax Department and Department of Telecommunication. An unsecured creditor had raised certain disputed claims against Transferee Company No. 1, however, it constituted much less than 5 per cent of total outstanding debt of Transferee Company No. 1 and as such, in terms of proviso to section 230, he did not have requisite locus to object to Scheme. [*Tata Teleservices Ltd.,* In re [2019] 101 taxmann.com 327 (NCLT - New Delhi)]

The Tribunal should not examine merit of a scheme or objection thereto while considering petition to order meeting for approval of the scheme. However, at that stage the Court (now Tribunal) has to satisfy itself that the scheme is, *prima facie*, valid - *Jube Leasing (Securities & Finance) Ltd., In re* [2007] 79 SCL 541 (Delhi). All these issues can be considered at a later stage when substantive petition is filed by the company. Any objection to the scheme should be raised in the meeting held for consideration of the scheme at the primary stage - *Essar Oil Ltd., In re* [2005] 62 SCL 345 (Guj.). The decision in *Shri Rama Multitech Ltd.* [2005] 62 SCL 539 (Guj.) is also on this line, only with a rider that though proceedings seeking direction of court (now Tribunal) for holding meeting are *ex parte* by nature, an interested party may be allowed to intervene if he has any issue on the direction, itself.

In *re Monarch Project and Finmarkets Ltd.,* [2014] 51 taxmann.com 355 (Bombay) the High Court held that where entire claim of objector-creditor had already been adjudicated and adjudicated amount had been fully adjusted/secured, objector would have no locus to raise any objection to scheme of amalgamation. The court further held that where an overwhelming majority of shareholders had approved scheme and the same was not found to be unjust and unfair to objecting creditor nor did it adversely affect interest of other creditors, the scheme shall be sanctioned.

Third Party Objection - When an aggrieved third party who was a director in the company and was allegedly illegally removed from that position, objected to a scheme of amalgamation on the plea that the company concerned has illegally transferred its assets to the transferor company in the scheme and cases are on in the matters alleged, the company court (now Tribunal) sanctioned the scheme, subject to the rider that interests of the objector have to be recognized in the scheme - *Sumilon Plastics (P.) Ltd., In re* [2010] 98 SCL 163 (Guj.). The Gujarat High Court in *Astorn Research Ltd., In re,* [2013] 33 taxmann.com 283 (Gujarat) considered the *locus standi* of the person raising objection to the petition under section 391 (now Section 230). The objector objected to the scheme as a shareholder, creditor and in public interest as it was detrimental to the interest of the employees of the transferor company. The objector had transferred the shares held by him and was

not a shareholder of either of the company. His status as a creditor was also doubtful, disputed and minimal. The objector who was also an ex-employee has raised objection in his personal interest rather that public interest. It was held that he had no *locus standi* to raise objection and the scheme was in interest of all stakeholders – shareholders, creditors and in public interest and was to be sanctioned. The workmen don't have a right to raise objection to the scheme of compromise and arrangements under Section 391 (now Section 230) on the grounds that interest of the workmen shall be adversely affected if the petition was sanctioned. [*Gati Cargo Management Services v. SBL Industries Ltd.* [2013] 36 taxmann.com 108 (Delhi)].

In the absence of violation of substantial law, merely because certain rights of a third-party are going to be affected, the sanction of a scheme of amalgamation cannot be stalled. The Income Tax Department's objection to the scheme on the ground that there are tax dues against the holding company of the transferor company is not sustainable. The court (now Tribunal) also took note of the fact that the said demand against the holding company stands stayed by Appellate Authority - *Essar Telecommunication Holding (P.) Ltd. In re* [2012] 111 SCL 795 (Mad.).

A scheme cannot be denied simply because one of the objectives of the scheme is to reduce tax liability. In *Goman Agro-Farms (P.) Ltd., In re* [2015] 63 taxmann.com 203 (Andhra Pradesh), the High Court held that a scheme of amalgamation to streamline affairs of companies cannot be denied only on that ground that one of the reason for proposed amalgamation was to reduce tax liability. However if the sole purpose of the arrangement is tax avoidance, the same could not be sanctioned. In *Uma Enterprises (P.) Ltd., In re* [2016] 67 taxmann.com 227 (Rajasthan) the court refused to sanction a scheme of demerger as it was observed that the proposed scheme of demerger was a mere device to avoid tax, capital gains and stamp duty and the company had no operative real estate business.

The High Court of Rajasthan rejected objections by the Regional Director to a scheme of arrangement. As the income tax department had not raised any objection to scheme of arrangement, objection of Regional Director that evasion of tax of upto Rs. 690 crores would result by transferor company if scheme was sanctioned was rejected [*Sistema Shyam Teleservices Ltd.,* In re [2016] 74 taxmann.com 261]

In re Heritage Housing Finance Ltd. [2013] 40 taxmann.com 103 (Calcutta) the High Court of Calcutta stated that even if the proposed scheme of compromise and arrangement has been approved unanimously by the shareholders, the Central Government still can raise objection in relation to share exchange ratio.

In *Bhagarati Rubber and Allied Products (P) Ltd.* v. *Rupani Footcare (P.) Ltd.* [2009] 90 SCL 189 (All.) the objection of the Regional Director of the Department of Company Affairs, was turned down, *inter alia*, on the issue of 'appointed date' in the scheme which preceded the incorporation of the resulting transferee-company.

The scheme should be bona fide to save the company from liquidation - It should not be directed to set apart a part or whole of the principal and interest of a particular class of its creditors[15] . The Bombay High Court in *Shree Niwas Girnni Kamgar Kruti Samity* v. *Ranganath Basudev Somani* has held that a scheme for revival of a

15. Sakamari Steel and Alloys Ltd. (*ibid*).

company may envisage new functions for the revived company and sale of a part of asset of the company, as a part of the scheme to pay off workers and creditors cannot be entertained to reject the scheme [2005] 62 SCL 175. A scheme prepared pursuant to the directions of Debt Recovery Tribunal should be allowed a trial as otherwise on winding up even secured creditor may not be paid in full - *Batliboi Ltd.* v. *Mideast Integrated Steel Ltd.* [2005] 62 SCL 141 (Delhi).

23.5 Powers of the Tribunal

The Tribunal has very wide powers in sanctioning or rejecting a scheme of compromise or arrangement, *inter alia*, including the following powers:

1. *Power of the Tribunal to supervise or modify compromise or arrangement*[16] - Where an order sanctioning a compromise or an arrangement has been made by the Tribunal it —

   (*i*) shall have power to supervise the carrying out of the compromise or the arrangement; and

   (*ii*) may at the time of making such order or at any time thereafter, give such direction in regard to any matter or make such modification in the compromise or arrangement as it may consider necessary for the proper working of the compromise or arrangement [Section 231(1)]. The Bombay High Court in *Reliance Natural Resources Ltd.* v. *Reliance Industries Ltd.* on a reference by petitioner found that by an agreement, subsequent to sanction of a scheme of demerger, the then management of the petitioner entered into an agreement with the respondent, varying a significant term of the scheme and ordered the new agreement as a nullity because the scheme approved largely depended upon that term; by an agreement subsequent to approval by Court (now Tribunal) of the scheme, the essence of the scheme cannot be subverted [2007] 79 SCL 21.

   The Calcutta High Court in *Castron Technologies Ltd. v. Castron Mining Ltd.* [2013] 179 Comp Case 311 (Calcutta) discussed various aspects relating to modification of a scheme of arrangement already sanctioned. Mere non-payment of stamp duty on the order sanctioning the scheme does not mean that the scheme doesn't come into operation. A scheme already sanctioned is not permitted to be recalled on the application of the transferor company alone. The court (now Tribunal) can allow in modification in the scheme in accordance with Section 392 (now Section 231) however substantial modification in scheme already approved by the shareholders cannot be made. Any substantial modification need to be approved by a general meeting of shareholders followed by a petition for sanctioning the same.

16. However, this power is subject to the Law of Limitation (Articles 136 and 137 of Schedule to the Limitation Act, 1963). It implies that if the High Court (now Tribunal) is approached under section 392 (now Section 231) to supervise the implementation of its order sanctioning a scheme after the period of limitation, the High Court is not empowered to do so because of the Law of Limitation - *Echjay Industries (P.) Ltd., In re* [2004] 54 SCL 43 (Bom.).

In *Hindustan Development Corpn. Ltd.* v. *Shaw Wallace & Co. Ltd.* (*supra*) it was held that the Court's (now Tribunal's) powers to modify a scheme is restricted to a scheme placed before it, which was duly approved by shareholders and/or creditors. The Bombay High Court, in *Brij Mohan Grover* v. *O.L. of High Court of Bombay* [2008] 81 SCL 334 has held that unpaid workers are creditors for the purpose of section 391 [now Section 230] and the Court approved the scheme presented by the workers as the same was fair to all parties involved and rejected the scheme approved by members and other creditors.

(*iii*) may make required deletion in the clauses in the approved scheme and the same need not be brought to the shareholders again so long the deletion did not affect the scheme as conceived - *Renuka Datla* v. *Duphar Interfran Ltd.* [2002] 35 SCL 579 (Bom.). The Supreme Court, however, in *Meghal Homes (P.) Ltd.* v. *Shree Niwas Girmi K.K. Samiti* (*supra*) has held that where there is modification in the scheme itself at the stage of implementation, the modified scheme has to come again for approval of members and creditors. The Court's (now Tribunal's) power under section 392 [now Section 231] is restricted to see that the scheme as originally approved is properly implemented.

2 *Power to make an order for winding up* - If the Tribunal is satisfied that a compromise or arrangement sanctioned under section 230 cannot be worked satisfactorily with or without modification and the company is unable to pay its debts as per the scheme, it may make an order for winding up of the company. Such an order shall be deemed to be an order under Section 273 [Section 231(2)]. Also *see CRB Capital Markets Ltd.* v. *RBI* [2006] 72 SCL 256. In this case, it was also held that during pendency of a winding up petition, if a viable scheme is formulated, the court is not prohibited in according sanction to the scheme provided conditions specified in proviso to section 391(2) [now Section 231(2)] are met.

It may be noted that inability to pay the debts as per the scheme is a pre-condition for the Tribunal to order winding up. If the scheme cannot be implemented with or without modification but the company is able to pay its debts, the Tribunal shall not have the power to order winding up.

However, resort to this provision is not permissible as a lever to recover dues or to seek winding up in the absence of a complaint that the sanctioned scheme was not properly working or that the scheme be set aside - *Maddi Lakshmaiah* v. *Duncan Agro Industries Ltd.* [2001] 34 SCL 250.

3. Where the required majority has not approved the scheme, the question of the court (now Tribunal) sanctioning the scheme does not arise - *Komal Plastic Industries* v. *Roxy Enterprises (P.) Ltd.* [1991] 72 Comp. Cas. 61 (Delhi).

4. If incorrect information were provided before the meeting, the court (now Tribunal) on receipt of correct information, has the power to order re-holding of the meeting on the basis of correct factual position - *Travancore National & Quilon Bank, In re* [1939] 19 Comp. Cas. 14 (Mad.).

5. *Power to issue order for repayment of dues of individual creditors/depositors* - The Delhi High Court in *Smt. Promila* v. *DCM Financial Services* [2001] 33

SCL 718, has recognized that in extraordinary circumstances, the court (now Tribunal) can order for repayment by the company to individual creditors/depositors *e.g.*, on health ground or on ground of old age.

6. *Power to recall its order* - The Court (now Tribunal) has the power to recall its order (passed *ex parte*) only if intervener or party affected was able to satisfy that *ex parte* order passed under section 391 [now Section 230] was patently illegal, erroneous or passed under misconception or misrepresentation - *Commerz Bank A.G.* v. *Arvind Mills Ltd. (supra).* The Delhi High Court in *Bharti Mobinet Ltd., In re* [2004] 54 SCL 261 has affirmed Court's (now Tribunal's) power to recall its order when it is proved that the order was obtained by committing fraud on the Court (now Tribunal). In *Ikisan Ltd., In re* [2015] 61 taxmann.com 324 (Bombay), SEBI requested for recall or review of a Court sanctioned scheme of arrangement on the grounds of non-compliance of accounting standards. The court observed that the scheme of arrangement was duly approved after considering approval granted by BSE/NSE and Regional Director and also after taking into consideration fact that Composite Scheme was passed by majority of shareholders at Court convened meeting and all disclosures as required under law were made and scheme had become effective. It was held by the High Court of Bombay mere non-compliance of accounting standards cannot be a ground for recall or review of a Court sanctioned scheme especially when due process of law has been complied with.

8. *Power to look into commercial merit or demerit of a scheme* - The Bombay High Court in *Mather & Platt (I) Ltd., In re* [2002] 39 SCL 58 has pronounced that Court (now Tribunal) would not enter into commercial merits/demerits of a scheme specially when the scheme is passed by overwhelming majority of shareholders after all the necessary material was placed before them. (However, when fairness of a scheme is apparently suspect, the court may go into that.). On the issue of fairness of the scheme, if the Court (now Tribunal) is satisfied that the scheme is discriminatory and unfair, it can reject the scheme - *TCI Infrastructure Finance Ltd., In re* [2007] 79 SCL 35 (Raj.).

   Observations by the Tribunal with respect to a scheme of arrangement before its adoption by shareholders - Whether justified? - Supreme Court in *Rainbow Denim Ltd.* v. *Rama Petrochemicals Ltd.* [2003] 166 Comp. Cas. 640 held 'No'. The appellant moved the company judge for an order dispensing with the calling of meetings of shareholders and creditors for the purposes of approving the scheme of arrangement between the appellant and the respondent company. The judge refused, but made certain adverse observations on the viability of the proposed scheme. On appeal, the Division Bench dismissed the appeal but gave liberty to the appellant to apply to the company judge for approval of the scheme. On appeal, the Supreme Court held, that the appropriate time for the company judge (now Tribunal) to consider the scheme was subsequent to approval thereof by the shareholders and creditors of the appellant company. Therefore, the order of the company judge and the Division Bench were to be set aside and liberty given to the appellant company to move the High Court for calling meetings of the

shareholders and creditors for the purpose of considering and approving the scheme. Once that was done a further application had to be made to the company judge and that would be the time for him to consider the scheme.

In regard to exercise of power by the Judge, the Supreme Court in *State of West Bengal* v. *Pronob Kumar Sur* [2003] 44 SCL 1, has stated that pre-requisites laid down under the Companies Act for passing order under sections 391-394 [now Section 230/232] cannot be treated as empty formalities which can be thrown at winds at the whims of the judge.

Overall approach of the Tribunal in considering a scheme - The question that often confronts the Tribunal is whether it can decline approval/sanction to a scheme of arrangement, even when the majority of members approved the scheme in the meeting convened pursuant to order of Tribunal and all the creditors gave their consent for the scheme. There cannot be any doubt that even in such a case the Tribunal can refuse its approval if such scheme is found to contravene the law. The Tribunal can reject sanction if the scheme is found to have been conceived with ulterior motive of playing fraud on public authorities. The Tribunal can also withhold its imprimatur if it is found that in the long run, such scheme is not in the interest of its members, creditors, employees and subverts public interest. The Tribunal can always throw out the scheme if it is intended to legitimize the lapses and illegalities that crept into the corporate governance for which persons at the helm of affairs of the company are alone responsible. Lastly, if the scheme of arrangement is an inchoate transaction affecting future, the Tribunal can always refuse sanction. [An extract from the judgment delivered in the case of *Aurobindo Pharma Ltd., In re* [2011] 105 SCL 717 (AP).] However, where ex-auditor, who as per ROC was a chronic litigant, raised unsubstantiated objections, sanction to scheme of amalgamation could not be withheld, if same was otherwise proper- *Phenil Sugars (P.) Ltd., In re* [2013] 31 taxmann.com 266 (Delhi)

A member/creditor also has a right to seek reconsideration of a scheme sanctioned by the Tribunal under section 230(6) irrespective of whether he consented to the scheme in the meeting held under section 230(1) or he was not present in the meeting. The agreement reached in a meeting over the scheme is a mere gate pass to gain entry into the next stage where section 231 comes into play and empowers the Tribunal to take fresh material into account as regards viability of the scheme. The court (now Tribunal) can even order withdrawal of the scheme at this stage if the scheme is not workable *vide Subhiksha Trading Services Ltd., In re* [2011] 108 SCL 13 (Mad.). This case also held that a company being terminally ill is not barred from evolving a scheme to bring life back to the company in suitable manner. It further held that a company, private or public, can suitably modify the requirements which are applicable to general meetings, when holding a meeting of a class of members.

The Calcutta High court, based on the principle of '*res judicata*' declined to order recall of the sanction of a scheme, as the sanctioning order had reached a stage of finality. The appellant had earlier accepted the scheme by not only being present but also participating in the entire process and the companies concerned were no longer in existence - *Suresh Kumar Rungta* v. *Roadco (I) Pvt. Ltd.* [2012] 111 SCL 329.

At post sanction stage of compromise and arrangement, Tribunal cannot direct parties to enforce such an obligation which did not exist in sanctioned scheme under section 230 - In *Real Lifestyle Broadcasting (P.) Ltd.* v. *Turner Asia Pacific Ventures Inc.* [2013] 31 taxmann.com 419 (Delhi), Transferor-company RGB was engaged in business of broadcasting. It purchased Set Top Boxes (STBs) from another company Turner, which held 50 per cent of its shares. Codes for set top boxes were held by Turner. Turner quit RGB. Subsequently, RGB entered into scheme with Company RLB for transferring business of RGB as a going concern, which was sanctioned. Turner filed contempt petition against RGB for non-payment for its share in RGB as per sanctioned scheme. Court ordered for payment. RLB filed present application claiming that decryption codes, being true property in distribution network, had not been transferred by Turner, rendering above scheme unworkable. It prayed for restoration of distribution network to it, by directing Turner to hand over STB codes or to declare scheme as unworkable and order winding up of RGB. Held that, at post sanction stage, Court (now Tribunal) could not direct Turner to restore distribution network to RLB by providing decryption code of STB since no such obligation existed in scheme sanctioned. Also, Court (now Tribunal) could neither declare scheme as unworkable nor order winding up of Petitioner Company.

23.6 Information as to compromise or arrangement [Section 230]

Section 230 further lays down the following rules regarding providing of information to the affected persons under a scheme of compromise or arrangement:

1. Where a meeting of the creditors (or any class of creditors), or of members (or any class of members) is called under sub section (1), the notice calling the meeting must be accompanied by a statement setting forth the terms of compromise or arrangement, a copy of the valuation report and explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders. The statement must, in particular, state any material interest of the directors and every trustee of debenture-holders of the company [Section 230(3)].
2. The notice shall be sent individually to all concerned and also be published in newspaper in the manner prescribed. In case notice calling the meeting is given by advertisement, there must be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid. Such copies must be furnished by the company free of charge. The notice and other documents are also required to be placed on the website of the company. In case of a listed company the notice with the requisite documents shall also be sent to the Securities and Exchange Board of India and every stock exchange where the securities of the company are listed for placing in their website.

   The notice shall clearly state that the persons may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice. [Section 230(4)]

3. A notice along with all the documents shall also be sent to the Central Government, the income-tax authorities, the Reserve Bank of India, the Securities and Exchange Board of India, the Registrar, the respective stock exchanges, the Official Liquidator, the Competition Commission of India and such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement. The notice shall require that they may make representations within a period of thirty days from the date of receipt of such notice. If no representation is received it shall be presumed that they have no representations to make on the proposals. [Section 230(5)]
4. The Tribunal also has a right to dispense with the requirement of calling of a meeting of creditor or class of creditors if ninety percent of them in value agree and confirm by way of affidavit to the scheme or compromise or arrangement.

23.6-1 Matter to be addressed in the Tribunal's order [Section 230(7)]

The Tribunal it its order shall provide for all or any of the following matters -

(*a*) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

(*b*) the protection of any class of creditors;

(*c*) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of section 48;

(*d*) if the compromise or arrangement is agreed to by the creditors, any proceedings pending before the Board for Industrial and Financial Reconstruction shall abate;

(*e*) such other matters including exit offer to dissenting shareholders, as may be necessary in the opinion of the Tribunal to effectively implement the terms of the compromise or arrangement.

The company's auditor also need to file a certificate stating that the accounting treatment proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133. Without this certificate no compromise or arrangement shall be sanctioned by the Tribunal.

It was held in *SMS Iron Technology (P.) Ltd.*, In re [2017] 82 taxmann.com 423 (NCLT - New Delhi) that obtaining a certificate from statutory/company auditor is a condition precedent for sanctioning scheme. A petition for amalgamation was not allowed as the auditors certified in their report that the accounting treatment of investments was not in consonance with prescribed accounting standards.

23.6-2 Is consent of stock exchange necessary for a scheme under clause 24 of Listing Agreement ?

No, the company concerned is only required to file the Scheme/Petition with the stock exchange one month before filing petition with the court - *Compact Power Sources (P.) Ltd., In re* [2004] 52 SCL 139 (AP).

23.6-3 Whether a scheme of arrangement sanctioned by the Tribunal would prevail over parallel agreement between the company and a shareholder?

The scheme of arrangement is to be *prima facie* considered as embodying final, complete and enforceable understanding between the parties to the arrangement and any parallel agreement between them, which is not involved in the scheme, cannot upset the scheme sanctioned - *Larsen & Toubro Ltd.* v. *Grasim Industries Ltd.* [2008] 82 SCL 172 (Bom.).

23.6-4 Financial corporations, statutory corporations and Government being shareholders/ lenders etc.

Sometimes these bodies hold shares or other material interests in a company and ordinarily their role in a scheme is expected to be conforming to public interest and interest of the company. However, occasions may be there that they might be in a position to gain more from the scheme than others of the same class and this fact cannot be ruled out by the Tribunal. If by the scheme another entity in which the institution or the Government has a larger stake gets undue benefit, it is possible that such body(ies) may vote in favour of the scheme to the detriment of the interest of other shareholders/creditors/lenders.

23.6-5 Buy-back of shares affected under section 230

Can buy-back of shares be affected under section 230 of the Act as an arrangement? Unless the buy-back of securities proposed under a scheme of arrangement or compromise is in accordance with the provisions of section 68 of the Act, it cannot be sanctioned by the Tribunal [Section 230(10)]. In view of the express restriction in sub-section (10), buy-back of securities under a scheme under section 230 is not permissible. Section 230 doesn't override the requirements of section 68 of the Act.[17]

23.6-6 Takeover offer under section 230

A scheme of compromise or arrangement sanctioned by the Tribunal may include takeover offer made in a manner as may be prescribed. However in case of listed companies, takeover offer shall comply with the regulations framed by Securities and Exchange Board of India in this regards [Section 230(11) and proviso]. Any party aggrieved by the order of the Tribunal involving takeover offer of companies other than listed companies, may make an application to the Tribunal. The Tribunal on such application may make such order as it may deem fit. It may be noted that in case of a listed company a takeover offer under a scheme sanctioned under section 230 shall be as per the regulation of SEBI. The salient feature of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 is given in Annexure 23.1 to this Chapter.

17. The Companies Act, 1956 didn't expressly prohibit buy-back of shares under a scheme of compromise and arrangement leading to conflicting judgments by the courts. See *Gujarat Ambuja Exports Ltd., In re* [2004] 52 SCL 399; *SEBI* v. *Sterlite Industries (India) Ltd.* [2004] 45 SCL 475 (Bom.).

23.6-7 Reduction of Share Capital under section 230

The explanation to section 230(12) clearly states that reduction of share capital in pursuant of Tribunal's order under this section does not attract provisions of section 66 of the Act. Accordingly the provisions of section 66 as applicable to the reduction of share capital are not applicable to capital reduction in pursuant of an order under section 230.

In *Ratnagiri Gas & Power (P.) Ltd.* v. *Purshottam Mareshwar Vartak* [2018] 91 taxmann.com 260 (NCL-AT), the Tribunal laid down that section 230 is complete code in itself and therefore the scheme of demerger approved by shareholders and creditors was to be approved with modification without obtaining fresh consent shareholders and creditors under section 66.

In an appeal in the case of *R. Systems International Ltd.,* In re [2018] 96 taxmann.com 347 (NCL-AT), the NCLAT held that the explanation to section 230 makes it clear that even for reduction of share capital effected in pursuance of order of Tribunal under section 230, provision of section 66 shall not apply.

23.6-8 Debt Recovery Tribunal and the Companies Act in the context of compromise and arrangement

The Bombay High Court in *IMP Powers Ltd., In re* [2007] 77 SCL 144 has held that the Recovery of Debts due to Banks and Financial Institutions Act, 1993 is a specific Act and as such provisions of that Act will prevail over the Companies Act, which is a general Act. Besides, the former Act is a subsequent legislation.

23.6-9 Compliance with Section 117

In case of an amalgamation, compliance with section 117 relating to filling of resolutions and agreements is not required. It was also held that the authorized share capital of transferee company would automatically increase without any further act, instrument and deed on part of transferee company. [*Sigma Soya Industries (P) Ltd., In re;* [2015] 54 taxmann.com 230 (Gauhati)]

23.7 Reconstruction and amalgamation

Arrangements and compromises may take place for the purposes of reconstruction and amalgamation of companies. A petition for reconstruction or amalgamation, in most of the cases, is accompanied by a petition under section 230. This is because there can hardly be any reconstruction or amalgamation which does not involve a compromise or arrangement between the company and its creditors or members. However, a reconstruction or arrangement under section 230 does not necessarily mean that there is a reconstruction or amalgamation within the meaning of section 232. Reconstruction, within the meaning of section 232, would involve two or more companies. This is unlike section 230, where the company and its members and creditors are only concerned.

23.8 Meaning of reconstruction

The term 'reconstruction', *inter alia*, indicates the process which involves (*i*) the transfer of undertaking of an existing company to another company, usually

incorporated for the purpose. The old company ceases to exist. However, all the assets might not pass to the new company; (*ii*) the carrying on of substantially the same business by the same persons; (*iii*) the rights of the shareholders in the old company are satisfied by their being allotted shares in the new company.

A reconstruction is made for any of the following purposes :

(*i*) *To extend the operations of the company.* If the shares are fully paid-up and it is desired to raise further capital, the shareholders in the old company may be issued only partly paid shares in the new company so that by calling up the uncalled amount, the company would have the necessary funds for carrying on its business.

Also, if the company wants to do business which is totally unrelated to its objects, it may resort to reconstruction. The objects clause of the new company may include the business which it wants to pursue.

(*ii*) *For purposes of reorganisation* - It implies alteration or modification of the rights of shareholders or creditors or both.

There is also the concept of internal reconstruction, wherein the company continues to exist and operate with adjustments of rights of shareholders and/or creditors, lenders, etc. In such a reconstruction, always some sacrifice is present for members and creditors to enable the company to operate as a going concern. If, pursuant to any scheme, shareholders who hold few shares get eliminated, such scheme cannot be rejected, if otherwise it meets all the requisites of an acceptable scheme - *ITW Signodge (I) Ltd., In re* [2004] 52 SCL 147 (AP).

23.9 Meaning of amalgamation and merger

Amalgamation is the blending of two or more undertakings (companies) into one undertaking, the shareholders of each blending undertaking becoming substantially the shareholders of the other company which holds blended undertakings.

Merger - Merger is a form of amalgamation where all the properties and liabilities of transferor company get merged with the properties and liabilities of the transferee company leaving behind nothing with the transferor company except its name, which also gets removed through the process of law. In reality, companies do not merge; only the assets and liability merge - *Areva T. and D. India Ltd., In re* [2008] 81 SCL 140 (Cal.). This concept of merger is in conformity with the concept given in Accounting Standard 14 issued by the ICAI. The other form of amalgamation is by way of purchase of assets and liabilities of the transferor where all the assets and liabilities may not be taken over.

23.10 Difference between amalgamation and reconstruction

The difference between amalgamation and reconstruction is that amalgamation involves the blending of two or more different entities, and not merely the continuance of one entity; reconstruction implies the carrying on of an existing business in some altered form, so that persons interested in the business may remain substantially the same.

However, on the question of whether the term 'amalgamation' includes the term 'compromise or arrangement', the High Court in *Patrakar Prakashan (P.) Ltd., In re* [1997] SCL XIII (M.P.) has held that section 391of the Companies Act has the effect of section 394 of the same Act [now sections 230 and 232] which includes in its fold the powers to make arrangement or compromise and amalgamation of two or more companies. Definition of 'amalgamation' as contained in section 2 of the Income-tax Act cannot be lifted and read for the purpose of the Companies Act.

[18] *Takeover vs. Merger* - Amalgamation/reconstruction may take the form of take-over or merger. Again, though quite related terms, the distinction between two was explained in *Bihari Mills Ltd., In re* [1985] 58 Comp. Cas. 6 (Guj.). Gujarat High Court observed that the distinction between a take-over and a merger is that in a takeover the direct or indirect control over the assets of the acquired company passed to the acquirer; in a merger the shareholding in the combined enterprise will be spread between the shareholders of the two companies. Often the distinction is a question of degree: if the dominant company (H. Co.) makes a share-for-share exchange offer for a target company (S. Co.), a company of roughly the same size, the former shareholders of S. Co. will finish up holding roughly 50 per cent of the share capital of H. Co., and the operation ought, undoubtedly, to be called a merger. If H. Co. is many times the size of S. Co., the operation ought generally to be regarded as a take-over of S. Co. by H. Co., although even in such a case, the result might be, if the shareholding in H. Co.,was far more widely dispersed than in S. Co. that H. Co., comes under the joint effective control of the former controllers of H. Co. and the former controllers of S. Co. or even under the sole effective control of the former controllers of S. Co.

Where H. Co. wishes to acquire complete control of a smaller company, S. Co. on a share-for-share basis, and the directors of S. Co. approve the proposal, it may be considered desirable to effect the takeover by way of a 'reverse bid' instead of a straight forward share-for-share bid by H. Co. for the capital of S. Co. In a reverse bid, S. Co. (at the instigation of the controllers of H. Co.) makes a share-for-share bid for the whole of the equity capital of H. Co. If the bid is accepted by the holders of at least 90 per cent in value of each class of equity capital of H. Co., and compulsory acquisition of any outstanding minority shares is carried out, the former shareholders of H. Co. will finish up as the majority shareholders in the enlarged capital of S. Co. and the pre-existing shareholders of S. Co. will hold a minority interest in S. Co.

H. Co. will be a wholly-owned subsidiary of S. Co. It will be observed that the position will be identical, in economic effect, with the position which would have been reached if H. Co. had made a share-for-share bid for the capital of S. Co. In either event, the original shareholders of the two companies will finish up holding the shares of the one company in roughly the proportion which the value of the net assets of the one company bears to the value of the net assets of the other company or which the earnings of one bear to the earnings of the other (or a mixture of the two) and the other company will be the wholly-owned subsidiary of the company in which the two groups of shareholders hold shares. Transaction will be a reverse takeover if it fulfils any one of a number of tests; if the value of the assets of H. Co.

18. Presently, takeover of Listed companies is regulated by SEBI's Takeover Code, 2011 and Clauses 40A and 40B of Listing Agreement.

exceeds the value of the assets of S. Co.; if the net profits (after deducting all charges except taxation and excluding extraordinary items) attributable to the assets of H. Co. exceed those of S. Co.; if the aggregate value of the consideration being issued by S. Co. exceeds the value of the net assets of H. Co.; if the equity capital to be issued by S. Co. as consideration for the acquisition exceeds the amounts of the equity share capital of S. Co. in issue prior to the acquisition; or if the issue of shares in S. Co. would result in a change in control of S. Co. through the introduction of a minority holder or group of holders. 'Reverse merger' is also a term in vogue; it implies a weak company taking over a strong company.

There was a scheme of demerger and certain assets of Fort Gloster Industries Ltd., were to be parked with the applicant in the case. One of the assets, *i.e.*, North Mills, though intended to be so parked, ultimately did not figure in the Schedule annexed to Court's order for sanction of the Scheme. While a long process of demerger was on, Fort Gloster passed on the possession of the North Mill to Hoogly Mills Ltd. Leaving aside certain developments of differences between Fort Gloster and Hoogly Mills, which were referable to arbitration, the applicant here, *i.e.*, Gloster Ltd. applied for setting up of Arbitral Tribunal and it was opposed by Hoogly Mills. The High Court rejected the application on the ground that the applicant's earlier assertion before Company Court has failed to get North Mill included in the Schedule as correction and no new ground is there to allow the application - *Gloster Ltd., In re* [2012] 113 SCL 264 (Cal.).

Demerger - Demerger means shedding of a part of the undertaking of a company to another company- In *Duphar Interfran Ltd., In re* [2001] 33 SCL 280, the Bombay High Court allowed the demerger of the pharmaceutical unit to another existing company as the arrangement was overwhelmingly approved by the shareholders and unsecured creditors as also by the Regional Director of the D.C.A. It was observed that the objectors to the arrangement were motivated by consideration of self-interest and not to protect the interests of the company or its members. Also see *Larsen & Toubro Ltd., In re* [2004] 54 SCL 461 (Bom.)

The Gujarat High Court in *Vodafone Essar Gujarat Ltd., In re* [2012] 115 SCL 94 has held that mere asset re-structuring is not same as reconstruction and therefore it is not a scheme coming under section 391 [now section 230]. Further as no consideration moved from one party to the other for transfer of assets, it is also not a valid contract. It is indeed a device to avoid paying huge tax liabilities. However, on appeal, Division Bench of the same High Court set aside the above judgment taking note of the fact that similar schemes were allowed by other High Courts and the Revenue Departments did not object to approval of such schemes. The judgment held that when the commercial wisdom of the company concerned decided to have a particular arrangement by which there can arise saving in tax, the scheme does not suffer from any infirmity especially when neither the Regional Director nor the Telecom Department raised any objection. Besides, no shareholder also raised any objection. The Bench also considered the scheme as arrangement under section 391 [now section 230] as it is a case of reconstruction and not a mere re-structuring. The issue of no consideration having been paid by transferee was held as not relevant. The objection of the Income-tax Department in the instant case also is not enough to upset the scheme - *Vodafone Essar Gujarat Ltd.* v. *Deptt. of*

Income-tax [2012] 116 SCL 256 (The Division Bench judgment does not seem to be in public interest even though the Government preferred to remain passive).

23.11 Reverse Merger

Merger or Amalgamation essentially involves merger of a loss making or less profit earning company with a company with a good track record, to obtain the benefits of economies of scale of production, marketing network, etc., through the two methods mentioned above.

Reverse Merger is the opposite of Merger. No clear definition of reverse merger has been given in the Companies Act nor the term has been precisely defined by the Indian courts. Reverse Merger represents a case where the loss making company or less profit earning company extends its embracing arms to the profitable company and, in turn, absorbs it in its fold. The loss making company in case of such an arrangement is called a 'Shell Company'.

The reverse merger is by no means a new invention, it flourished in the 1980s. It boomed again in the 1990s with the advent of globalization and competition. In this era, small-to-medium-sized privately held companies that were looking to raise additional capital or to make acquisitions were forced to look for methods of going public other than through initial public offering. A popular alternative was the reverse merger: which is a transaction wherein a private company merges with and into a public 'shell' company in order to become publicly listed. There are two leading motivations behind these mergers: *first,* the private company does not want to spend the time or money to undergo an IPO; or *second,* it cannot find an underwriter for its stock, but wants to enter into the capital market.

However, the Indian courts, though not rejecting the above view, have a different approach. The flow of the Indian courts is unambiguously towards the protection of the interest of financial institutions, which, in most cases, have themselves mooted the idea of reverse merger to the promoter, and the protection and welfare of the creditors and members of the loss making or less profit earning company. From the Indian perspective, it is believed that reverse mergers are predominantly because of two reasons. *Firstly,* it is the scheme which can be used as a mode of tax savings for a healthy unit. *Secondly,* to protect the losses of the sick company as under the Income-tax Act, only the person who has sustained the loss can carry forward the same. In essence, one can say that reverse mergers are rehabilitation-oriented schemes aimed at achieving a quick corporate turnaround.[19]

23.11-1 Features of Reverse Merger

The Gujarat High Court in its judgment of *Bihari Mills Ltd., In re, Maneklal Harilal Spg. & Mfg. Co. Ltd.* [1985] 85 Comp. Cas. 6 (Guj.), heavily relied upon various tests laid down in the classical book - *Takeovers and Mergers.* These tests have to be satisfied before an arrangement can be termed as a reverse merger. The Court laid down the following tests to be satisfied before an arrangement can be termed as a reverse merger:

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(*i*) if the value of the assets of the healthy company exceeds the value of the loss making or less profit making company;

(*ii*) if the net profits (after deducting all charges except taxation and excluding extraordinary items) attributable to the assets of healthy company exceed those of loss making or less profit making company;

(*iii*) if the aggregate value of the consideration being issued by loss making or less profit making company exceeds the value of the net assets of healthy company;

(*iv*) if the equity capital to be issued by loss making or less profit making company as consideration for the acquisition exceeds the amount of the equity share capital of loss making or less profit making company prior to the acquisition; or

(*v*) if the issue of shares in loss making or less profit making company would result in a change in control of loss making or less profit making company through the introduction of a minority holder or group of holders.

23.11-2 Characteristics of a Shell Company

A shell company, for the purpose of this project, refers to a loss making or a less profit making company. A shell company for the purposes of a valid reverse merger may be:

(*i*) a former operating company that is public or private, for some reasons has ceased operations and liquidated its assets; or

(*ii*) one which never had any operations but was formed from scratch for the specific purpose of creating a shell.

In the former situation, shell promoters gain control of defunct operating companies by buying up a majority of their shares. In the latter situation, shell promoters incubate the shells - they incorporate a company, under Companies Act. In exchange for letting an operating company merge into a shell, the promoter charges the operating company a fee and retains an ownership interest in the shell post-merger.

23.11-3 Legal Structure and Compliance

The legal framework governing mergers and acquisition in India broadly consists of provisions of the Companies Act, 2013 (sections 230-239) and the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The terms 'mergers' and 'acquisitions' mentioned herein would also include the term 'reverse merger'.

Section 230 of the Companies Act states that where a compromise or arrangement is proposed:

(*a*) between a company and its creditors or any class of them; or

(*b*) between a company and its members or any class of them,

the Tribunal may, on the application of the company, or any creditor or member or liquidator, order a meeting of the creditors or of the members or any class of them. If majority of three-fourths present and voting agree to the compromise or

arrangement and if it is sanctioned by the Tribunal then it will be binding on all the creditors or all the members and also on the company.

Section 232 states that where an application is made to the Tribunal under section 230 for the sanctioning of a scheme, the Tribunal may make provision for the matters mentioned therein. Section 232, read together with section 230, like for any other merger or acquisition would be complied with even for a scheme of reverse merger.

Merger of Telecom Service Providers - DOT (Deptt. of Telecommunication) had issued merger guidelines for these companies, which *inter alia,* require prior approval of DOT for merger of licences. Spice and Idea Cellular Ltd. proposed a scheme of amalgamation under which overlapping licences stood vested in 'Idea'. 'Idea' sent a communication about proposed merger to DOT but did not seek prior approval for vesting of the licence of 'Spice' in 'Idea'. The fact that approval of DOT is necessary for the merger was suppressed from Court (now Tribunal) and the scheme was sanctioned. It was held that prior permission of DOT was a relevant consideration for the Court (now Tribunal) in considering the scheme. Though the Court further held that the suppression did not amount to fraud but the overlapping licence of spice vested in 'Idea' was to be kept in abeyance, to be decided by TDSAT - *Idea Cellular Ltd.* v. *Union of India, DOT* [2012] 115 SCL 43 (Delhi).

23.11-4 Procedure of a Reverse Merger

Process of a reverse merger starts when a healthy company reverse merges with a loss making or less profit making (Shell) company and the two companies enter into a 'Share Exchange Agreement'. This agreement basically sets forth the terms under which the two companies merge. The shell company is the surviving entity. The business that was once of the healthy company now is part of the shell company and takes on a new identity. Other essential elements of the reverse merger process include a reverse stock split and name changes.

The reverse stock split is almost always required of the shell company to achieve the percentage ownership. Upon closing, the healthy company's management team would like to do a name change. A competent and thorough attorney and auditor are important for conducting due diligence on the shell. The due diligence process is a very important step in determining whether or not the shell has 'skeletons in its closet'. Most shells will be carrying some sort of debt that the private company will have to assume when the reverse merger is completed.

In conclusion, one may say that the Companies Act though not expressly but impliedly included the concept of reverse merger within sections 230-239, but a need is felt for separate provisions for such mergers for assistance of the Tribunal and clarity on the points of law.

Thus, in era of globalization wherein a number of healthy companies are showing their interest in revival of loss making or less profit earning company, particularly for their own interest and also in the interest of latter, a need is felt for a precise definition and an elaborative text from the judiciary and the Legislature on the subject-matter of reverse merger.

There is a need of a step prior to the step of the scheme of reverse merger coming into action, *i.e.,* clearing off the bad loans or debts before the whole scheme could

actually be brought into action so as to prevent a healthy company from falling sick by its merger into a sick company.

23.11A Legal provisions regarding reconstruction and amalgamation

A reconstruction or amalgamation may take any of the following forms:

1. By sale of undertaking
2. By sale of shares
3. By a scheme of arrangement[20]

23.12 Reconstruction/Amalgamation by sale of undertaking [Section 232]

According to section 232, where an application is made to the Tribunal under section 230 and it is shown to the Tribunal that the compromise or arrangement has been proposed for the purpose of or in connection with a scheme of reconstruction of any company or companies involving amalgamation of two or more companies and that under the scheme the whole or any part of the undertaking, property or liabilities of any company is to be transferred to another company or is proposed to be divided among and transferred to two or more companies the Tribunal may make provisions for all or any of the following matters:

(*a*) the transfer to the transferee-company of the whole or any part of the undertaking, property or liability of any transferor-company;

(*b*) the allotment or appropriation by the transferee-company of any shares, debentures, policies or other like instruments in that company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person;

(*c*) the continuation by or against the transferee-company of any legal proceedings pending by or against any transferor-company;

(*d*) the dissolution, without winding up of any transferor-company. However, no order for dissolution of any transferor-company can be made unless the Official Liquidator is of the opinion that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or public interest - *Shankaranarayana Hotels (P.) Ltd.* v. *Official Liquidator* [1992] 74 Comp. Cas. 290 (Kar.);[21]

(*e*) the provision to be made for any persons who within such time and in such manner as the Tribunal directs, dissents from the compromise or arrangement;

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20. Already discussed
21. Where Central Govt. sanctions a scheme of amalgamation of a banking company with another banking institution under section 45 of the Banking Regulation Act, 1949, the transferor banking company does not need to be dissolved under section 232 of the Act. The Central Government's action in sanction of the scheme operates as amounting to dissolution without winding up.

(*f*) the allotment of shares of the transferee company in case where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force;

(*g*) the transfer of the employees of the transferor company to the transferee company;

(*h*) where the transferor company is a listed company and the transferee company is an unlisted company,—

A. the transferee company shall remain an unlisted company until it becomes a listed company;

B. if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre-determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal. The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;

(*i*) the set-off of the fee paid by transferor company (which is getting dissolved) on its authorised capital against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and

(*j*) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

For the purpose of this section property includes assets, rights and interest of every description and liabilities include debts and obligations of every description [*Explanation* (*iv*) to Section 232]. Section 232 envisages following types of compromises or arrangements –

(*a*) The undertaking, property and liabilities of one or more companies are to be transferred to an existing company (merger by absorption);

(*b*) The undertaking, property and liabilities of two or more companies are to be transferred to a new company (merger by formation of a new company);

(*c*) The undertaking, property and liabilities of a company are divided and transferred to two or more companies, existing or new. [*Explanation* (*i*) to (*iii*) to Section 232].

Where the only purpose for which the transferor-company was created was to facilitate the transfer of a building to the transferee-company without attracting the capital gains tax and the dissolution of the transferor-company was sought without winding up, the Court (now Tribunal) refused to sanction the scheme - *Wood Polymer Ltd., In re* [1977] 47 Comp. Cas. 597.

Again, in *Union of India* v. *Ambalal Sarabhai Enterprises Ltd.* [1984] 55 Comp. Cas. 623, the Gujarat High Court held that if the proposed amalgamation of companies (transferor and transferee-companies) is not in public interest, the Court (now Tribunal) has power to refuse to sanction the scheme of amalgamation. ". . . . the

amalgamation must fulfil some felt need, some purpose, some object and that must have some co-relation with the public interest. If the only purpose discernible behind amalgamation is defeating certain tax law and prior to the amalgamation a situation is brought about by creating a paper company and transferring an asset to such company which can, without further consequence, be amalgamated with another company to whom the capital asset was to be transferred so that, it can pass on to the amalgamated company, it would distinctly appear that the provision for such a scheme of amalgamation was utilised for the avowed object of defeating tax law. The court (now Tribunal) is charged with a duty, before it finally permits dissolution of the transferor-company by dissolving it without winding up, to ascertain whether its affairs have been carried on not only in a manner not prejudicial to its members but even to public interest."

The Calcutta High Court in *Areva T & D India Ltd., In re* (*supra*) had to deal with the situation of the transferee company disclaiming its liability to pay the fees for enhancement of its authorized capital necessitated by merger of two transferor companies with it. The claim of the transferee was based on the fact that the transferors had paid the requisite fees for having their authorized capital and since the merger amounts to merging of authorized capital of transferors with that of the transferee, there does not arise any question of paying the fees all over again in respect of increase in the authorized capital of the transferee as a result of the merger. The claim treated the right on the authorized capital as 'property' and felt that it should be treated as any other property that passes on to the transferee. The court disagreed with this claim and pronounced that what merge are the assets and liabilities of the transferor but not the company or its name obtained by paying statutory fees to the government in the same manner as a company pays fees for its registration. It remains with the name of the company and is not a property that is capable of being transferred under the provisions of section 394 [now Section 232]. The Court also held that though passage of a scheme/arrangement under section 391 [now section 230] is a single window clearance, it nevertheless, requires the company to follow the procedure(s) laid down in the Act for separate resulting components underlying the scheme, e.g. - change in the object clause in the memorandum or reduction or increase in the capital. Only relieving aspect is that the transferee has not to approach different authorities prescribed in the Act for respective actions. When the Court considers a scheme, it takes into account all the things need to be done under the Act to give effect to the scheme. The fees payable for different procedures need to be paid to the government and there is no waiver for this in the Act. [Also *see Ashim Investment Co. Ltd., In re* [2007] 76 SCL 358 (Delhi)]. Madras High Court disagreeing with the Calcutta High Court verdict in *Areva T & D's* case, has dismissed Regional Director's objection on amalgamation of authorised capital of transferor companies with the transferee company's authorised capital as no fees are payable on amalgamation even though the authorised capital of the transferee was enhanced - *Convansys (India) Pvt. Ltd.*, In re [2009] 96 SCL 470 (Mad.). It may be noted that this controversy has been put to rest by section 232(3) sub-clause (*i*). The Tribunal in its order is required to make a provision for the offsetting the fees paid by the transferor company, going into

liquidation, on its authorized capital against the fees payable by the transferee company subsequent to amalgamation.[22]

It may be noted that the provisions of section 232 relating to amalgamation are applicable only to companies registered under 2013 Act or under any previous company law and therefore registered partnership firm cannot be treated as 'company' and thus, cannot participate in amalgamation proceedings. [*Kediya Ceramics,* In re [2017] 86 taxmann.com 166 (NCLT - Ahd.)]

As regards taking a new name by the transferee company on amalgamation with transferor company, the Bombay High Court (seems purely on technicality) had allowed the new name in the scheme sanctioned by it, rejecting the objection of the ROC that the change of name requires compliance with procedure laid down in the Act. *Intertek Testing Services (I) Pvt. Ltd., In re* [2009] 93 SCL 157. Interestingly the Karnataka High Court in *Vinarom (P.) Ltd., In re* [2009] 93 SCL 144 had, *inter alia,* upheld ROC's stand that procedure under section 21[corresponding to Section 13 of the Act] has to be complied with.

In the context of creditors of the transferor company in an amalgamation by way of merger, the Rajasthan High Court had held in *Shreya's India (P) Ltd.* v. *Samrat Industries (P) Ltd.* [2007] 80 SCL 131 that creditors of the transferor become creditors of the transferee, irrespective of whether they had or intend to have dealings with the transferee. In this case, the amalgamation scheme had the objective to bring about synergy as both the companies had same line of business and no meeting of the creditors of the transferor company was ordered by the court under applicable rules, giving it an inherent power to dispense with meeting of creditors.

Whether giving of notice to Income-tax Department is mandatory - Once an application under section 232 is presented to the Tribunal, the provisions of sub-sections (3) to (6) section 230 shall be applicable *mutatis mutandis* to the proceedings. Under section 230(5), notice along with all the documents needs to be given to income-tax authorities. The income-tax authorities shall have a right to make a representation within thirty days of the receipt of the notice. It may be noted that it is mandatory to given the notice to the income-tax authorities as required. In absence of this requirement in the Companies Act, 1956, the courts had taken a view that there was no necessity to give any separate notice to the income-tax department.[23]

Obligations of transferor and transferee companies - The Karnataka High Court in *Kirloskar Electric Co. Ltd., In re* [2002] 40 SCL 745 has held that both the transferor and the transferee companies must obtain Court's (now Tribunal's) directions and meet the requirements of section 391(1) [now Section 230(1)] of the Act. Only the transferor company complying with sections 391 to 394 [now Sections 230 to 232] will not meet the requirements of the law.

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22. There was no corresponding provision relating to offset of fees on authorized capital in Companies Act, 1956.

23. See *Vinay Metal Printers Pvt. Ltd., In re* and *Anand Crown & Seal Pvt. Ltd., In re* [1997] 24 CLA; also *Sadanand S. Varde* v. *State of Maharashtra* [2001] 30 SCL 268.

On pendency of any income tax case, while proposing a scheme for sanction by the court, the Gujarat High Court in *Aangi Shares and Services (P) Ltd., In re* [2012] 113 SCL 515 has held that the pendency will not stand in the way of sanction of the scheme (Provided applicable parameters are met). In the same case, the court held that issue and allotment of shares are in the domain of Board of directors and this too does not affect the scheme.

Transferee company, duties of, in case of increase of share capital - Where as a result of amalgamation, share capital of transferee-company stands increased, transferee-company has to pass a resolution of board of directors to increase share capital by mentioning that it is as a result of scheme of amalgamation and has to give a notice to authority so that records can be updated - *Shaily Engineering Plastics Ltd., In re* [2003] 42 SCL 115 (Bom.). In *Fetchius Finsec Ltd., In re* [2007] 76 SCL 123 (Delhi) it was held that any amendment in the object clause in the memorandum of association of transferee arising out of amalgamation has to be done only by following the procedure laid down by the Act. [Also *see Max Estates Ltd.* v. *Malsi Estates Ltd.* [2007] 78 SCL 429 (Punj. & Har.)].

Amalgamation resulting in reduction of share capital - In *EOC Tailor Made Polymers (I) (P.) Ltd., In re* [2005] 59 SCL 199 (Bom.) it has been held that when due to holding of shares by transferor-company in the transferee company produces a reduction of share capital of the transferee company, no separate procedure under section 101 [now Section 66] is necessary.

Whether proceedings under sections 391 to 394 [now Sections 230 to 232] can be suspended on the basis of section 22 of SICA, 1985 - The court held No. The court also held that section 32 of the above Act would not be applicable to proceedings under sections 391-394 [now sections 230 to 232] - *National Organic Chemicals Ltd.* v. *NOCIL Employees Union* [2005] 62 SCL 373 (Bom.). In *Phlox Pharmaceuticals Ltd., In re* [2005] 63 SCL 237 (Guj.) it was held that the court (now Tribunal) can grant a scheme under sections 391-394 [now sections 230-232] when reference of a scheme was pending before BIFR. This case also held that neither fee for increase in authorised capital nor stamp duty on such capital is payable by the transferee company as the same are parts of the scheme.

Amalgamation and permanent employees of transferor-company - When a scheme of amalgamation clearly provides that all permanent employees of the transferor-company on the effective date of amalgamation would become employees of the transferee-company without any break in service and terms and conditions as to employment and remuneration would not be less favourable than those on which they were in employment of the former company, there is no need to provide further details to the terms and conditions of employment of permanent employees of the transferee-company on the effective date when the same are better than those of the transferor-company. If the employees of the transferor-company opting to join the transferee-company feel aggrieved by any service condition of the transferee- company or seek better conditions of service, they can approach appropriate forum in this regard *e.g.* under labour laws. Also, if there arises any specific omission/commission, after their getting absorbed in the transferee-company involving fundamental rights under the Constitution of India or any statutory rights, they can approach appropriate forum for redressal of their grievances either individually or as a group. However, it is not open to the court

(now Tribunal) considering the scheme to *suo motu* pass any observation on these unless the matter is raised. Also, an employee or worker of transferred company has the right not to join the transferee-company and claim retrenchment compensation from the transferee-company *i.e.* successor-company.

The issues referred above are relevant only when a transferor-company is absorbed by an existing company *i.e.* the transferee-company. *See IPCL Employees Association* v. *Indian Petrochemical Corporation Ltd.* [2008] 84 SCL 133 (Guj.).

Filing of Tribunal's order with the Registrar - A certified copy of the Tribunal's order should be filed by every company with the Registrar within thirty days of the passing of the receipt of the order [Section 232(5)].

The Calcutta High Court in *HBR Sales (P.) Ltd., In re* [2011] 110 SCL 481 has observed that a procedural law is not to be a tyrant, but a servant, not an obstruction but an aid to justice. In the instant case failure of the advocate of the company to file the Court's (now Tribunal's) order with the RoC as required by section 394(3) [now Section 232(5)] in time cannot be allowed to make the process and outcome infructuous. The court allowed company petition to file the court's order for amalgamation within time extended by the court.

In a case where order of the Court (now Tribunal), *inter alia*, had the effect of increase in the share capital of the company, the Court held that filing of the court's order with ROC should amount to giving notice to the ROC as envisaged in sections 95 and 97 [now Section 64] - *RKS Motors (P.) Ltd., In re* [2004] 50 SCL 261 (AP).

Power to amalgamate - Whether necessary in the Memorandum of Association - A moot point for consideration is, whether or not, the two or more companies under a scheme of reconstruction or arrangement should have power in their memorandum to go for reconstruction or amalgamation. According to a decision of the English Court - *Oceanic Steam Navigation Co. Ltd., In re* [1938] 3 All ER 740, the Court has no jurisdiction to sanction a scheme of amalgamation if it is *ultra vires* the memorandum of association. The Calcutta High Court does not, however, agree that the court is powerless to sanction an arrangement where the company does not have power as per its objects clause, to have jurisdiction for amalgamation - *Harikrishan Lohia* v. *Hoolungooree Tea Co., In re* [1970] 40 Comp. Cas. 458; *Marybong & Kyel Tea Estates Ltd., In re* [1977] 47 Comp. Cas. 802 and *United Bank of India Ltd.* v. *United India Credit & Development Co. Ltd.* [1977] 47 Comp. Cas. 689. Similar view was expressed by the Bombay High Court also in *Sir Mathrudas Vesanji Foundation, In re* [1992] 8 CLA 170. These views of the Calcutta High Court proceed on the basis that a power which is conferred by the statute itself need not be a derivative of the objects clause of the memorandum. Moreover, to amalgamate, with another company, is an inherent power of a company and need not be the object of the company.

Once again, the Calcutta High Court in *Eita (I) Ltd.* [1996] 4 CLJ 346 has held that the power to amalgamate is a statutory power and this power may be exercised notwithstanding the fact that the memorandum of the company does not contain express power to amalgamate with another company. Also *see Highland Electro Appliances (P.) Ltd., In re* [2003] 42 SCL 516 (Delhi) and *Hindhivac (P.) Ltd., In re* [2006] 71 SCL 423 (Kar.) and *RBR Knit Process (P.) Ltd., In re* [2008] 82 SCL 147 (Mad.). This latest case also decided that application money awaiting issue of shares

in the books of transferor company shall be treated as unsecured loan in the books of transferee.

Transferor and transferee-companies in dissimilar business - Whether amalgamation can be refused - The question was examined in *EITA India Limited, In re* [1996] 10 SCL. The court held 'No'.

Whether power to amalgamate is statutory power and this power may be exercised notwithstanding the fact that memorandum of association of a company may not contain express power to amalgamate with another company. *Held,* yes. Another issue considered in this case was *whether where majority of shareholders accepted valuation and fixation of ratio of exchange of shares and scheme was approved at a meeting* of members, *Central Government could oppose sanction of scheme of amalgamation* on ground that fixation of share exchange ratio in scheme was unfair - *Held,* 'no'.

Where, transferor and transferee-companies had been carrying business, almost similar in nature and it was believed by the Boards of the concerned companies that amalgamation would be advantageous to the companies, their respective members and creditors and the same was approved by majority of the shareholders of the respective companies, the scheme of amalgamation was approved by the court (now Tribunal) when there was no objection to the scheme from anywhere - *In re, Cheminor Drugs Ltd.* [2001] 29 SCL 277 (AP). However, the Punjab and Haryana High Court dismissed the petition of the transferor-company, although the scheme received approval of members and creditors and there was no objection from the Central Government and the official liquidator as the court found that the scheme was intended to defeat certain provisions of law which otherwise might apply in passing of property of the transferor-company to the transferee-company and what was being projected was not correct. *In re, Exedy Ceekay Ltd.* [2001] 29 SCL 203. This is an instance where the court (now Tribunal) acted in supervisory capacity and not merely as a rubber stamp.

Provisions governing scheme of amalgamation have overriding effect - Infringement of the provisions of section 42 [now Section 19] in the matter of a subsidiary coming to hold share in its holding company in a scheme of amalgamation was held to be in order in view of the overriding nature of the provisions governing scheme of amalgamation and its sanction by the Court - *Consolidated Coffee Ltd.* v. *Arun Kr. Aggarwal* [1999] 21 SCL 11 (Kar.).

23.12-1 Effect of amalgamation

The true effect of and character of amalgamation largely depends on the scheme of merger. But, when two companies amalgamate and merge into one, the transferor-company loses its entity as it ceases to have its business. However, their respective rights and liabilities are determined under the scheme of amalgamation - *Saraswati Industrial Syndicate Ltd.* v. *CIT* [1991] 70 Comp. Cas. 184 (SC).

When the transferee-company takes over a property subject to charge, from the transferor-company, the transferee-company has to file the necessary form with R.O.C. for registration of charge in its name.

23.12-2 Duties of the Tribunal with respect to reconstruction/amalgamation

The duties of the Tribunal with respect to a scheme of reconstruction/amalgamation are:

1. *To see that the scheme is reasonable and fair.* For this purpose, it is not enough to show that the members of the company had unanimously agreed to the scheme - *Carron T. Co. Ltd., In re* [1966] 2 Comp. LJ 278 (Cal.). However, if the scheme is reasonable and there is no fraud alleged, the Court (now Tribunal) will be inclined to sanction it - *Cotton Agents Rajasthan Ltd., In re* [1969] 39 Comp. Cas. 663 (Raj.). Unless it affirmatively shows that the scheme of amalgamation was unfair, the court (now Tribunal) will not interfere - *U. Cal. Fuel System Ltd., In re* [1992] 7 CLA 175 (Mad.) and *Flex Industries Ltd., In re* [1989] 3 Comp. LJ 28 (Delhi).

   "Amalgamation should not only be beneficial to the companies, but should also be in the interests of the creditors and members of both the transferor and transferee-companies and should also be in public interest - *Shankaranarayana Hotels (P.) Ltd.* v. *Official Liquidator* [1992] 74 Comp. Cas. 290 (Kar.).

   In *Vinay Metal Printers (P.) Ltd., In re* [1997] 14 SCL 26, two private limited companies wherein the directors and shareholders taking both the companies together were related to each other and held the entire equity capital of both the companies, decided to amalgamate. The ROC pointed out that a notice should be given to the Income-tax Department to enable the department to assess whether any tax evasion may take place. The Official Liquidator, however, did not raise any objection to the scheme of amalgamation. *The court* (now Tribunal) *held that* if a scheme of amalgamation is beneficial to the members of both the companies and affairs have not been conducted in a manner prejudicial to the interests of the members or public interest, commercial merit or demerit should not be looked into. Also, the court noted that the Official Liquidator has not indicated that the scheme is to avoid tax or to reduce liability. On these considerations, the point raised by the ROC was not material and there was no need to inform the Income-tax Department.

   Again in *Mcleod Russel, In re* [1997] 4 CLJ 60 (Cal.), three companies belonging to a group but having different lines of business decided to amalgamate for reaping the commercial advantages of a large unit and the Central Government rejected the scheme on the ground that amalgamating companies have different and dissimilar lines of business and unless provisions relating to capital reduction are complied with, the scheme should not get the sanction. The court (now Tribunal) held that in matters relating to scheme of amalgamation, it is for the shareholders to consider on commercial plane as to whether the amalgamation would benefit the companies involved. If the proposed merger is not for evading law or not manifestly unfair or is not intended to defraud shareholders and creditors, the court would normally not interfere. It is not necessary that in a scheme of amalgamation, companies should be involved in similar business.

2. *To ascertain the wishes of the members* – Upon receiving an application under section 232(1), the Tribunal may call a meeting of creditors or members or any class of them. The provisions of section 230(3) to 230(6) shall *mutatis mutandis* apply to such meetings. In addition the following information and documents are required to be circulated for the meeting:

   (*a*) proposed terms of the scheme in draft form duly drawn up and adopted by the directors of the merging company;

(*b*) confirmation that a copy of the draft scheme has been filed with the Registrar;

(*c*) a report explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties. The report shall be adopted by the directors of the merging companies before circulation;

(*d*) the report of the expert with regard to valuation;

(*e*) if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme, a supplementary financial statement.

It is the duty of the Tribunal to ascertain the wishes of the members by directing the calling of meeting as aforesaid. However the use of the expression 'may' indicates exercise of discretion by the Tribunal. This procedure cannot be dispensed with even if the shareholders have already unanimously approved the merger at an ordinary meeting - *Southern Automotive Corporation (E) Ltd.,* In re [1960] 30 Comp. Cas. 119 (Mad.). However, the power to decide convening of meeting is vested in the NCLT. The appellant company could not claim 'dispensing' meetings as a right. The appellate tribunal refused to interfere with the decision of the NCLT to convene meetings. *Mega Corporation Ltd.,* In re [2018] 90 taxmann.com 335 (NCL-AT)/[2018] 146 SCL 227 (NCL-AT). However, the court (now Tribunal) will not usually go into the question of business decision of amalgamation and the fact that two companies under amalgamation have totally different businesses may not be relevant for the court - *Canara Bank Ltd., In re* [1973] 43 Comp. Cas. 157.

When the transferor-company had only two members, the meeting was not required to be called in view of written approval given by these members - *Sita World Travel (I) Ltd.* v. *Kuoni Travel (I) Ltd.* [2001] 33 SCL 168 (Delhi). However the Madras High Court in *Ne Plus Technologies (P.) Ltd., In re* has held otherwise. In this case there were six shareholders and their individual consent for amalgamation was taken and the meeting was dispensed with. The Court (now Tribunal) held that collective decision of equity shareholders was far different from individual decision taken by them at their house or office. The decision affected entire structure and business of the company and hence discussion in a meeting is a pre-requisite for a decision - [2003] 42 SCL 739.

The Bombay High Court, following the decisions in *Bank of India Ltd.* v. *Ahmedabad Mfg. & Calico Printing Co. Ltd.* [1972] 42 Comp. Cas. 211 and in *Sharad Hardware Industries (P.) Ltd., In re* [1978] 48 Comp. Cas. 23 held that no separate petition by the transferee-company is necessary when a cent per cent subsidiary is merged with its holding company, having regard to the fact that in no way the interests of the members and creditors of the transferee-company are getting affected as no share is being issued to the transferor (merging) company and both the transferee and transferor-companies hold

considerable amount of net assets (*i.e.*, excess of assets over liabilities). The shares held by the transferee-company in the transferor-company are only being cancelled - *Mahaamba Investments Ltd.* v. *IDI Ltd.* [2001] 33 SCL 383.

In *J.K. Cement Ltd., In re* [2009] 90 SCL 151, the transferor-company being the wholly owned subsidiary of the transferee-company was allowed exemption from holding the meeting of the members. However, it was required to hold meeting of creditors. Similarly on a question whether the convening of meeting of the equity and preference shareholders be allowed in case the number of shareholders is small, the High Court of Karnataka answered in affirmative however direction to convene meeting of unsecured creditors was given. *In re Schneider Electric IT Business India (P.) Ltd.,* [2014] 45 taxmann.com 170 (Karnataka)

3. *To see that the scheme is designed to overcome difficulties and re-establish the business* - The object of amalgamation or reconstruction is to enable companies to come out of difficulties and to re-establish their business - *Pioneer Dyeing House Ltd.* v. *Dr. Shankar Vishnu Marathe* [1967] 37 Comp. Cas. 546 (Bom.).

23.12-3 Amalgamation with existing company only

It may be observed that section 232 only authorises a sale to a company already in existence or formed for the purpose of purchasing the assets of the old company. Therefore, a sale to an individual cannot be carried out under section 394 [now Section 232] - *Bird* v. *Bird's Patent Sewage Company* [1874] 9 Ch. App. 358. In *AIA Engg. (P.) Ltd., In re* the Gujarat High Court held, if reduction of share capital is part of the scheme under reference, the same would fall under the scope of sections 391-394 [now Sections 230 to 232] and therefore no separate procedure for reduction of share capital would be necessary in *AIA Engg. (P.) Ltd., In re* [2004] 52 SCL 43 (Guj.). However, the Karnataka High Court in *Comat Infoscribe (P.) Ltd., In re* [2004] 53 SCL 41 has held that while reduction of share capital or reduction of securities premium can form part of the scheme, the procedures under section 100 or under section 78 [now Section 66 and Section 52], as the case may be, have to be followed. Apparently there is some disharmony in these two judgments.

23.12-4 Synergy of operation

A wholly owned subsidiary was allowed to be amalgamated with its holding company on court being satisfied that the amalgamation was aimed at achieving synergy of operation and overall economic benefit to the companies concerned. An objection by the Official Liquidator that the Memorandum of Association of the transferee (holding) does not contain a specific clause to undertake the kind of business carried on by the transferor-company was of no avail as another clause of general nature was cited as the enabling clause and it was acceptable to the Court (now Tribunal) - *Allied Coatings and Compounds Ltd., In re* [1999] 20 SCL 480; *Kwality Zippers Ltd., In re* [2000] 23 SCL 189 (All.); *Consolidated Coffee Ltd.* v. *Arun Kr. Aggarwal* [1999] 21 SCL 11 (Kar.). In a clear statement of legal position, the Delhi High Court has held that diversity of object of the companies concerned is not a bar to amalgamation—*Steel Kingdom NetCom Ltd., In re* [2005] 59 SCL 544. Few NBF companies not being able to fulfil RBI Guidelines regarding minimum net worth,

individually decided to amalgamate to jointly achieve the minimum net worth and the schemes were duly approved in respective company meetings. Such amalgamation was allowed as the same was not contrary of any law or against public policy - *Uma Sridhar Hire Finance (P.) Ltd., In re* [1999] 22 SCL 295 (AP).

In *Ion Exchange (I) Ltd., In re* [2001] 32 SCL 56, the Bombay High Court, having regard to the beneficial effects of synergy and compliance by the concerned companies of the applicable provisions of the law, dismissed the plea of the intervener (a sub-contractor of the transferee-company) against sanction of the scheme of an amalgamation of the transferee-company and two of its wholly-owned loss making subsidiaries. The court (now Tribunal) was satisfied that the combined net assets of the amalgamating companies provided ample financial cushion. According to this judgment, the law should be slow to retard or impede the discretion of corporate enterprise to adapt itself to the needs of the changing times and to meet the demands of increasing competition. The law, as it has evolved in the area of mergers and amalgamations has recognized the importance of the court (now Tribunal) not sitting as an Appellate Authority over the commercial wisdom of those who seek to restructure business. In this case, the court dispensed with the necessity of calling the meeting of the creditors of the transferor- companies as all the shareholders of the respective transferor-companies consented in writing to the scheme. Instead it directed the companies to issue individual notices to every unsecured creditor about the hearing of the petition and ordered the publication of the same in the newspapers and the Maharashtra Government Gazette.[24]

The AP High Court *In re Management Solutions (P) Ltd.* [2007] 80 SCL 496 has held that when a wholly owned subsidiary is merged with its holding company, it may not be necessary to order calling of meetings of creditors.

23.12-5 Compliance with the scheme

To ensure compliance with the scheme in accordance with the orders of the Tribunal, section 232(7) requires an annual certificate till the completion of the scheme to be filed with the Registrar duly certified by a chartered accountant or a cost accountant or a company secretary in practice. Any company contravening the provisions of this section is liable to fine of not less than rupees one lakh but extending to rupees twenty five lakh. Every officer in default is punishable with fine that may range from rupees one lakh to rupees three lakh and imprisonment which may extend to one year or both.

23.12-6 Effect on legal proceedings

The legal proceedings may continue in the names of the amalgamated or reconstructed company. In *R.K.O. Pictures Inc.* v. *Cannon Screen Entertainment Ltd.* [1990] BCLC 364 (QBD), proceedings were commenced by a company to enforce an agreement which it had entered into with the defendant. Unknown to the solicitors, the company had ceased to exist as a separate entity. Prior to the issue of the writ, the company had merged with another company and this company was the sole person entitled to sue under the agreement. It was held that the court (now

24. Also see *Steel Kingdom Netcom Ltd., In re,* May, 2004 (Delhi) The Chartered Accountant Student, Page 8, January 2005.

Tribunal) had sufficient power within the fold of its inherent jurisdiction to substitute the name of the post-merger company for that of the pre-merger company. In *Smt. Bhavita Jitendra Mehta* v. *Sudera Enterprises (P.) Ltd.* [2004] 51 SCL 290 (Cal.), it has been held that a tenant of the transferor company cannot raise objection to amalgamation of that company with another company. The Bombay High Court in *Zee Telefilms Ltd., In re* has held that prosecution under various sections cannot stall merger of a transferor (wholly owned subsidiary company) with its holding company - [2006] 68 SCL 72. Also *see Sequent Scientific Ltd., In re* [2009] 94 SCL 55 (Bom.) where the supplier of know-how to transferor was denied right of intervention because normally the transferee will step in the shoes of transferor and all the obligations under the arrangement of supply of know-how will devolve upon transferee. However, the intervenor has his recourse to civil court for any breach of contract by the transferor.

Applicable Accounting Standard - Before a scheme is sanctioned by the Tribunal a certificate by the company's auditor needs to be filed with the Tribunal stating that the accounting treatment proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133 [proviso to Section 232(3)]. The Punjab and Haryana High Court in *Punjab Tractors Ltd., In re* [2009] 91 SCL 9 and in *Mohta Bearings Ltd., In re* [2009] 91 SCL 17 had approved the schemes subject to compliance with Accounting Standard-14. Accordingly, it seems that the mandatory standard has to be complied with in all cases of merger and amalgamation.[25] On transferee company giving an undertaking that it would comply with AS-14 and shall preserve its books of account, papers and records and not dispose of records without prior permission of Central Government, proposed scheme of amalgamation was allowed to be sanctioned [*Gopikishan Polyplast (P.) Ltd.,* In re [2016] 76 taxmann.com 200 (Gujarat)]

In *Hindalco Industries Ltd., In re* [2009] 94 SCL 1, the Bombay High Court allowed the scheme of arrangement involving equity shareholders and financial restructuring, subject to disclosure of deviation from applicable accounting standard in the final accounts of the company. Also *see Reliance Communications Ltd., In re* [2009] 94 SCL 219 (Bom.) and *Khatri Essence (P.) Ltd., In re* [2010] 98 SCL 204 (All.)

23.12-7 Critical dates in amalgamation, mergers, etc.

Sub-section (4) of section 232, *inter alia,* provides that where an order provides for the transfer of any property or liabilities, then, by virtue of the order that property shall be transferred to and vest in, and those liabilities shall be transferred to and become the liabilities of the transferee-company. The order may also provide that any property being so transferred be freed from any charge. To give effect to the transfer of properties and liabilities, it is important to have an appointed date. Section 232(6) requires that the appointed date shall be clearly indicated in the scheme and the scheme shall take effect from such date and not from a subsequent date. In view of this, the effective date of amalgamation for this purpose will be the date so specified by the Court (now Tribunal) in its order - *CIT* v. *Swastik Rubber Products Ltd.* [1983] 53 Comp. Cas. 174. This view of the Bombay High Court has

25. The requirement regarding mandatory compliance with accounting standards has been introduced in the Companies Act, 2013, some of the judgment of courts in the earlier Act will become redundant.

been upheld by the Supreme Court.[26] The appointed date denotes the date on which assets and liabilities stand transferred to the transferee-company unless, the court (now Tribunal) alters the appointed date contained in the scheme, the date so contained will be the appointed date and all the assets and liabilities of transferor-company shall vest in the transferee-company with effect from the appointed date. Effective date, on the other hand is the date on which the entire legal process concerning the amalgamation is completed. Appointed date precedes the effective date. However, in a scheme of amalgamation involving amalgamation of two companies, the 'appointed date' cannot be earlier than the date of incorporation of either of the two companies - *Prerna Premises Private Ltd., In re* [1992] 9 CLA 171 (Bom.). In this case, the 'appointed date' as per the scheme was fixed as 1-4-1991 whereas the transferee-company was incorporated on 28-10-1991. The 'appointed date' was accordingly, modified by the Court to 28-10-1991 (being the date of incorporation) overruling the objection of the Central Government that the appointed date cannot be earlier than 9-4-1992 when the certificate of commencement of business was issued to the transferee-company.

In *Krishna Laminations (P) Ltd., In re* [1995] 5 SCL 210 (P & H), in pursuance of the Court's order separate meetings of the shareholders and creditors of both the transferor-company and the transferee-company were held wherein the scheme of amalgamation of the two companies was approved with the stipulation that the same be implemented with effect from 1-4-1995 instead of 31-8-1994 as proposed. Both the Official Liquidator and the Regional Director, Deptt. of Company Affairs, had no objection to the scheme being sanctioned but the latter represented that in the absence of the last audited balance sheet for the period ending 31-3-1995, the scheme could not be made effective from 1-4-1995 but only from the date as originally proposed. The Bombay High Court in *Zee Interactive Multimedia Ltd., In re* [2002] 39 SCL 534 held that it is not compulsory that the company must get accounts audited time and again till the petition comes up for hearing. The statutory requirement of submission of latest auditor's report would mean latest auditor's report for period for which accounts are audited or ought to have been got audited by the company.

In *Marshall Sons & Co. (I) Ltd.* v. *ITO* [1997] 1 CLJ, the court considered the question of determining the effective date of an amalgamation if no specific date is laid down by the court (now Tribunal) sanctioning the scheme. It was held that every scheme of amalgamation has to necessarily provide a date with effect from which the amalgamation/transfer shall take place. In the instant case, a date was incorporated in the scheme for transfer/amalgamation. It is open to the court (now Tribunal) considering the scheme to prescribe any other date for transfer/amalgamation. Since in the case under consideration the court did not prescribe any date for giving effect to the scheme, the date contained in the scheme itself shall be the date of transfer/amalgamation.

When a scheme stipulates a date for completion of a merger, but provides for extension of such a date, then the scheme does not become nullity on expiry of

26. [1983] 140 ITR (St.) 2; also *see* Supreme Court decision arising out of Madras High Court Judgment in *Marshall Sons & Co. (I.) Ltd.* v. *ITO* decided on 27-11-1996. Also *see M.N. Chhaya* v. *P.R.S. Mani* [2005] 63 SCL 509 (Bom.).

stipulated date, provided extension of the date has been made by the Board of Directors of concerned companies - *Rohit Soaps and Detergents (P.) Ltd., In re* [2005] 61 SCL 161 (All.). This situation does not call for any further direction of the court (now Tribunal) to hold meetings again of creditors/shareholders.

23.12-8 Valuation of shares and fairness of exchange ratio

Under clause (d) of section 232(2) a report of the expert with regard to valuation shall be circulated before the meeting of creditors or members or any class of them. The material on the basis of which share valuation has been worked out should be placed on record of the Court (now Tribunal) and also brought to the notice of the shareholders - *Bank of Baroda Ltd.* v. *Mahindra Ugine Steel Co. Ltd.* [1976] 46 Comp. Cas. 227 (Guj.). The Supreme Court in *CWT* v. *Mahadeo Jalan* [1972] 86 ITR 621, after examining various aspects of valuation of shares in a limited company, laid down six *principles for guidance*, which are set out below:

1. Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.
2. Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company, the value is determined by reference to the dividends, if any, reflecting the profit-earning capacity on a reasonable commercial basis. But, where they do not, then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value. The dividend and earning method or yield method are not mutually exclusive; both should help in ascertaining the profit-earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.
3. In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profit of the company in computing the yield. In such companies the restriction of share transfers will also be taken into consideration in arriving at a valuation.
4. Where the dividend yield and earning method breakdown by reason of the company's inability to earn profits and declare dividends and if the setback is temporary, then it is perhaps possible to take the estimate of the value of the shares before setback and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.
5. Where the company is ripe for winding up, then the break-up value method determines what would be realised by that process.
6. As in *Attorney General of Ceylon* v. *Mackie* [1952] 2 All ER 775 (PC), a valuation by reference to the assets would be justified where, as in that case, the fluctuations of profits and uncertainty of the conditions at the date of the valuation prevented any reasonable estimation of prospective profits and dividends.

Again, in *Bihari Mills Ltd., In re* (*supra*), the Gujarat High Court had listed the following factors which should be taken into account in determining the final share exchange ratio.

(*i*) The stock exchange prices of the shares of the two companies before the commencement of negotiations or the announcement of the bid.

(*ii*) The dividends presently paid on the shares of the two companies.

(*iii*) The relative growth prospects of the two companies.

(*iv*) The cover for the present dividends of the two companies.

(*v*) The relative gearing of the shares of the two companies.

(*vi*) The values of the net assets of the two companies.

(*vii*) The voting strength in the merged enterprise of the shareholders of the two companies.

(*viii*) The past history of the prices of the shares of the two companies.

Unless the person who challenges the valuation, satisfies the court (now Tribunal) that the valuation is grossly unfair, the court will not disturb the scheme - *Piramal Spg. & Wvg. Mills Ltd., In re* [1980] 50 Comp. Cas. 514 (Bom.)[27]. Where the valuation is confirmed to be fair by eminent firms of valuers (auditors) and is also approved by overwhelming majority, the Court [now Tribunal] will not find fault with exchange ratio - *Tata Oil Mills Co. Ltd., In re Hindustan Lever Ltd., In re* [1994] 14 CLA 13 (Bom.)[28]. Share values cannot be ascertained with exactitude for arriving at exchange ratios either on 'net worth' basis or by the usual methods of valuation namely, break-up value, yield value and market value. Qualitative factors like market fluctuations, competition, Government policy, managerial skills are also relevant for the purpose - *Sanghi Industries Ltd., In re* [1994] 13 CLA 326 (AP). A petitioner claiming to question fairness of valuation is not entitled to any mathematical calculation underlying the valuation made and such computational statement cannot be said to form part of statements to be furnished under sub-sections (1) and (3) of section 393 [now Section 230 (3)] or under section 173(2) [now Section 102] - *Challa Rajendra Prasad* v. *Asian Coffee Ltd.* [1999] 20 SCL 201 (AP). In *Kiritbhai Hiralal Patel* v. *Arvind Intex Ltd.* [2000] 28 SCL 130 (Guj.) it was held that the High Court cannot exercise the jurisdiction of an appellate court and interfere with the wishes of the requisite number of shareholders only because valuation figure could have been different had another method of valuation was followed. However, the

27. Also *see NODS Worldwide Ltd., In re (supra).*

28. Also *see Jaiprakash Investment (P.) Ltd., In re* [2001] 32 SCL 552 (All.), in which the objection of the Regional Director of the D.C.A. was not entertained when, there was no challenge from any of the shareholders on the fairness of ratio of exchange. In the case of *ICICI Ltd.,* In re the Bombay High Court held that in the absence of material to prove that the valuation of shares was grossly unfair, the sanction of the scheme for amalgamation cannot be withheld. In this case also overwhelming majority of shareholders consented to the scheme [2002] 37 SCL 481. *In re Ratnamani Engg. Ltd.* [2003] 45 SCL 526 (Guj.) same views were held about the valuation by firm of C.A. and the exchange ratio. In *Ratan Housing Development Ltd., In re* [2005] 58 SCL 274 (All.), the Court did not find it to be wrong to value the shares of the transferor company by a method which was not used to value the shares of the transferee as no unfairness was proved.

court (now Tribunal) should interfere; if it finds that the scheme approved by majority is unconscionable, unfair or illegal.

Even though the court (now Tribunal) has to be satisfied that a fair procedure has been adopted and an honest attempt has been made to arrive at a fair and reasonable share exchange ratio, Court (now Tribunal) should nevertheless refrain from embarking on an exercise of evaluation on its own to test correctness of figures reached by experts *i.e.,* in the instant case by firms of chartered accountants. The scheme was approved by overwhelming majority of shareholders of the company concerned - *Covelong Beach Hotels (I) Ltd.* v. *Oriental Hotels Ltd.* [2002] 38 SCL 815 (Mad.)

Chartered Accountant's opinion on appropriateness of amalgamation - The Gujarat High Court in *Amerzinc Products (P.) Ltd., In re* [2011] 105 SCL 682, has held that when a chartered accountant was assigned a duty by the Official Liquidator of transferor companies to give report on the state of affairs of the companies, his report, *inter alia,* stating that the amalgamation was in larger interest of its members, creditors and public at large, was just not called for.

Valuation of shares of Banking Companies - Under section 44A of the Banking Regulation Act, the RBI has been given specific powers to grant approval to scheme of merger of banking companies and to determine market value of shares of dissenting shareholders. The Madras High Court in *Bank of Madura Shareholders' Welfare Association* v. *Governor, RBI* [2002] 40 SCL 1 has dismissed a writ petition seeking High Court's intervention as it was claimed that the swap ratio of shares was not fair to shareholders of the transferor banking company, in view aforesaid powers of the RBI.

Perverse valuation - In *Mihir Chakraborty* v. *Multitech Computers (P.) Ltd.* [2001] 33 SCL 257 (Delhi), the Court, *inter alia,* held that where the expert's valuation report suffers from mistake or perversity, the same can be set aside by the court (now Tribunal).

In *Jindal (I) Ltd.* v. *Cold Rollings (I) Pvt. Ltd.* [1998] 1 CLJ 36 (Delhi), the issue was whether the ROC can object to a scheme of amalgamation on the ground that shares should have been valued on market value instead of book value. The Court (now Tribunal) held that when formalities of amalgamation as laid down in law have been complied with, it is to be further seen whether the scheme is fair and reasonable and no fraud is involved. Valuation of shares falls in the domain of experts in the field. In this case the valuation was done by a firm of chartered accountants on the basis of guidelines issued by the Government and therefore no fraud can be inferred. The court relying on the Supreme Court judgment in *Miheer H. Mafatlal* [1996] 4 CLJ 124 declared that on the facts of the case the contention of the ROC fails.

Broadly on the same grounds the Court, in *Aradhana Beverages and Foods Co. Ltd., In re* [1998] 3 CLJ 421 (Delhi), rejected the objection of the Regional Director, of DCA on the amalgamation scheme. It held, when the shareholders and creditors, who are better equipped to gauge the value of the shares, have approved the scheme, the Regional Director cannot be heard to say that the merger will not be in the interest of shareholders, creditors and the Public. The companies involved in the scheme were subsidiaries of Pepsico and were closely held. Similarly, in *Ratnamani*

Engineering Ltd., In re [1999] 19 SCL 124 (Guj.), the Court expressed that the jurisdiction of the Court (now Tribunal) in the matter of a scheme of amalgamation is peripheral and supervisory and not appellate. Where a scheme has got approval of almost all the shareholders and the creditors and does not appear to be contrary to law or public interest, there could be no impediment to sanction such a scheme. In *Consolidated Coffee Ltd.* v. *Arun Kumar Agrawal* [1999] 21 SCL 11 (Kar.), the Court held the valuation (also determination of share exchange ratio) of shares should be done by firms who are most familiar with the work. The objection raised regarding share exchange ratio calculated by firms of Chartered Accountants was not accepted.

In an interesting case, *Operations Research (India) Ltd., In re* [1999] 19 SCL 414, the Gujarat High Court rejected the contentions of the Regional Director that the main objects of the company have not been spelt out in the memorandum of association and the share exchange ratio was improper and as such the scheme should not be sanctioned. The Regional Director raised these objections on the scheme filed by the transferor-company. Same objections were raised by him on the scheme filed by the transferee-company but later on withdrawn. As such the objections on the scheme filed by transferor-company automatically got vacated. However, the court held that it remained the duty of the court (now Tribunal) to examine the objections raised but withdrawn to see that the scheme is not prejudicial not only to the shareholders of both the companies but also to public at large.

'Break-up method' may be adopted for valuation of shares, though company is not to be wound up - *Bihari Mills Ltd., In re* (*supra*). It is no doubt true that so far as the question of valuation of shares in mergers and take-overs is concerned, the transferor-company is not to be wound up but nonetheless it is to be dissolved without formal winding up. If, therefore, in such a context an attempt is made to evaluate the break-up value of the transferor-company, it cannot be said that the approach is unjustified. If once, therefore, in relation to the transferor-company the break-up value has been arrived at, it would be reasonable to find out the break-up value of the transferee company. However, this does not mean that if the stock exchange prices are higher than the break-up value or on the basis of yield method or dividend method, the higher valuation is not justified. Emphasis is on the application of relevant principles of fair valuation and consequent determination of exchange ratio of shares between the transferor-company and the transferee-company. However, if workers and bankers of the transferor-company were not duly informed, the valuation is liable to be set aside - *Richa Jain* v. *ROC* [1990] 69 Comp. Cas. 248 (Raj.). In the absence of fraud/irregularity, valuation accepted by shareholders cannot be set aside for objection by creditors *In re* : *Blue Star Ltd.* [2000] 124 SCL 300.

In re, Sesa Goa Ltd. [2013] 35 taxmann.com 657 (Bombay), the Bombay High Court held that if no objection was raised on the exchange ratio in the court convened meeting, it was not open to the objector, who was also present in the meeting, to seek directions for appointment of fresh valuers. If the process laid down under section 391 [now Section 230] has been followed, the court (now Tribunal) shall not deny the sanction simply because of some allegations against the company. The fact that one of the company proposed to be amalgamated is loss making shall not deter the

court from sanctioning the scheme if the scheme is going to increase the assets of the amalgamated company.

Share Exchange ratio coupled with share premium - In re Shiva Texyarn Ltd. [2002] 38 SCL 1073, the Division Bench of the Madras High Court held that inclusion of share premium factor in determination of share exchange ratio between shares of the transferor company and the transferee company was only an accounting necessity to adjust the residual amount of the consideration on application of 1:3 ratio of exchange. No adverse view on share premium can be taken as the same is governed by section 78 [now Section 52] and nobody will be able to reap any special benefit out of the same.

Notice to be given to Central Government and other authorities [Sec. 230(5)] - Section 230(5) requires notice of every application made to it under section 230 to be sent to the Central Government besides income-tax authorities, RBI, SEBI, Registrar, respective stock exchanges, Official Liquidator, Competition Commission of India and sectoral regulators or authorities likely to be affected by the compromise or arrangement. The Tribunal should take into consideration the representations, if any, made to it by that Government or other authorities before passing any order.

Scope of section 230(5) - With regard to scope of section 230(5), the observations made by the Madras High Court in *Ucal Fuel Systems Ltd., In re* [1992] 73 Comp. Cas. 63 (Mad.) may be relevant: "Section 394A[29] [now Section 230(5)] makes it obligatory on the court to give notice to the Central Government of every application to be made to it under section 391 or section 394 [now Section 230/232] and to take into consideration the representations made by that Government before passing any order on the proposed scheme of amalgamation. This would enable the Central Government to study the proposal and raise objections thereto as it thinks fit in the light of the facts and information available with it, and also place the Court [now Tribunal] in possession of certain facts which might not have been disclosed by those who appear before it so that the interests of the investing public at large may be fully taken into account by the Court [now Tribunal] before passing its order. . . . The role played by the Central Government in cases of amalgamation is that of an impartial observer who acts in public interest and advises the Court (now Tribunal) whether it is or it is not feasible for the two companies to amalgamate."

In re, Heritage Housing Finance Ltd. [2013] 40 taxmann.com 103 (Calcutta) the High Court of Calcutta stated that even if the proposed scheme of compromise and arrangement has been approved unanimously by the shareholders, the Central Government still can raise objection in relation to share exchange ratio. The Court (now Tribunal) is, however, not bound to accept the views of the Central Government. Thus, objection of the Central Government as regards valuation of shares was rejected by the court, in the face of views expressed by two independent chartered accountants - *M.G. Investments & Industrial Co. Ltd.* v. *New Shorrock Spg. & Mfg. Co. Ltd.* [1972] 42 Comp. Cas. 145. Also *see Gulmohar Finance Ltd., In re* [1995] 5 SCL 207 (Delhi).

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29. It may be noted that section 394A of the Companies Act, 1956 required notice to be sent to the Central Government alone whereas section 230(5) requires the same to be sent to other authorities specified in the section as well.

There is no need to issue notice to the Central Government as soon as the application is made to the Tribunal. The language used in section 394A [now Section 230(5)] clearly shows that notice must be issued to the Central Government whose views must also be available before the court (now Tribunal) before an order is passed under section 391 or 394 [now Section 230/232] - *Jindal (India) Ltd., In re* [1993] 10 CLA 168 (Delhi).

The affidavit filed by Registrar incorporating the views of the Central Government can be regarded as "representations" of the Central Government in terms of section 394A [now Section 230(5)] - *Gwalior Strips Ltd., In re* [1994] 79 Comp. Cas. 178 (MP).

Joint petition by companies in a scheme - In absence of any specific prohibition in the Act against any joint petition under sections 391-394 [now Section 230/232] by the companies in the scheme and because Order I Rule I of the CPC allows this procedure, a joint petition by the transferor company and the transferee company is maintainable - *Chembra Orchard Produce Ltd., In re* [2004] 51 SCL 60 (Kar.).

Secured creditors' right to object to an amalgamation scheme - The Bombay High Court, *In re Blue Star Ltd.* has held that merely because creditors are secured, it cannot be said that they are disentitled to object to the scheme [2000] 24 SCL 300. In this case the court also ruled that even where assets are transferred for a meagre sum, that by itself will not render the agreement bad or against public policy. Inspite of objection by objectors to the scheme, where overwhelming majority of shareholders approve the scheme, the scheme can be sanctioned.

Objection of creditors with a view to recover disputed amount - When creditors object with the sole purpose of recovering dues under dispute from the petitioning transferee company, the objection cannot be considered as *bona fide* - *EMCO Ltd., In re* [2004] 54 SCL 76 (Bom.), also *see Sanvijay Alloys (P.) Ltd., In re* [2004] 54 SCL 213 (Bom.).

The Companies (Compromises, Arrangements and Amalgamation) Rules, 2016, lay down the following procedure for filling petition under Section 230/232

1. *Application for order of a meeting:*

An application for compromise or arrangements by the creditors and shareholders under section 230 of the Act may be made to the National Company Law Tribunal (Tribunal) for convening creditors meeting or shareholders meeting in the prescribed form (Form No. NCLT-1). The application needs to be accompanied by a notice of admission (Form No. NCLT - 2), an affidavit (Form No. NCLT - 6) and a copy of scheme of compromise or arrangement.

If more than one company is applying before the Tribunal for compromises and arrangements, then the application may be filed as a joint application.

A creditors' responsibility statement needs to be included (Form No. CAA. 1) for corporate debt restructuring.

2. Hearing of Application by the Tribunal:

At the hearing, the Tribunal determines the class or classes of creditors who are to attend the meeting to discuss the proposed compromises and arrangements, fixes the date, time and place for such meeting to be conducted, appoints a chairperson for such meetings and determines the quorum and procedure to be followed for

such meetings. The Tribunal also gives directions with regard to the notices to be issued to the creditors and the concerned sectoral authorities and advertisement of such notices. The Tribunal may dispense with holding of any class or classes of creditors' meeting.

1. ***Notices of Meeting:***

   The notices of the meeting (Form No. CAA.2) need to be sent to each creditor or member by the chairperson of the meeting through the prescribed means. The notice shall include a copy of the scheme of compromise or arrangements and other details which are material but haven't been included in the scheme. The notice of the meeting to the creditors and members will need to accompany a copy of the scheme of compromise or arrangement.

   The notice of such meetings is also required to be sent to the Central Government, RoC and Income Tax Authorities, Reserve Bank of India, SEBI, Competition Commission of India and concerned stock exchanges and to other sectoral authorities (Form No. CAA.3) to give them an opportunity to make any representation. Regulatory/statutory authorities may make a representation within 30 days from the date of receipt of such notice failing which it shall be presumed that the authorities have no representation to make on the proposed scheme of compromise or arrangement.

   The notice of the meeting also needs to be advertised (Form No. CAA.2) in at least one English and one vernacular newspaper which is widely read across the State in which the Company has its registered office. It shall also be advertised on the website of the company, not less than 30 days before the meeting. If it is a listed company, it shall be mentioned on the website of Securities Exchange Board of India and the website of the stock exchanges where the company's securities have been listed. In case separate meetings of classes of creditors or members are to be held, a joint advertisement for such meetings may be given.

   The chairperson of the meeting of the company or any other person authorised, shall file an affidavit with the Tribunal within 7 days before the commencement of the meeting stating that all the requirements regarding the issue of notices and advertisements have been complied with.

2. ***Voting and proxies:***

   The proposed scheme of compromise or arrangement shall be discussed at the meeting. Voting at the meeting shall take place by poll or by electronic means. Voting by proxy shall also be permitted.

   The chairperson of the meeting shall submit a report of the result to the Tribunal (Form No. CAA.4) within three days after the conclusion of the meeting.

3. ***Filing of the petition:***

   If the scheme proposed for compromise or arrangement has been approved in the meeting, the company needs to present a petition (Form No CAA.5) within 7 days after the chairperson of the meeting submitted the report.

The Tribunal shall fix a date of hearing for the petition. The date of hearing need to be notified in the same newspapers used to notify the meeting. The Tribunal shall send notices of hearing of petition to member and creditors who have objected to the scheme and also to other authorities and bodies who had made a representation earlier.

4. ***Hearing of Petition:***

   The petition shall be heard by the Tribunal on the appointed date. The Tribunal would grant the scheme by an order (Form. No. CAA 6). The Tribunal may give any additional directions or modifications that it may deem necessary. A certified copy of the order shall be filed with the concerned RoC within 30 days of receipt of the same.

5. ***Application for direction under section 232:***

   When the scheme concerns restructuring or amalgamation of companies and the mere sanction of the scheme by the Tribunal isn't sufficient to implement it, an application may be filed with the Tribunal for the directions with regard to the same.

The application shall be made by a notice of admission supported by an affidavit for directions of the Tribunal. The Tribunal may direct the manner of notice of admission to be given.

Upon the hearing, the Tribunal may make such order (Form No. CAA.7) or give such directions as it may think fit as to the proceedings to be taken for the purpose of reconstruction or amalgamation. The direction by the Tribunal may include an inquiry as to the creditors of the transferor company and the securing of the debts and claims of any of the dissenting creditors.

Once the order in favour of the scheme has been granted and until the completion of the scheme for restructuring or amalgamation takes place, a statement (Form No. CAA.8) needs to be filed with the RoC within 210 day from the end of the financial year.

The Tribunal at any point after the issue of the order of sanction of scheme may ask for a report of the working of the scheme and may ask for its submission within a specified period of time.

Any creditor or member, company or liquidator may apply to the Tribunal for the determination of any question relating to the working of the compromise or arrangement.

23.13 Merger and Amalgamation of certain companies [Section 233]

Section 233 provides a simplified procedure for merger or amalgamation of two or more small companies or between a holding company and its wholly-owned company or such other class or classes of companies as may be prescribed. The provisions of sections 230 and 232 shall not apply in such cases. It may be noted that use of the provisions of section 233 is optional for the companies covered. They may use the provisions of section 232 for the approval of any scheme for merger or amalgamation [Section 233(14)]

The following procedure is required to be followed under section 233 :

(*i*) The transferor company or companies and the transferee company to issue a notice of the proposed scheme (Form CAA 9) inviting objections or suggestions. The notice is required to be issued within thirty days to the Registrar and Official Liquidators where registered office of the respective companies are situated and persons affected by the scheme;

(*ii*) Convene general meetings of both the companies for considering the objections and suggestions and for approving the scheme (Form CAA 10) by the respective members or class of members holding at least ninety per cent of the total number of shares;

(*iii*) Each of the companies to files a declaration of solvency with the Registrar of the place where the registered office of the company is situated;

(*iv*) Convene meetings of creditors by giving a notice of twenty-one days along with the scheme (Form CAA 11) for approval of the scheme by majority representing nine-tenths in value of the creditors or class of creditors of respective companies. Alternatively approval may be obtained in writing.

(*v*) The transferee company to file a copy of the scheme so approved with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

(*vi*) If no objection is raised by the Registrar or the Official Liquidator, the scheme shall be registered by the Central Government and a confirmation will be issued to the companies. The Registrar or Official Liquidator may raise an objection in writing within thirty days.

(*vii*) On consideration of the objections or suggestions or for any reason the Central Government is of the opinion that the scheme is not in public interest or in the interest of the creditors, it may file an application with the Tribunal for considering the scheme under Section 232. Such an application needs to be made within sixty days.

(*viii*) The Tribunal may direct the scheme to be considered under Section 232 or may confirm the same by passing an order. A copy of the order confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned. The Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

(*ix*) Upon registration of the scheme the transferor company shall stand dissolved without process of winding-up.

(*x*) The registration of the scheme shall have the following effects:

(*a*) transfer of property or liabilities of the transferor company to the transferee company;

(*b*) the charges on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

(*c*) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and

(*d*) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

(*xi*) The transferee company to file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. However the fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

(*xii*) A transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

The provisions of this section shall *mutatis mutandis* apply to a company or companies specified in sub-section (1) in respect of a scheme of compromise or arrangement referred to in section 230 or division or transfer of a company referred to clause (*b*) of sub- section (1) of section 232.

23.14 Merger or Amalgamation with foreign company [Section 234]

In view of increasing number of cross-border mergers and acquisitions, Section 234 lays down the requirements relating to merger and amalgamation between a company registered under this Act and a company or body corporate incorporated outside India. The foreign company may or may not have a place of business in India. The provisions of this chapter shall apply *mutatis mutandis* to such schemes of merger and amalgamation subject to –

(*i*) The foreign company shall be incorporated in such countries as may be notified by the Central Government;

(*ii*) The provisions of this chapter shall apply subject to any other law for the time being in force;

(*iii*) The Central Government may make rules in consultation with the Reserve Bank of India and any scheme of merger and amalgamation shall comply with such Rules.

Section 234(2) states that a foreign company may merge with a company registered under this Act or *vice versa*. However such a merger requires prior approval of the Reserve Bank of India. The scheme of merger may inter alia provide for payment of consideration in cash or in Depository Receipt or a combination of the two.

Rule 25A of Companies (compromises, Arrangement and Amalgamation) Rules 2016 lay down the procedure for merger or amalgamation of a foreign company with a Company and *vice versa**. The rules provide that:

(*a*) A foreign company incorporated outside India may merge with an Indian company. A company may merge with a foreign company incorporated in any of the specified jurisdictions. Cross border merger would require prior approval of Reserve Bank of India and compliance with the provisions of sections 230 to 232 of the Act and these rules.

(*b*) The transferee company to obtain valuation by valuers who are members of a recognised professional body in the jurisdiction of the transferee company and further that such valuation is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect need to be attached with the application made to Reserve Bank of India.

(*c*) The concerned company shall file an application before the Tribunal as per provisions of section 230 to section 232 of the Act and these rules after obtaining approvals from RBI.

23.15 Power to acquire shares of shareholders dissenting from scheme or contract approved by majority [Section 235]

Sale of shares is the simplest process of amalgamation or take-over. It involves take-over without following the Tribunal's procedure under sections 230 and 232. Shares are sold and registered in the name of the purchasing company or on its behalf based on a contract between the transferee-company and the transferor-company for wholesale acquisition of shares of the latter company by the former company. The selling shareholders receive either compensation or shares in the acquiring company. In case certain shareholders dissent, section 235 contains provisions for the compulsory acquisition by the transferee-company of shares of the dissenting minority. The shares may be acquired on the same terms on which the shares of the approving shareholders are to be transferred to it. This will prevent the minority shareholders from demanding too high a price for their shares.

Section 235 lays down as follows:

1. Where the transferee-company has offered to acquire the shares or any class of shares of the transferor-company, the scheme or contract embodying such offer has to be approved by the shareholders concerned within four months. The approval must be given by the holders of not less than 9/10th in value of the shares whose transfer is involved. In computing 9/10th value of shares, the shares already held by the transferee-company or its nominee or subsidiaries are excluded.

*Inserted *vide* G.S.R. 368(E), dated 13 April 2017.

2. If the offer is approved, the transferee-company may, at any time within two months of the expiry of the said four months,[30] give a notice to the dissenting shareholders that it desires to acquire their shares. The transferee-company is entitled and bound to acquire the shares of dissenting shareholders on the same terms on which the shares of approving shareholders were acquired unless on the application of the dissenting shareholders within one month of such notice, the Tribunal orders otherwise.
3. After the expiry of the said one month or disposal of the application of the dissenting shareholders by the Tribunal, the transferee company is required to send the instrument of transfer and the consideration representing the price of shares acquired under this section to the transferor company.
4. The transferor company is required to register the transferee company as the holder of the shares in question and send a notice informing the dissenting shareholders about the registration and receipt of the consideration.
5. The amount received needs to be kept in a separate bank account and shall be disbursed in a time bound manner i.e. within sixty days.

It may be noted that shares already held by the transferor company or its subsidiary companies or by a nominee company are not taken into account for the purpose of counting the nine-tenth in value of shares as prescribed.

23.15-1 Purchase of Minority Shareholding [Section 236]

Section 236 provides a mechanism to enable the acquirer of the prescribed shareholding in a company to 'squeeze out' the minority shareholders at a fair price. The provisions of Section 236 are attracted where the acquirer or a person acting in concert with such acquirer becomes registered holder of ninety percent or more of the of the issued share capital of the company or any person or group of persons becoming ninety percent majority or holding ninety percent of the issued share capital of a company. This may happen by virtue of an amalgamation, share exchange, conversion of securities or otherwise. The process to be followed in such a case is set out below:

(*i*) The acquirer, person or group need to notify the company of its intention to buy the remaining shares and make an offer to the minority shareholders to buy the shares held by them. The price for such a purchase is determined on the basis of valuation by a registered valuer. Alternatively the minority shareholders may offer to sell the shares at a price so determined.

(*ii*) The amount of consideration is required to be deposited by the majority shareholders in a separate bank account to be opened by the transferor company. The consideration shall be disbursed within sixty days however

30. The transferee-company need not wait for the expiry period of four months for serving notice on the dissentient shareholders to acquire the shares - *Western Manufacturing (Reading) Ltd., In re* [1955] 3 All. ER 733 (Ch. D). However, the Delhi High Court in *AIG (Mauritius) LLC* v. *Tata Televentures (Holdings) Ltd.* [2003] 43 SCL 22 has held a different view in this respect. If the transferee does not wait for four months of first notice to serve the second notice, it is an offence under section 395 (now Section 235).

the account shall remain active for at least one year for making payment to the minority shareholders who fail to receive or claim payment within sixty days.

(*iii*) Even if the shares are not physically delivered by the shareholders, they shall be deemed to be cancelled and company whose shares are being transferred shall be authorised to issue shares in lieu of cancelled shares.

(*iv*) In case of a shareholder who have died, or ceased to exist or whose heirs, successors, administrators or assignees have not been brought on record by the transmission, the right to make offer for sale shall be available for a period of three years.

(*v*) If on or prior to the date of transfer of shares of minority shareholders, the shareholders holding seventy five or more of minority shareholding have negotiated a higher price for the shares held by them without disclosing the same, the majority shareholders are required to share the additional compensation received by them with minority shareholders on a pro rata basis.

(*vi*) In case the majority shareholders fails to acquire all the shares of the minority, the aforesaid provisions shall continue to be applicable to the residual minority though the shares of the company had been delisted and period of one year specified under Securities and Exchange Board of India Regulations has elapsed.

The Companies (Compromises, Arrangements and Amalgamation) Rules, 2016, provides rules for determination of purchase price. In case of a listed company, offer price to be determined in the manner as specified by the SEBI and a valuation report by a registered valuer would need to be provided to the Board of Directors of the company.

For an unlisted company, the offer price needs to be determined after taking into account the highest price paid by the acquirers for the acquisition in the last 12 months and the fair price of the equity shares determined by a registered valuer by the taking into account the valuation parameters. A registered valuer would need to provide its report to the Board of Directors giving justifications for arriving at a particular fair value.

23.15-2 Registration of offer of schemes involving transfer of shares

As per Section 238, the following provisions are to apply in relation to every offer or a scheme or contract involving the transfer of shares or any class of shares in the transferor-company to the transferee company:

(*a*) Every circular containing such offer, or every recommendation by the directors of the transferor company to its shareholders to accept such offer, must be accompanied by such information as may be prescribed.

(*b*) Every such offer must contain a statement by or on behalf of the transferee-company disclosing the steps it has taken to ensure that necessary cash will be available.

(*c*) Every circular containing or recommending acceptance of such offer must be presented to the Registrar for registration, and no such circular can be issued until it is so registered.

(*d*) The Registrar may refuse to register any such circular which does not contain the prescribed information as per clause (*a*) above, or which sets out such information in a manner likely to give a false impression. The Registrar must record the reasons for refusal and communicate such refusal within thirty days to the applicant.

(*e*) An appeal may be made to the Tribunal against an order of the Registrar refusing to register such circular.

Any person responsible for issue of a circular containing an offer involving transfer of shares under a scheme or contract without getting the same registered shall be liable to a penalty of one lakh rupees*. The party relying on section 395 (now Section 236) has to act *bona fide* and must establish that every act was imbued with fair play. Also the 9/10th majority voting for transfer should consist of different and distinct persons. Transfer of shares by person/persons through a complex set of relationships to him/them is not permissible under section 395 (now Section 236) - *AIG (Mauritius) LLC* v. *Tata Televentures (supra).*

Valuation of shares - Where a dissenting shareholder files a petition before the Tribunal in this regard, the Tribunal may take into account the following factors:

1. Where the shares are quoted on the stock exchange, there is a satisfactory indication of the value of the shares - *Press Caps Ltd., In re* [1949] 1 All ER 1013 (CA).
2. Where large majority of shareholders have already approved of the valuation, there is heavy burden on the applicant, who challenges the valuation, to prove that the valuation is inadequate - *Grierson, Oldham and Adm's Ltd., In re* [1967] 1 All ER 192. After all, where 90 per cent of the shareholders accept an offer as being fair, the burden is heavy on the ten per cent of the shareholders to prove that the offer is inadequate or unfair - *Piramal Spg. and Wvg. Mills Ltd., In re* [1980] 50 Comp. Cas. 514.
3. The court (now Tribunal) will not normally interfere with the valuation given by experts unless, of course, *mala fide* is suspected - *Associated Hotel of India Ltd., In re* [1968] 2 Comp. LJ 292. But the court (now Tribunal) will certainly not make an order in favour of the transferee-company if the transaction is unfair or unjust or is otherwise unconscionable and the court feels satisfied that the majority has been duped - *S. Vishwanathan* v. *East India Distilleries and Sugar Factories Ltd.* [1957] 27 Comp. Cas. 175.
4. The dissenting shareholders should not receive any treatment which is unfavourable as compared to the treatment received by other shareholders who have consented to the acquisition - *Carlton Holdings Ltd.* v. *Prian Instrument Ltd.* [1971] 2 All ER 1092. Courts (now Tribunal) have consistently taken the view that offer made to the dissenting shareholders should not be less favourable than the offer made to the other shareholders and this is despite the fact that the offer to the dissenting shareholders is made after the period of four months is already over - *Carlton Holdings Ltd.'s* case.

*Substituted *vide* Companies (Amendment) Act, 2019.

It may be observed that acquisition of shares u/s 236 does not result in the dissolution of the transferor-company. If the transferor-company is taken over u/s 236, then striking off the name of the transferor-company u/s 248 is one possible approach to dissolution. However, till the name is struck off a relationship of holding and subsidiary between the companies will accrue. The other alternative is to resort to the procedure of voluntary winding up.

Right of the Income-tax Department to object to a scheme of amalgamation : In *Indo Continental Hotel and Resorts Ltd., In re* [1997] 30 SCL 102 the court held that in the matter of amalgamation of two companies, public interest should be the supreme matter to be kept in mind. If the scheme protects the interests of creditors and shareholders, it may not be prejudicial to the interests of the Income-tax Department. Income-tax, if any is still due, the department can always recover the same by the process of law. The court held that the scheme before it was not a colourable exercise of power given under section 394 (now Section 232) of the Companies Act, 1956. However, in *Highland Electro Appliances (P.) Ltd., In re (supra)* the court (now Tribunal) made it a condition for sanction of the scheme that both transferor company and the transferee give undertaking to make the payment of income-tax.

Right of small group of shareholders - In *Brook Bond Lipton India Ltd., In re* [1998] 15 SCL 81, the court (now Tribunal) held that when the stake of the objectors is very small, the wishes of the majority shareholders cannot be ignored. It was seen that with the amalgamation of two companies, Brook Bond Lipton India Ltd. and Hindustan Lever Ltd., both being subsidiaries of a foreign company, the position of the holding company has not changed. Consent of the holding company to the amalgamation was not considered as indispensable element at the stage of amalgamation. As regards, the exchange ratio the court held that since the ratio has been fixed by an experienced and reputed firm of chartered accountants, it is acceptable.

Duty of dissenting shareholders - In terms of the decision of the Bombay High Court in *Alstom Power Boilers Ltd.* v. *State Bank of India & IDBI* [2003] 42 SCL 197 - the following are the duties of dissenting shareholders—

(1) It is a fundamental duty of shareholders opposing a scheme of amalgamation to attend general meeting of shareholders and creditors convened by the company and to place their objection to convince management as well as members and failure to do so would be serious one.

(2) Where shareholders dissenting the scheme claim to constitute a separate and distinct class for which separate meeting is to be called, they ought to have placed their objections before convenors of the meeting and put forth their case on receipt of notice of meeting for approval of amalgamation scheme.

In the instant case, the scheme approved by overwhelming majority of shareholders and creditors was opposed by financial institutions who were assignees of preferential shares held by the Government. They did not attend the meeting and at a later stage opposed the scheme. The decision further elaborated that 'class' as contemplated in section 391 (now Section 230) does not mean molecule of sub-section and classification is to be on basis of broad interest of classes.

Post-amalgamation events/consequences - Can they be raised as a ground for stalling amalgamation ? - In *Winfield Agro Services (P.) Ltd.* v. *Hindustan Antipests Pvt. Ltd.* AIR 1996 July, AP 230[31], Winfield Agro (P.) Ltd. was being amalgamated with Hindustan Antipests (P.) Ltd. The Scheme was approved unanimously by the shareholders of both the companies. The Central Government, however, raised objection on the following two grounds :

(*i*) that the transferee-company was to increase its authorised capital to accommodate the allotment of shares to the members of the transferor-company and unless the same was done, amalgamation could not be given effect to;

(*ii*) that after giving effect to the scheme, the total members of the transferee-company may exceed 50.

Held, the post-amalgamation events cannot be made subject-matter of dispute. Amalgamation was, therefore, allowed. However, the specific requirements of law must be met in due course after amalgamation.

Similar views have been held in *Hotel Hot Celdings (P.) Ltd., In re* [2005] 57 SCL 367 and in *Jaypee Cement Ltd., In re* [2004] 122 Comp. Case. 854 by Delhi and Allahabad High Courts respectively. These decisions were followed in *Bysani Consumer Electronics Ltd.* v. *Jain Son Corpn. Ltd.* [2006] 69 SCL 66 (Mad.). In *Juggilal Kamlapat Holdings Ltd., In re,* the Allahabad High Court ruled that when wholly owned subsidiaries merge with the holding company no additional fees are payable to the ROC so long combined authorised capital is not exceeded in the merged company [2006] 68 SCL 40. Also *see Motorola India (P.) Ltd., In re* [2006] 71 SCL 444 (Punj. & Har.) and *Jaypee Greens Ltd., In re* [2007] 74 SCL 118 (All.).

In case of merger of telecommunication companies, no merger of licences of the combining companies can take place unless prior permission for transfer of licence is obtained under section 4 of the Telegraph Act, 1885. Also, the court (now Tribunal) has the power to stipulate that a scheme being sanctioned can be operative only when all necessary statutory/contractual permissions have been obtained - *Spice Communications Ltd., In re* [2011] 108 SCL 372 (Delhi). As regards, other properties of the transferor company without having any conditions attached to their transfer, the same should get transferred in normal course. Accordingly, the demand of the respondent to charge a transfer fee for effecting the transfer in its record was held as unsustainable - *Dabur India Ltd.* v. *Vishwa Properties (P) Ltd.* [2011] 108 SCL 707 (Delhi).

Impact of other legislations on amalgamation, merger and acquisitions - Since amalgamation/merger/acquisition has become vehicle of growth in the dynamic economic environment in India and as such is a regular occurrence phenomenon, persons involved in the process have to reckon with the impacts of legislations like Income Tax Act, 1961, Competition Act, 2002 (as amended in 2007) and SEBI Act 1992 (specially the Take Over Code) on the Scheme, apart from other Acts like, Transfer of Properties Act, Stamp Act etc. Of these Competition Act is the most recent. Under Section 6 of that Act it is mandatory to get approval of the Competition Commission, if the resultant size of the post amalgamation, merger etc. of the entity exceeds parameters like asset values and turnover as specified in

31. The Chartered Accountant; March 1997.

Section 5 of the Act. An application has to be made to the Commission, within 30 days of making of the decision and to wait for approval for 210 days of the application reaching the Commission. If the Commission does not issue its approval/disapproval within 210 days, it will be presumed that approval has been given.

23.16 Amalgamation of companies in public interest [Section 237]

Where the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, then the Central Government may order the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges and with such liabilities, duties and obligation as may be specified in the order [Section 237(1)].

Section 237 provides for amalgamation of two or more companies at the instance of Government, in public interest, so as to obviate delays by observance of the usual procedure laid down in the Act in such cases. Although section 237 does not specifically refer to Government companies and their amalgamation in public interest, provisions of corresponding section of earlier Act (Section 396) have so far been invoked only for the purposes of amalgamation of two or more Government companies.[32]

A sort of elucidation of the concept of public interest can be seen in the case of the merger of TOMCO with Hindustan Lever Ltd.[33] Brief facts are as under :

The two companies involved in this case were Tata Oil Mills Company Ltd. (TOMCO) and Hindustan Lever Ltd. (HLL), which is a subsidiary of Uni-Lever (UL), a multinational company. Both these companies were manufacturers of soaps, detergents, toiletries and animal feeds. As TOMCO was incurring losses from 1990-91, its Board of directors decided to amalgamate their company with HLL, which was a more prosperous company in the same field of activities and the proposal was accepted by HLL. The scheme of amalgamation was accepted by the Board of directors of both the companies, a large majority of shareholders, debenture holders and others.

However, two of the shareholders of TOMCO, holding a nominal percentage of shares and two workers' unions and others opposed the scheme of amalgamation on various grounds of statutory violations, procedural irregularities of provisions of the Companies Act, MRTP Act, under valuation of shares including preferential allotment on less than the market price to the multinational company which was against the public interest. On preferential allotment of shares to Uni Lever on less than market value, the High Court held that HLL was already the holder of 51 per cent shares before any allotment, therefore, the allotment at a lower price which placed them at par with the same holding was neither illegal nor violative of public interest. The matter was referred to the Supreme Court.

Decision & Reasons: *Two separate but concurring judgments were delivered by the Supreme Court Judges* - Dealing in a more elaborate way the question of public

32. A.M. Chakraborti : *Company Law,* 1994 Edition, page 1110.

33. *Hindustan Lever Employees' Union* v. *Hindustan Lever Ltd.* [1994] 4 Comp. LJ. 267 (SC).

interest, Justice Sen stated that merely because 51 per cent of shares of HLL were being given to a foreign company, the scheme could not be said to be against public interest. In fact, the Foreign Exchange Regulation Act had been amended specifically to encourage foreign participation in business in India.

Further, with a view to give greater freedom to the companies for doing business in India, the MRTP Act[34] had also been amended and prior approval of Government was not necessary for amalgamation of companies any more. In fact, it was in the public interest that TOMCO with its 60,000 shareholders and also a very large work force, did not become a sick company, the Judge observed.

However, he added, that public interest which should be taken into account as an element against approval of amalgamation would not include a mere future possibility of merger resulting in a situation where the interest of the consumer might be adversely affected. If, however, in future, the working of the company turned out to be against the interest of the consumers or the employees, suitable corrective steps could be taken by appropriate authorities in accordance with the law.

Justice Sahai, in his judgment, also stated that transfer of assets at a lower price could not be upheld as violative of public interest. The reasons put forth by the Judge in support of his judgment were that in the case of amalgamation of companies the principle of "prudent business management test" is to be applied. When the court is concerned with a scheme of merger with a subsidiary of a foreign company then the test is not only whether the scheme would result in maximising the profits of the shareholders or whether the interest of the employees was protected but it has to ensure that the merger shall not result in impeding promotion of industry or shall not obstruct growth of national economy. The merger should not be contrary to the basic national objective of liberalised economic policy. Even assuming that the assets were being transferred for a very meagre sum, that by itself would not render the agreement bad or against public policy, elucidated Justice Sahai.

23.16-1 Saving of proceedings

Sub-section (2) of section 237 provides that the order of the Central Government under sub-section (1) may provide for the continuation by or against the transferee-company of any legal proceedings pending by or against any transferor-company and may also contain such consequential, incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

23.16-2 Protection of members and creditors

Sub-section (3) of section 237 makes provisions for payment of compensation to any member or creditor who stands to lose by the amalgamation. The amount of compensation is to be assessed by the Central Government and has to be published in the Official Gazette. The sub-section provides that every member or creditor of each of the companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the company resulting from the amalgamation as

34. Now repealed.

he had in the company of which he was originally a member or creditor. To the extent the rights or interest of such member or creditor against or in the company resulting from the amalgamation are less than the interest in or rights against the original company, he shall be entitled to compensation which shall be assessed by such authority as may be prescribed. The compensation so assessed shall be paid to the member or creditor concerned by the company resulting from the amalgamation.

23.16-3 Role of Tribunal

Any person aggrieved by any assessment of compensation made by the prescribed authority under sub-section (3) may, within 30 days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal [Section 237(4)].

The Government, before making the order, must:

(*a*) send a draft copy of the proposed order to each of the companies concerned,

(*b*) have considered and made such modifications in the draft order as may seem to it desirable in the light of any suggestions and objections which may be received by it from the companies concerned, or from shareholders therein, or from any creditors thereof [Section 237(5)]. The time for raising objection, not less than two months from the date of receipt of the copy of the draft order, shall be fixed by the Central Government

Copies of every order made under section 237 must, after it has been made, be laid before both Houses of Parliament as soon as possible [Section 237(6)]. The provisions of Section 238 regarding disclosure and registration shall also apply to transfer of shares under Section 237 (see para 23.15-2).

23.17 Preservation of Books and Papers of Amalgamated Company (Section 239)

Section 239 requires that the books and papers of a company, which has been amalgamated with, or whose shares have been acquired by, another company, must not be disposed of without the prior permission of the Central Government. The Central Government, before granting such permission, may appoint a person to examine the books and papers for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the first mentioned company or its amalgamation or the acquisition of its shares.

23.18 Offences committed prior to merger, amalgamation (Section 240)

The officer in default of the transferor company shall continue to remain liable in respect of offences under this Act committed prior to its merger, amalgamation or acquisition. The liability will continue even after the merger, amalgamation or acquisition.

23.19 Impact of Stamp Duty on amalgamation

If the Stamp Duty Legislation of the concerned State contains a specific clause to charge duty on transfer of assets in an amalgamation by treating the Court's [now Tribunal's] sanction as the instrument, then stamp duty becomes payable as is the case in Maharashtra - *vide* Supreme Court's decision in *Hindustan Lever* v. *State of Maharashtra* [2003] 48 SCL 630 and the decision of the Division Bench of the Calcutta High Court in the case of *Gemini Silk Ltd.* v. *Gemini Overseas Ltd.* [2003] 53 CLA 328. In the HLL's case the levy of the duty was upheld. The Division Bench judgment of Calcutta High Court struck down the levy allowed by the original judgment. Also *see Madhu Intra Ltd.* v. *ROC* [2005] 58 SCL 160 (Cal.). As per this decision, the combined effect of sub-sections (1) and (2) of section 394 [now sub sections (1) and (4) of Section 232] negates the requirement of suffering stamp duty. The Punjab and Haryana High Court has also decided in this light - *Max Estates Ltd.* v. *Malsi Estates Ltd.* [2007] 78 SCL 429.

23.20 Some more cases on Compromises, Arrangements, amalgamations etc.—

1. A scheme of amalgamation between a holding and its subsidiary company, not involving any re-organisation or restructuring of shares, or any variation of members' rights in the transferee company, does not need the sanction of the High Court (now Tribunal) insofar as the transferee company is concerned - *Nebula Motors Ltd., In re* [2003] 45 SCL 143 (AP).
2. Merely because a winding up petition is pending before the company court (now Tribunal), the company cannot be barred from submitting a scheme of arrangements to the court, even for avoiding winding up - *Macho Foods (P.) Ltd.* v. *Modiluft Ltd.* [2003] 45 SCL 159 (Delhi).
3. Where majority of creditors had no notice of petition for amalgamation, their interest should be protected and petition for sanction of amalgamation scheme should be dismissed - *Kaveri Entertainment Ltd., In re* [2003] 45 SCL 294 (Bom.). In this case the transferor company concerned obtained court's permission for non-holding of creditors' meeting on condition that it would issue notices to all creditors - which it did only selectively *i.e.* only to some unsecured creditors.
4. Unless the exchange ratio and scheme are unconscionable or illegal or unfair or unjust, court (now Tribunal) would not act as a court of appeal and sit in judgment. The court (now Tribunal), in exercise of its jurisdiction is to satisfy that (*i*) statutory provisions have been complied with, (*ii*) class of persons who attended meeting was fairly represented, (*iii*) statutory majority was acting *bona fide* and (*iv*) the arrangement (Scheme) was such that an intelligent and honest man, acting in respect of his interest might reasonably approve. The concept of market value means the price that a willing purchaser will pay to a willing seller for a property having due regard to its existing conditions with all its advantages and potential possibilities - *Reliance Petroleum Ltd., In re* [2003] 46 SCL 38 (Guj.). Also *see German Remedies Ltd., In re* [2004] 50 SCL 77 (Bom.).

5. The Delhi High Court in *HCL Infosystems Ltd., In re* [2003] 46 SCL 365 has held that in matter of section 394 (now Section 232), the jurisdiction of the court (now Tribunal) is limited only to merit of the scheme and issue raised beyond the scheme cannot be considered. The court (now Tribunal) would accept *bona fide* of explanatory statements appended to notice of meetings and would not investigate into such *bona fide* unless objectors could show that there was a fraudulent intention in not disclosing material interest. Once the court (now Tribunal) has fixed timing for meetings after considering all factors, no objection could be raised afterwards alleging time given for meeting was inadequate.
6. While the court (now Tribunal) has necessary power to sanction a scheme subject to the direction that the objecting creditor, whose interests are adversely affected, should either be paid or secured, it does not mean that in every case, the court (now Tribunal) is bound to include such condition. In order to get any relief, the objecting creditor must show that scheme is *mala fide* or fraudulent and is likely to adversely affect him or class of creditors to which he belongs - *May Fair Ltd., In re* [2003] 46 SCL 672 (Bom.).
7. A swap ratio is an integral part of the scheme of amalgamation and an amendment of the swap ratio proposed in the meeting will nullify the basis of the scheme. The jurisdiction of the court (now Tribunal) in these matters is not appellate in nature but is founded on fairness. Court (now Tribunal) will not interfere only because valuation could have been improved upon, had another method been adopted, when the scheme has been approved. The voting in a meeting pursuant to the court order under section 391(now Section 230), has to be by poll and not by head count of the members - *Dinesh Vrajlal Lakhani* v. *Parke Davis (India) Ltd.* [2003] 47 SCL 80 (Bom.).
8. When a dispute about who is really in management of a company is pending before the High Court, there is no bar to the person who appear to be in control of the management to file the application under section 391(1) [now Section 230(1)], in the absence of an interim order by the court on the dispute. In the present case, the *bona fide* of the application under section 391(1) (now Section 230(1)) cannot be doubted when 83% of the trade creditors have consented to the scheme. Alleged preference in payment of dues to the Government and other statutory authorities in the scheme cannot be considered as fraudulent as it has been done, pursuant to the conditions of the no objection certificate granted by Ministry of Civil Aviation - *Modiluft Ltd., In re* [2003] 47 SCL 227 (Delhi).
9. A bank, which though not a company, is nevertheless a body corporate. Because of its status of the holding company of the transferor company, it need not file a separate application for approval of the scheme of amalgamation. This is specially so because the scheme did not affect the rights of the members of the transferee bank or its creditors. It also did not involve any re-organisation of the share capital of the bank - *Andhra Bank Housing Finance Ltd., In re* [2003] 47 SCL 513 (AP). In another case, where transferor was a subsidiary of the transferee, which was not a bank, the above ratio was maintained but because the transferor and the transferee fell within jurisdictions of different High Courts and in view of the High Court having

jurisdiction over the transferor company giving approval to the scheme subject to approval of the scheme by the High Court having jurisdiction over the transferee company, the transferee company was required to make application to the High Court for approval of the scheme - *Goodlass Nerolac Paints Ltd., In re* [2003] 47 SCL 526 (Bom.).

10. Non serving of notice to a creditor, who has to get an insignificant proportion of the total dues to all the creditors, when all other requirements of section 391(now Section 230) have been complied with, will not invalidate a scheme, so long the court (now Tribunal) sees that necessary provision has been made to pay or secure the dues - *Vikrant Tyres Ltd., In re* [2003] 47 SCL 613 (Ker.).

11. Secured debenture holders belong to the class of secured creditors for the purpose of section 391 (now Section 232) and specially so when all the secured creditors have been treated alike in the scheme. One such debenture holder holding less than 25% of the total value of creditors cannot claim separate meeting/consideration in the scheme. The exchange ratio also cannot be questioned as the same was arrived at by applying one of the accepted methods of valuation of shares and approved by shareholders and creditors in terms of section 391 (now Section 232) - *SIEL Ltd., In re* [2003] 47 SCL 631 (Delhi).

12. A scheme, though approved by secured creditors but failed to get approval with requisite majority of unsecured creditors, preferential creditors and shareholders, has to be rejected. Section 391 (now Section 232) contemplates meeting of each distinct class of creditors and not of all the classes of creditors together - *K. Sudhakar Gupta* v. *Electro Thermics (P.) Ltd.* [2003] 47 SCL 727 (AP).

13. When a non-banking company is amalgamating with its associate banking company - no prior permission of RBI under section 44A of the Banking Regulation Act is necessary. Aforesaid section 44A is applicable when two banks amalgamate. Company court (now Tribunal) does not have jurisdiction to sit in appeal over commercial wisdom of majority of shareholders even if in court's view a scheme, different from the one approved, could be more beneficial to the company and its members or creditors. In the instant case the company was debt free and the scheme was approved by majority of shareholders of the transferor company and the transferee company - *Indus India Enterprises & Finance Ltd., In re* [2004] 50 SCL 68.

14. A court (now Tribunal) cannot substitute its own notion of economic policy for practical considerations which must weigh with business. It cannot also give a construction which restricts power of a company to adapt to a rapidly changing business environment - *Nicholas Piramal (I) Ltd., In re* [2004] 51 SCL 360 (Bom.).

15. Karnataka High Court in *Maharashtra Apex Corporation Ltd., In re* [2005] 57 SCL 305 has ruled as under:—

    (*i*) Meeting held pursuant to the Court's (now Tribunal's) order has to approve the scheme on the basis of affirmative vote of majority of

members/creditors. But such majority must hold 3/4th of the value of shares/credits held by persons present in the meeting and voting.

(*ii*) Action of persons who are eligible to be present in the meeting and cast their votes and have been informed/invited to do so and chose not to be present and to cast the vote, will amount to their consent to the scheme.

(*iii*) When in a meeting convened on the basis of Court's order to consider a scheme, the scheme has not been approved or the meeting failed to transact its business, there is no prohibition in the Act for convening another meeting for the purpose.

(*iv*) Order of the Court (now Tribunal) according sanction to a scheme, would have overriding effect over other statutory provisions and may even go contrary to any such provision.

16. The consent to a scheme, prepared by the transferee company, from creditors is not necessary where no compromise of creditors interest appears in the scheme - *Phlox Pharmaceuticals Ltd., In re* [2005] 63 SCL 237 (Guj.).

17. In the context of demerger (approved by the court) of units of the respondent which was awarded one petroleum block, alongwith another contractor, pursuant to a family MOU, when the respondent acted not in compliance with the family MOU basing which court (now Tribunal) approval was given, on the plea that after demerger of the units the respondent has to act in its interest and terms of the family MOU have ceased to have any continuing relevance, the court held it is inconceivable and it has ample power and jurisdiction to supersede and modify the scheme sanctioned for its smooth working. Passing of an order under section 394 (now Section 232) does not block the power of the court (now Tribunal) under section 392 (now Section 230) to modify, if required, the scheme to make it work. However, the court cannot pass order on complex technical matters that may affect the working of the scheme. The Court can only pass order under section 392 [now Section 230] to see that the broad framework of the scheme is made workable - *Reliance Natural Resources Ltd.* v. *Reliance Industries Ltd.* [2008] 82 SCL 303 (Bom.).

18. Validity of resolution passed by the transferee company for amalgamation with transferor company for alleged lack of quorum arising out of presence of directors common to both the companies, in the context of a violation of section 295 (now Section 185) was raised by the Regional Director of the Ministry of Corporate Affairs. Having regard to the fact that sufficient material was already with the members about the aspects of the guarantee there was no need to bring that fact once again, and the scheme duly approved by members was to be sanctioned - *Niulab Equipment Co. (Pvt.) Ltd., In re* [2009] 91 SCL 387 (Bom.).

19. Section 391 (now Section 230) does not mandate holding of creditors' meeting in a scheme of arrangement between company and its members. So is the case with regard to meeting of members in a scheme between company and creditors. A scheme really takes effect only when sanctioned by the Court (now Tribunal) and it is incumbent on the court to *see* whether

creditors' interest or members' interest in respective situations is affected in a reckonable manner. In that case the Court (now Tribunal) would order the meeting of the creditors or members, as the case may be before considering the sanction - *Teckmen Tools (P.) Ltd., In re* [2009] 92 SCL 59 (AP).

20. As law does not require the details of items underlying Balance Sheet and Profit and Loss Account to be disclosed in a scheme of demerger and since the scheme as prepared has been approved by relevant parties, there is no reason for the court (now Tribunal) to reject the scheme - *Ajmera Realty & Infra India Ltd., In re* [2009] 96 SCL 105 (Bom.).

21. The High Court (now Tribunal) cannot sit over decisions of the Board of Directors and of class of stakeholders as court of appeal and scrutinise criticism pressed into service by objectors disregarding commercial wisdom of overwhelming major of equity shareholders. The fact that the entire process of formulating and approval of the scheme by the Board was completed within a very short span of period, does not *per se* mean that the approval by the Board suffered from non-application of mind - *Reliance Industries Ltd., In re* [2009] 94 SCL 35 (Bom.).

22. An arrangement to issue irredeemable debentures to shareholders out of general reserve. On the basis of Board of Directors decision to issue non-redeemable fully paid debentures, the shareholders approved the same in their meeting. The company had enabling provision in its Articles. The Regional Director of the Ministry of Company Affairs objected to the arrangement as there was no proposal to create Debenture Redemption Fund as required by section 117(*c*) (now Section 71) and also for the facts that it would amount to indirect way of distribution of dividend without complying with the applicable rules under the Act and the company funding the issue which is forbidden by section 77 (now Section 67). On the company agreeing to create Debenture Redemption Fund, the Court (now Tribunal) allowed the scheme as it took note of the enabling Clause of the Articles and was of the view that issuance of non-redeemable debenture is not distribution of dividend in an indirect form and also the company is not parting with its fund making section 77 (now Section 67) inapplicable - *Asha Zeneca Pharma (I) Ltd., In re* [2010] 97 SCL 51 (Kar.).

23. A scheme of demerger is not a scheme of amalgamation - The Gujarat High Court in *Gallops Realty (P.) Ltd., In re* [2010] 97 SCL 93 has so held by not accepting the objection of the Regional Director that the scheme does not provide for treating the surplus gained by the resulting company on transfer of the hotel business to it by the transferor company as capital reserve. According to this decision, Accounting Standard 14 on Amalgamation does not apply to demerger as in demerger the transferor company continues to exist and for the transferee company the transfer to it of assets is nothing but an acquisition. The surplus in the transaction should instead be treated as share premium and the scheme was modified to that effect.

24. When a Court (now Tribunal) sanctions a scheme of amalgamation, it is sanctioned as a whole with all its clauses and proposals and, therefore, separate, compliance of various sections of the Act involved in the Scheme

like change in object clause or in the name is not required - *Mekaster Valves & Engineering Services (P.) Ltd., In re* [2010] 98 SCL 8 (Guj.). In a related but interesting case, the same High Court held that the petitioner transferee company needs to file necessary forms/declaration with ROC for changes, if effected for compliance with sections 17, 94/97 and 21 (now Sections 13, 61 and 64) with requisite fee payable after offsetting fees already paid by transferor companies for their authorised capital - *Ramboo Proten (India) (P.) Ltd., In re* [2010] 98 SCL 17.

25. In a case involving complex sets of facts (transactions), the company that got an arrangement with, creditors sanctioned by the company court (now Tribunal) and thereafter became a defending party in an arbitration proceeding started by one of the creditors, set up a committee to sell the property that was subject of execution order of the arbitration award by a competent court. The sale took place. All these happened without the knowledge of the scheme sanctioning company court. The company court (now Tribunal), when it came to know of these events, not only cancelled the sale, but also ordered criminal action against all erring persons who were directly or indirectly concerned with the transactions to overreach orders of the courts of law and to bring the property in question back to the company for sale, the proceeds of which are to go for payment to creditors under the scheme. The Court also ordered the entity which received payment on the unauthorized sale of the property to return the money - *Europlast India Ltd., In re* [2010] 99 SCL 91 (Bom.).

26. Is it necessary to include joint shareholders' names in the scrutineers' report on the shareholders' meeting for sanction of the scheme? - The Court held 'No'. Also, whether filing of un-audited accounts with the petition which pertained to not a distant past can nullify the petition? The Court held 'No'. Further issue raised was on whether writing off goodwill of the petitioner against share premium account is a violation of section 78 (now Section 52), the court (now Tribunal) held 'No', on the basis of facts and circumstances of the case. It also held that this write off could not be treated as planned for depriving minority shareholders of possible future issue of bonus shares to them - *Cairn India Ltd., In re* [2010] 101 SCL 435 (Bom.).

27. In *J.K. Agri Genetics Ltd.* v. *Florance Alumina Ltd.* [2010] 102 SCL 495 (Cal.). Two issues were contested in a scheme of demerger. One was that some votes cast were missing and the other was on the proposal of conversion of zero coupon redeemable preference shares and zero coupon non-convertible bonds which would benefit only the promoter's group. The Court (now Tribunal) found that even if the missing voting ballots are taken into account the result of voting in the shareholders' meeting will not alter and, therefore, on this count the scheme, approved in the shareholders' meeting, cannot be rejected. But on the other issue, the Court found merit and ordered deletion of the conversion from the scheme as it would serve only a sectarian interest.

28. A company court (now Tribunal) has to look into fairness of a scheme put before it for sanction. If the scheme has not provided for payment/provision for statutory dues or workers' claims, the same cannot be sanctioned - *Rajeev S. Mardia* v. *Rasik S. Mardia* [2010] 103 SCL 72 (Guj.).

29. A company court (now Tribunal) is not empowered to consider merits of terms on which scheme of amalgamation has been proposed by consenting parties. The court (now Tribunal) can only consider whether the scheme is in violation of principles of law, public policy and is not opposed to public interest. While the legislature failed to include a scheme of amalgamation as an 'instrument' or 'conveyance', in the Stamp Act, 1899, it does not mean that the legislature intended to exclude the same from statutory provisions. The properties transferred from the transferors to the transferee under a scheme is exigible (liable to be extracted) to stamp duty under the Stamp Act, 1899 - *Delhi Towers Ltd.* v. *Govt. of National Capital Territory of Delhi* [2010] 103 SCL 447 (Delhi).

30. *Quick Flight Ltd., In re* [2014] 43 taxmann.com 321 (Gujarat), the Gujarat High Court held that as the scheme of arrangement was in the interest of the shareholders and creditors as well as in public interest the same deserved to be sanctioned. Objections raised by the Regional Director, Ministry of Corporate Affairs pertaining to meeting of creditors and disputed tax liabilities were set aside as the company had already undertaken to pay all dues to creditors and also the tax liabilities when crystallized.

31. A composite arrangement with equity shareholders for reduction of paid-up capital and conversion of the notionally released amount into unsecured loan at interest, repayable to the shareholders is perfectly in order and does not call for separate compliance with provisions of sections 100 and 101 (now Section 66) of the Act. Had it been only reduction of share capital not followed by conversion into unsecured loan, the provisions would have required compliance - *Al-Ahali Business Trade Links (P) Ltd., In re* [2011] 105 SCL 130 (Ker.).

32. When majority of shareholders along with 'financiers' applied to the company court (now Tribunal) which had admitted the petition for winding up of the company, for revival of the company and taking into account that all secured creditors' claims either have been paid or are being adjudicated by the O.L., there is no need for separate compliance with provisions of sections 391 and 394 (now Section 230/232)—*Dabriwalla Steels and Engineering Ltd. (in liquidation), In re* [2011] 105 SCL 186 (P&H).

33. The Gujarat High Court in *Vodafone Essar Gujarat Ltd., In re* [2011] 105 SCL 301, has held that an arrangement involves 'give and take' between parties. In other words, due consideration must pass between parties to constitute an 'arrangement' in terms of section 391 (now Section 230).

34. When a transferee company held meeting of its secured creditors, fully complying with the order of the concerned court in that respect including on the quorum for the meeting as also quorum for adjourned meeting in case of adjournment, the objection of the Regional Director of MCA that only 6 such creditors attended the adjourned meeting constituting only 4% of the total amount payable to the secured creditors numbering 2096 is not sustainable as the interest of the secured creditors was duly protected in the scheme and all of them were served with the notice for the meeting, giving a presumption that those who absented did not have any objection to the

scheme - *Citi Financial Home Finance (I) Ltd.* v. *Citi Financial Consumer Finance (I) Ltd.* [2011] 105 SCL 560 (Delhi).

35. If even valuation report and fairness report in respect of a scheme of amalgamation are made ready by an expert within a span of two days of the Board taking the decision to amalgamate, the same cannot be questioned on the ground of non-application of mind in preparing the reports so long as no material is produced to contradict the conclusions reached in the reports - *Anup Kumar Sheth* v. *Reliance Industries Ltd.* [2011] 106 SCL 64 (Bom.).
36. In the matter of section 391 (now Section 230), the High Court, which cannot altogether dispense with holding of meetings, has the discretion of directing the calling and conducting of the meeting. It has the power to relax requirements in the procedure based on facts and circumstances of each case - *Singhal Enterprises (P.) Ltd., In re* [2011] 106 SCL 173 (Cal.).
37. Since a scheme which gets sanctioned by court (now Tribunal) would be binding on dissenting members or creditors, court is obliged to examine the scheme in its proper perspective together with its various manifestations and ramifications with a view to find out whether the scheme is fair, just and reasonable to concerned members (and creditors) and is not contrary to any law or public policy - *Sesa Industries Ltd.* v. *Krishna H. Bajaj* [2011] 106 SCL 239 (SC).
38. In *Laxmi Pat Surana* v. *Pantaloon Retail (India) Ltd.* [2014] 41 taxmann.com 275 (Bombay), the Bombay High Court refused to interfere with the sanctioned scheme on an appeal made by a creditor. The scheme of arrangement involved transfer of a division of the respondent to another company. It was held that as the claim of the creditor has been secured by a bank guarantee and he had failed to furnish details of fraud as alleged despite the opportunity given, there is no need to interfere with the scheme already sanctioned under Section 391 (now Section 230).
39. *Sterlite Industries (India) Ltd., In re* [2014] 41 taxmann.com 111 (Madras) the Madras High Court held that the court (now Tribunal) will not reject a scheme unless it is contrary to any law or is unfair to members or creditors or any class of them of is against public interest or public policy or otherwise shock the conscience of the court. It was also held that if the arrangement was purely between the members and therefore not adversely affecting the creditors or any class of them, a meeting of the creditors may not be convened. Petition under Section 391 (now Section 230) cannot be allowed as a tool in the hands of creditors to coerce the company to pay, the objecting creditors must show that the scheme was mala fide or fraudulent.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (FINAL), C.S. INTER/(FINAL), ICWA (INTER)]

1. Distinguish between amalgamation and reconstruction.
2. What points will the Court bear in mind while sanctioning a scheme of arrangement? Summarise the provisions of section 235 of the Companies Act, 2013 relating to take-

over of a company by acquisition of its shares. What are the rights of dissenting shareholders under section 235?

3. Write short note on 'Amalgamation in public interest'.

4. (*a*) What are the provisions of the Companies Act, 2013 for acquiring the shares of the dissenting shareholders in case of reconstruction and amalgamation?

(*b*) What are the powers of the Central Government to order amalgamation of two or more companies?

5. Explain clearly the meaning of 'compromise'. What procedure must a company adopt to give effect to a compromise, when such a company is a going concern?

6. Explain the terms 'compromise', 'arrangement', 'reconstruction' and 'amalgamation'. Who can apply to Tribunal for compromise or arrangement? What are the powers of the Tribunal with regard to enforcement of its order sanctioning a compromise or an arrangement?

7. Who is a dissenting shareholder in case of 'amalgamation' of companies? Explain the provisions of the Companies Act with regard to the acquisition of shares of dissenting shareholders.

8. What is take-over bid? What is the procedure to be followed, under the Company Law, in such a case? Can take-over be challenged by any one and if so, on what grounds?

9. What are the powers of the Tribunal to enforce its orders relating to compromise and arrangement?

10. What is meant by 'Reconstruction' ? How can a company under a members' voluntary winding-up be reconstructed by sale of its business or property? What are the rights of dissenting shareholders in such a case ?

11. DEJYAS Ltd. has made an offer to acquire all the equity shares of ABC Ltd. at certain price. Members of the company who hold 90 per cent of the shares of ABC Ltd. have accepted the offer. The remaining shares are held by 2 NRI's who do not agree to the deal. Explaining the procedure to finalize the deal, state the steps to be taken by the offeror company to acquire shares of dissenting shareholders.

Decide also whether DEJYAS Ltd. can acquire all the shares in ABC Ltd., under the provisions of the Companies Act, 2013.

12. What is the meaning of 'public interest' and its relevance under the Companies Act in matters relating to transfer of shares? What is the role of the Tribunal in this regard ?

Hint : *See* section 237; TOMCO's case.

13. ABC Co. Ltd. was amalgamated with, and merged in, XYZ Co. Ltd. Some workers of ABC Ltd. refuse to join as workers of XYZ Co. Ltd. and claim compensation for premature termination of service. XYZ Co. Ltd. resists the claim on the ground that their services are transferred to XYZ Co. Ltd. by the order of amalgamation and merger and, therefore, the workers must join service of XYZ Co. Ltd. and cannot claim any compensation. Who will succeed - the workers of ABC Ltd. or the XYZ Co. Ltd.? Give reasons.

14. What do you understand by takeover bid or takeover offer? What are the types of takeover bid/offer.

15. A few days after a scheme of arrangement filed by Tarzon Ltd. is sanctioned by the Tribunal, majority of the directors/promoters of the company concerned are indicted

by the SEBI of certain wrong doing jeopardising the implementation of the scheme. Advise.

Hint : *See* section 231.

16. Briefly explain the simplified procedure for merger or amalgamation between two small companies or a holding company and its wholly-owned subsidiary.

17. (*a*) Not only section 230 is a complete code but it can also be called a single window clearance system by the court in connection with an approved scheme.

(*b*) The issue of valuation of shares in the context of amalgamation of companies is often agitated by stakeholders. The Tribunal have laid down broad parameters for valuation of shares for guidance of companies/valuers. Discuss the parameters with reference to decided cases.

Hint : *See* Para 23.12-6.

18. In a company a scheme of internal reconstruction was approved by the Tribunal. While the scheme was under implementation, the company prayed for a declaration by the Tribunal that no income-tax would be payable by the company till the expiry of 3 years of working of the reconstructed company. Can Tribunal accede to this prayer?

Hint : No; no such power rests with the Tribunal in sections 230-232.

19. The entire assets of a company are acquired by another company. Will it constitute taking over the management of the company? Why?

20. A company was in dire need of further capital. The majority representing 98% of the shares were willing to provide the capital if they could buy-up the 2% minority shares. The majority passed a resolution altering the articles and enabling them to purchase the minority shares. The minority shareholders refused to surrender their shares and challenged the validity of the majority resolution. Decide.

21. Happy Ltd. (HL) was merged with Very Happy Ltd. (VHL) and the authorised capital of HL was added to that of VHL in accordance with the scheme of amalgamation resulting an increase of the VHL's authorised capital. Is VHL required to pay stamp duty and apply for increase in authorised capital? Would it be required to pay fees for the increased authorised capital? Discuss with reference to decided cases and relevant provisions of the Act.

22. In a corporate debt restructuring exercise, the lenders agreed to reduce interest on loan as part of a scheme which envisaged reduction of the borrowing company's capital by a certain percentage. The scheme has been approved by the Board and shareholders of the company. However, if the reduction of capital is confirmed by the Tribunal, the promoters' stake will go up. Will the Tribunal confirm the capital reduction?

23. Who is a 'dissenting shareholder' in a scheme or contract of amalgamation under section 395? Discuss the position of a dissenting shareholder in such a scheme or contract.

24. In a situation where the winding-up order for a company has been made by the court and the liquidator has been appointed, is it still permissible to propose a scheme of compromise under section 230?

25. Is the court order sanctioning amalgamation leads to transfer of assets for the purpose of payment of stamp duty?

26. The Tribunal has sanctioned the scheme of amalgamation of IM Ltd. with VR Ltd. Prepare a note on the steps required thereafter.

27. No foreign company can be amalgamated with an Indian company—Examine the statement.

PRACTICAL PROBLEMS

P-1. On ABC Company Ltd.'s inability to pay debts, the company was placed under winding up. Thereafter, a scheme for reviving the company was proposed by 80% of the shareholders. After that, a better scheme was proposed by D an outsider who agreed to purchase 80% shares and to satisfy the creditors by paying their debts. The scheme was accepted by the parties concerned and was also acted upon by them. A better scheme was later proposed by J, who wanted the Tribunal to accord its approval to the scheme. D objected to the proposal made by J on the ground that when the proposal made by the former (D) was already accepted and he (D) had acted upon it, the proposal made by J had no validity. Decide giving reasons and referring to the provisions of the Companies Act, 2013:

(*i*) Whether D's objections will sustain?

(*ii*) Whether the Tribunal will be justified in rejecting the proposal made by J?

Hint : (*i*) *See* Section 230 (para 23.3)

(*ii*) *See A.K. Mishra* v. *Wearwell Cycle Co. (India.) Ltd.* [1993] 78 Comp. Cas. 252 (Delhi)

P-2. X Co. Ltd. offers to take-over the shares of Y Co. Ltd., at the rate of Rs. 60 per share. Y Co. Ltd.'s shares are quoted on the stock exchange, at that time, at Rs. 50 per share. So, more than 90% of shareholders of Y Co. Ltd., agree to the take-over bid. Only four shareholders disagree, because they had bought the shares from the market when they were quoted at Rs. 70 per share. They challenge the takeover bid in Tribunal and complain that the scheme is manifestly unfair to them.

(*i*) On whom does the burden lie to prove that the scheme is fair or unfair? Why?

(*ii*) When is a scheme said to be unfair?

(*iii*) Is quotation on the stock exchange a conclusive proof of the fairness of a scheme?

Hint : (*i*) On those who allege that the scheme is unfair since it is accepted by an overwhelming majority (9/10th in value).

(*ii*) When it is unfair to the body of shareholders as a whole.

(*iii*) Quotation on the stock exchange is only a *prima facie* evidence of the fairness of the scheme but cannot be regarded as conclusive proof.

P-3. A scheme of amalgamation of company 'X' with company 'Y' was presented to the Tribunal for sanction after the scheme was approved by an overwhelming majority of shareholders and secured and unsecured creditors of both companies at meetings held under section 230.

While the scheme was pending in the Tribunal, some of the members requisitioned an extra-ordinary general meeting for the purpose of requesting Company 'X' to negotiate with Company 'Y' as according to the requisitionists the exchange ratio was not fair and reasonable. Can the directors refuse to call the extraordinary general meeting ?

Hint : The facts in the problem are similar to the facts of *Pavin Kantilal Vakil* v. *Rohini Ramesh Save* [1985] 57 Comp. Cas. wherein it was held that the Court (now Tribunal) cannot prevent a company from holding a requisitioned meeting for considering a proposed modification of a scheme which is already lying before the court (now Tribunal) for its sanction. The Court has been given wide powers under section 392 (now Section 231) to give directions or modify the compromise or arrangement for its proper working and that a mere discussion by shareholders of modifications at a properly requisitioned meeting would not affect either the scheme or the Court's powers.

Directors, therefore, cannot refuse to call the extraordinary general meeting requisitioned by the members in this case.

P-4. "In order to enable an amalgamation to take place, the objects clause of transferor and the transferee company should be similar."—Comment.

Hint : To amalgamate with another company is the power of the company and not an object of the company. So long as the scheme of amalgamation is not prejudicial to public interest, there need not be any 'unison of objects' of transferor and the transferee company.

P-5. In the context of judicial rulings in the matter of merger, answer the following:

(*i*) Whether exchange ratio approved by shareholders of merging companies can be questioned by a small group of dissenting shareholders?

(*ii*) Whether transferor company is justified in excluding assets held on lease and licence arrangement, from those transferred to the transferee company?

(*iii*) Whether there was contravention of section 230(3) inasmuch as the fact that the chartered accountant entrusted with the valuation of the shares was also a director of the amalgamating company, had not been disclosed?

Hints :

(*i*) *No;* in *Hindustan Lever Employees' Union* v. *Hindustan Lever Ltd.* [1994] 4 Comp. LJ 228 (Bom.), the Bombay High Court held that where the exchange ratio has been approved by an overwhelming majority of shareholders and there is no basis to doubt their judgment and the valuation having been also confirmed to be fair by the firm of auditors, the objections of the same cannot be sustained.

(*ii*) *Yes* ; the Supreme Court in *Hindustan Lever Employees' Union* v. *Hindustan Lever Ltd.* [1995] 83 Comp. Cas. 30 held that the leasehold assets and properties held by a company were neither transferable nor heritable; they are in the nature of a personal privilege. Accordingly, the transferor-company was justified in excluding them.

(*iii*) *No*; the Supreme Court in the aforesaid case explained that the interest contemplated under section 393 [now Section 230(3)] is material interest for consideration of the scheme by the shareholders, where both the amalgamating companies repose confidence in the professional skill of a professional, the chartered accountant, in the given cases. The non-disclosure of the fact that he was also director of the amalgamating company cannot be said to affect the amalgamation schemes in any way. This was also held as not amounting to suppression of any material interest of a director in the scheme.

P-6. Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 2013:

(*i*) Whether companies being amalgamated must be companies registered in India?

(*ii*) What is the majority required for approving the scheme of amalgamation in a meeting of members of a company called as per directions of the Tribunal? Is the scheme to be approved by preference shareholders?

(*iii*) When will the Tribunal order dissolution of the transferor company?

Hint :

(*i*) No, see Section 234.

(*ii*) Majority in number representing three-fourths in value of shares, present and voting either in person or by proxy or by postal ballot, must approve the scheme or arrangement providing for amalgamation of companies [section 230(6)]. Any member who though present at the meeting, does not vote for or against, but remains neutral, is not to be taken into consideration.

As the expression used is 'member', not only holders of equity shares but also preference shareholders will have to be taken into account and the value of their shares be included or, if the meeting of holders of preference shares and equity shares are ordered by the court to be held separately, the three-fourths majority of each class will have to be ascertained separately.

(*iii*) The scheme may provide for the dissolution, without winding up, of any transferor-company [section 232(3)(*d*)]. See para 23.12

P-7 X Limited is considering the merger of Y Limited, a subsidiary with itself. Can it take advantage of the procedure laid down in Section 233 of the Companies Act, 2013? If yes, what steps it needs to take?

Hint: Possible only if Y Limited is a wholly owned subsidiary. See para 23.13 for the procedure to be followed.

Salient Features of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

1. Meaning of Certain Terms

(i) Acquirer - Acquirer means any person who, whether by himself, or through, or with persons acting in concert with him, directly or indirectly, acquires or agrees to acquire shares or voting rights in, or control over a target company. An acquirer can be a natural person, a corporate entity or any other legal entity.

(ii) Person Acting in Concert (PACs) - PACs are individual(s)/company (ies) or any other legal entity (ies) who, with a common objective or purpose of acquisition of shares or voting rights in, or exercise of control over the target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly cooperate for acquisition of shares or voting rights in, or exercise of control over the target company. SAST Regulations, 2011 define various categories of persons who are deemed to be acting in concert with other persons in the same category, unless the contrary is established.

(iii) Target Company - The company/body corporate or corporation whose equity shares are listed in a stock Exchange and in which a change of shareholding or control is proposed by an acquirer, is referred to as the 'Target Company'.

(iv) Control - "control" includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

2. Disclosure Requirements

(A) Any person, who along with PACs crosses the threshold limit of 5% of shares[35] or voting rights, has to disclose his aggregate shareholding and voting rights to the: (i) Target Company at its registered office; and (ii) to every Stock Exchange where the shares of the Target Company are listed within 2 working days of acquisition as per the format specified by SEBI.

(B) Any person who holds 5% or more of shares *or* Voting rights of the target company and who acquires or sells shares representing 2% or more of the voting rights, shall disclose details of such acquisitions/sales to the Target company at its registered office and to every Stock Exchanges where the shares of the Target Company are listed within 2 working days of such transaction, as per the format specified by SEBI.

Please note that shares by way of encumbrance will be treated as an acquisition.

3. Illustration for the calculation of trigger limits for disclosures

Total Shares/voting capital of the company

- Company A has 100 equity shares, 50 partly convertible debentures (PCDs) and 10 GDRs. 1 GDR carries 1 voting right.

  - Total shares of company A= 100+50+10 = 160
  - Total voting capital of Company A= 100+10=110

Person B's holding of shares and voting rights:

- Person B has 8 equity shares, 7 PCDs and 1 GDR.

35. The word Share for purposes of disclosure includes convertible securities also

- Person B has 8+7+1 =16 shares (shares for disclosure purpose includes convertible securities)
- Person B's holding in terms of shares= 16/160=10% of shares
- Person B's voting rights= 8+1= 9 voting rights
- Person B's holding in terms of voting rights = 9/110=8 % of voting rights

Since person B is holding more than 5% of shares or voting rights, he is required to make disclosures for any acquisition/ sale of 2% or more of shares or voting rights.

Acquisition by Person B

Scenario I

- Person B acquires 2 equity shares and 2 PCDs.
- In terms of shares, person B has acquired 4/160= 2.5% of shares
- In terms of voting rights, person B has acquired 2/110= 1.8% of voting rights
- Since acquisition done by person B represents 2% or more of shares, the disclosure obligation is triggered.

Scenario II

- Person B acquires 20 PCDs
- In terms of shares, person B has acquired 20 shares, i.e. 20/160, i.e. 12.5% shares.
- In terms of voting rights, he has not acquired a single voting right, i.e. '0' voting right.
- However, since acquisition done by person B represents 2% or more of shares (though no voting rights), the disclosure obligation is triggered.

4. Initial Threshold Limit for Triggering of an Open Offer - An acquirer is mandated to make an open offer if he, alone or through persons acting in concert, acquires 25% or more of voting rights in the target company. Therefore, a strategic investor, including private equity funds and minority foreign investors, can hold up to 24.99% of equity capital of a listed company without inviting the rigours of Takeover Code.

5. Creeping Acquisition - Any acquirer, holding 25% or more but less than the maximum permissible limit[36] can purchase additional shares or voting rights of up to 5% every financial year, without being required to make a public announcement for open offer. Thus, the promoters can increase their shareholding in the company without necessarily purchasing shares from the stock market.

6. Voluntary offer - Takeover Code, 2011, has introduced the concept of voluntary offer by which an acquirer who holds more than 25% but less than the maximum permissible limit, shall be entitled to voluntarily make a public announcement of an open offer for acquiring additional shares subject to their aggregate shareholding after completion of the open offer not exceeding the maximum permissible non-public shareholding**.**

7. Restrictions on voluntary open offer

(*i*) During the offer period such acquirer shall not be entitled to acquire any shares otherwise than under the open offer.

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36. "Maximum permissible non-public shareholding" means such percentage shareholding in the target company excluding the minimum public shareholding required under the Securities Contracts (Regulation) Rules, 1957-Regulation 2(o). As per Rule 19(2)(*b*) of the Securities Contracts (Regulation) Rules, 1957, (i) At least twenty five per cent of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document; or (ii) At least ten per cent of each class or kind of equity shares or debentures convertible into equity shares issued by the company was offered and allotted to public in terms of an offer document if the post issue capital of the company calculated at offer price is more than four thousand crore rupees. *Again, in case of public sector enterprises, the requirement of public shareholding is 10%.*

(*ii*) Voluntary offer cannot be made if the acquirer or any person acting in concert with him had acquired shares of the target company in the preceding fifty-two weeks.

(*iii*) An acquirer and persons acting in concert with him, who have made a public announcement under this regulation to acquire shares of a target company shall not be entitled to acquire any shares of the target company for a period of six months after completion of the open offer. *However*, the restriction will not apply to acquisition of shares by way of *bonus issue* or as a result of *split*.

8. Exemptions from the Requirement of Open Offer

***(i) Inter-se* Transfers -** Takeover Code of 2011 does not apply to *inter-se* transfers between:

(*a*) ***Immediate relatives***. "Immediate relative" means any spouse of a person, and includes parent, brother, sister or child of such person or of the spouse.

(*b*) ***Promoters***;

(*c*) a company, its subsidiaries, its holding company, other subsidiaries of such holding company;

(*d*) persons holding not less than 50% of the equity shares of such company;

(*e*) *persons acting in concert for not less than 3 years* prior to the proposed acquisition, and disclosed as such pursuant to filings under the listing agreement.

To avail exemption from the requirements of open offer under the Takeover Code of 2011, the following conditions will have to be fulfilled with respect to an *inter-se* transfer:

- If the shares of the target company are frequently traded – the acquisition price per share shall not be higher by more than 25% of the volume-weighted average market price for a period of 60 trading days preceding the date of issuance of notice for such *inter se* transfer.
- If the shares of the target company are infrequently traded, the acquisition price shall not be higher by more than 25% of the price determined by taking into account valuation parameters including, book value, comparable trading multiples, etc.

***(ii) Rights issue* –** The Takeover Code of 2011 provides exemption from the requirement of open offer to increase in shareholding due to rights issue, but subject to fulfilment of two conditions:

(*a*) The acquirer cannot renounce its entitlements under such rights issue; and

(*b*) The price at which rights issue is made cannot be higher than the price of the target company prior to such rights issue.

***(iii) Buyback of shares* –** The Takeover Code of 1997 did not provide for any exemption for increase in voting rights of a shareholder due to buybacks. The Takeover Code of 2011 however provides for exemption for such increase.

9. Offer Price in respect of Open Offer (Regulation 8)

The offer price shall be *the highest of*,—

(*a*) the highest negotiated price per share of the target company for any acquisition under the agreement attracting the obligation to make a public announcement of an open offer;

(*b*) the volume-weighted average price paid or payable for acquisitions, whether by the acquirer or by any person acting in concert with him, during the fifty-two weeks immediately preceding the date of the public announcement;

(*c*) the highest price paid or payable for any acquisition, whether by the acquirer or by any person acting in concert with him, during the twenty-six weeks immediately preceding the date of the public announcement;

(*d*) the volume-weighted average market price of such shares for a period of sixty trading days immediately preceding the date of the public announcement as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period, provided such shares are frequently traded;

(*e*) where the shares are not frequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other parameters as are customary for valuation of shares of such companies.

10. Exemptions by SEBI

Regulation 11 empowers SEBI, for reasons recorded in writing, to grant exemption from the obligation to make an open offer for acquiring shares under these regulations subject to such conditions as the Board deems fit to impose in the interests of investors in securities and the securities market.

11. Conditional Offer (Regulation 19)

(1) An acquirer may make an open offer conditional as to the minimum level of acceptance. However, where the open offer is pursuant to an agreement, such agreement shall contain a condition to the effect that in the event the desired level of acceptance of the open offer is not received the acquirer shall not acquire any shares under the open offer and the agreement attracting the obligation to make the open offer shall stand rescinded.

12. Competing Offers (Regulation 20)

(1) Upon a public announcement of an open offer for acquiring shares of a target company being made, any person, other than the acquirer who has made such public announcement, shall be entitled to make a public announcement of an open offer within fifteen working days of the date of the detailed public statement made by the acquirer who has made the first public announcement.

(2) The open offer made under sub-regulation (1) shall be for such number of shares which, when taken together with shares held by such acquirer along with persons acting in concert with him, shall be at least equal to the holding of the acquirer who has made the first public announcement, including the number of shares proposed to be acquired by him under the offer and any underlying agreement for the sale of shares of the target company pursuant to which the open offer is made.

Every open offer made under sub-regulation (1) and the open offer first made shall be regarded as competing offers for purposes of these regulations- Sub-regulation (4).

Unless the open offer first made is an open offer conditional as to the minimum level of acceptances, no acquirer making a competing offer may be made conditional as to the minimum level of acceptances- Sub-regulation (6).

Upon the public announcement of a competing offer, an acquirer who had made a preceding competing offer shall be entitled to revise the terms of his open offer provided the revised terms are more favourable to the shareholders of the target company.

Again, the acquirers making the competing offers shall be entitled to make upward revisions of the offer price at any time up to three working days prior to the commencement of the tendering period- Sub-regulation (9).

13. Withdrawal of Open Offer (Regulation 23)

(1) An open offer for acquiring shares once made shall not be withdrawn except under any of the following circumstances,—

(*a*) statutory approvals required for the open offer or for effecting the acquisitions attracting the obligation to make an open offer under these regulations having been finally refused;

(*b*) the acquirer, being a natural person, has died;

(*c*) any condition stipulated in the agreement for acquisition attracting the obligation to make the open offer is not met for reasons outside the reasonable control of the acquirer, and such agreement is rescinded, subject to such conditions having been specifically disclosed in the detailed public statement and the letter of offer; or

(*d*) such circumstances as in the opinion of the Board, merit withdrawal.

(2) In the event of withdrawal of the open offer, the acquirer shall through the manager to the open offer, within two working days,—

(*a*) make an announcement in the same newspapers in which the public announcement of the open offer was published, providing the grounds and reasons for withdrawal of the open offer; and

(*b*) simultaneously with the announcement, inform in writing to,—

(*i*) the Board;

(*ii*) all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public; and the target company at its registered office.

24 Winding Up

24.1 Meaning

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a 'liquidator', is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their respective rights. In the words of Pennington[1] winding up or liquidation is the process by which the management of a company's affairs is taken out of its directors' hands, its assets are realised by a liquidator, and its debts and liabilities are discharged out of the proceeds of realisation and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities, and it will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.

Winding up of a company differs from insolvency of an individual inasmuch as a company cannot be made insolvent under the insolvency law. Besides, even a solvent company may be wound up.

24.2 Modes of winding up [Section 270(1)]

With the passing of Insolvency and Bankruptcy Code, 2016, a company can now be wound up under the Companies Act, 2013 only by the Tribunal. The concept of voluntary winding up, as provided earlier, has been removed. Section 2(94A), as amended by the Insolvency and Bankruptcy Code, defines the expression winding up to mean winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable. Chapter XX of the Act contains provisions for winding up of a company.

24.2-1 Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 received the assent of the President of India on 28 May 2016. The code aims to consolidate and amend the laws relating to

1. Pennington's Company Law, 5th Edition, Page 839

insolvency resolution of companies and limited liability entities, partnerships and individuals, which are contained in various enactments, into a single legislation. The main focus of this legislation is at providing resurrection and resolution in a time bound manner for maximization of value of debtor's assets. The Code has put forth an overarching framework to aid sick companies to either wind up their business or engineer a revival plan, and for investors to exit. Notably, the Code has also empowered the operational creditors (workmen, suppliers etc.) to initiate the insolvency resolution process, if default occurs.

The code contains provisions for insolvency resolution process as well liquidation of companies. It also provides for voluntary liquidation of companies. With the passing of the Code, the concept of voluntary winding up of companies under the Companies Act, 2013 has been removed. Consequently Sections 304-323 of the Act have been deleted. Likewise Chapter XIX of the Act, dealing with the Revival and Rehabilitation of Sick Companies has been omitted and Sections 253-269 of the Act have been deleted. Two of the grounds for winding up by the Tribunal - due to inability to pay debts and winding up under Chapter XIX - have been omitted.

The Insolvency and Bankruptcy Board of India has notified Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations, 2017, effective 1 April 2017.

24.3 Winding up by the Tribunal

Winding-up by the Tribunal, may be ordered in cases mentioned in section 271. The Tribunal will make an order for winding up on an application by any of the persons enlisted in section 272.

Apart from sections 271 to 303 (Part I of Chapter XX) which deal specifically with winding up by the Tribunal, sections 324 to 358 (Part III of Chapter XX), being the provisions applicable to every mode of winding up, are also relevant to the subject of "winding up by the Tribunal". Sections 304 to 323, which dealt with the voluntary winding up, have been deleted, with the passing of the Insolvency and Bankruptcy Code, 2016.

Grounds for compulsory winding up [Section 271] - Section 271 provides for circumstances in which a company may be wound up by Tribunal. The section reads:

"A company may be wound up by the Tribunal—

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

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

(*c*) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have

been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

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

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

Two of the grounds for winding up by the Tribunal - Inability to pay debt and winding up under Chapter XIX of the Act - have been deleted with the passing of Insolvency and Bankruptcy Code.

24.3-1 Winding up by Special Resolution [Section 271(a)]

The company may, by special resolution, resolve that it can be wound up by the Tribunal. The resolution may be passed for any cause whatsoever. However, court (now Tribunal) must see that the winding up is not opposed to public interest or the interest of the company as a whole - *B. Viswanathan* v. *Seshasayee Paper and Boards Ltd.* [1992] 73 Comp. Cas. 136 (Mad.).

The court (now Tribunal) is also to take into account the possibility/potency of the company to have a financial revival, when the company is incurring loss that led the company to pass special resolution for winding up. The court (now Tribunal) cannot allow a design underlying to frustrate an arbitration proceeding where a significant amount is involved - *Advance Television Network Ltd.* v. *ROC* [2011] 108 SCL 702 (Delhi)

This clause is based on the premise that, barring other circumstances, the shareholders themselves are the best judge to decide as to whether or not the company should go out of existence. It is the shareholders who had formed themselves into the company and, therefore, it is for them to dissolve the company. The directors are not entitled to file a winding up petition without the authority of the general meeting. Of course, the directors may file such a petition, subject to the general meeting ratifying their action - *Galway & Salt Hill Tramways Co.,* In re [1918] 1 IR 62/521 LG 93. The company has to call general body meeting and pass a special resolution including therein specifically their resolve for winding up by court (now Tribunal) and setting out grounds in the explanatory statement appended thereto as to why such winding up of the company is called for.

It may be noted that the court (now Tribunal) has a discretion in the matter and is under no obligation to order winding up merely because company has so resolved. The word 'may' in section 433 [now Section 271] denotes that the court (Tribunal) is vested with a discretion in taking a decision. The discretion, no doubt, is to be exercised in a judicial manner - *New Kerala Chits & Traders (P.) Ltd.* v. *Official Liquidator* [1981] 51 Comp. Cas. 601 (Ker.).

Further, it may be noted that the right of the company to file the winding up petition is not based merely on the ground mentioned in clause (*b*) (*i.e.* by passing special resolution). A company may present that petition, without special resolution, on other grounds mentioned in Section 271.

24.3-2 Company acting against the interests of sovereignty and integrity of India, the security of the State, the friendly relations with foreign states, public order, decency or morality [Section 271]

While grounds like acting against the interests of sovereignty and integrity of India or of the security of the State or even of the friendly relations with foreign States are understandable given the prevailing geo-political scene and its contours, the remaining grounds of public order, decency and morality, do not appear to belong to the same strain. How they have been combined together with the former three grounds and what precisely they stand for, need clarification. How a corporate entity can affect public order, decency and morality need explaining. Is it that a corporate entity engaged in media related activities or in advertisement and publicity, producing obscene literature or graphics is to be wound up under this clause? For these, other regulating agencies are there to control these activities like the Press Council, Censor Board and the Police. It is also possible that the Press Council does not hold an article in a magazine as against public order but a State administrator files winding up petition on this ground with the Tribunal and the Tribunal upholds the prayer in the petition. The company publishing the magazine would then be wound up. But would it be fair? Corporate matter should remain encompassed by activities that make corporate entities and abstract individualistic propositions, in fairness, should not find place in corporate legislation. Even a conflict based on fundamental rights enshrined in the Constitution of India can arise; further it has a damaging potential of stifling an individual or a group of individuals working perfectly legally when he or they earn the wrath of ruling political group and/or the ruling bureaucracy. A public debate on this clause is very much an urgent necessity before it inflicts damage to responsible freedom in the society.

The Tribunal will entertain petition under this clause only from the Central Government or a State Government and it appears from the language used in proviso to this section that Tribunal will order winding up on receipt of the petition.

24.3-3 Company's affairs been conducted in a fraudulent or unlawful manner etc. [Section 271(c)]

The Registrar or any other person authorized by the Central Government may make application to the Tribunal for winding up. On such an application, the Tribunal may order winding up on the following grounds:

(*i*) The affairs of the company are being conducted in a fraudulent manner; or

(*ii*) The company was formed for fraudulent or unlawful purpose; or

(*iii*) The persons concerned in the formation of the company or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith.

It may be noted that an action under sub-clause (*e*) can be taken by the Tribunal only on application made to it by the Registrar or person authorized by the Central Government for reasons specified therein. It may be noted that under section 213(*b*) the Tribunal is empowered to order investigation into the affairs of a company on the grounds mentioned therein which are similar to the grounds mentioned under

sub-clause (*e*) as aforesaid. Under section 224(2)(*a*) the Central Government may make a petition to the Tribunal for winding up of the company.

24.3-4 Company making default in filing with the Registrar its Financial Statements or Annual returns for immediately preceding five consecutive financial years [Section 271(d)]

It may be recalled that under section 164 any person who is or has been a director of a company which has not filed financial statements or annual returns for any continuous period of three financial years shall not be eligible for appointment or reappointment as a director. On similar lines, Section 271(*d*) provides a ground of winding up for default in filing financial statements or annual returns. It is a welcome feature as non-accountability and indiscipline in running the affairs of the company is widespread and chronic and Government companies are no exceptions. However, to what extent the danger of being wound up will discourage rampant indiscipline by corporate management in this regard is a matter of conjecture specially the time frame of five consecutive years is too long a period to inflict considerable damage to the corporate viability. This clause contains two distinct non-compliances (*i*) non-filing of the financial statements and (*ii*) non-filing of annual return. If default is made in respect of either (for consecutive five immediately preceding financial years), this clause for winding up can be invoked. It is not necessary that default has to be for both financial statements and annual return. If financial statements filed regularly but annual return has not been filed for five consecutive years, the clause becomes applicable. If converse is the case then also it becomes applicable. The test of its applicability lies in default in either matter for consecutive five financial years. However, say default in filing annual accounts is for two years and the same for annual returns is for three years, then this clause cannot be invoked. Further the default has to be in respect of five 'immediately preceding five consecutive' financial years. That follows is that default in the earlier years is not a ground of winding up under this clause and also that the default must be for five consecutive years.

24.3-5 Just and Equitable [Section 271(e)]

The Tribunal may also order for the winding up of a company if it is of the opinion that it is just and equitable that the company should be wound up. This is a separate and independent ground for a winding up order, and for a case to be made out under it, it is not necessary that the circumstances should be analogous to those which justify an order on one of the six other specific grounds already dealt with. In exercising its power on this ground, the Court (now Tribunal) shall give due weightage to the interest of the company, its employees, creditors and shareholders and the interest of the general public. The relief based on the just and equitable clause is in the nature of a last resort when the other remedies are not efficacious enough to protect the general interests of the company - *Gadadhar Dixit* v. *Utkal Flour Mills (P.) Ltd.* [1989] 66 Comp. Cas. 188 (Ori.). The Gujarat High Court held a similar view in *Kiritbhai R. Patel* v. *Lavina Construction & Finance Ltd.* [1999] 20 SCL 158. The Madras High Court in *S. Palaniappan* v. *Tirupur Cotton Spg. & Wvg. Mills Ltd.* [2004] 50 SCL 293 also followed the above principle and dismissed the winding up petition. While in the foregoing six grounds for winding up definite conditions should be fulfilled, in the 'just and equitable' clause the entire matter is

left to the 'wide and wise' direction of the court (now Tribunal) - *Hind Overseas Pvt. Ltd.* v. *R.P. Jhunjhunwala* [1977] ASIL XIII. The winding up must be just and equitable not only to the persons applying but also to the company and to all its shareholders. Same view has been expressed in *Prem Seth* v. *National Industrial Corpn. Ltd.* [2002] 35 SCL 636 (Delhi). A few examples of 'just and equitable' ground on the basis of which the Tribunal may order the winding up are given below:

1. Disappearance of substratum - A company's substratum is the purpose or group of purposes which it was formed to achieve (in other words, its main objects). If the company has abandoned all of its main objects and not merely some of them, or if it cannot achieve any of its main objects, its substratum is gone, and it will be wound up.

A company may lose the ability to achieve its main objects in a variety of ways. It will do so if it fails to obtain a patent for an invention which it was formed to exploit on the assumption that the patent would be granted[2], or if it fails to acquire the business which it was formed to purchase[3], or if it fails to obtain the necessary approval of a local authority for the erection of the building which it was formed to erect[4].

The fact that the company is exercising some of the ancillary powers conferred by its memorandum of association will not save it, because these powers are intended merely to aid it in achieving its main objects, and not to enable it to carry on a different kind of business or to preserve some appearance of activity[5]. If the company's memorandum of association provides that each of the powers conferred by the objects clause shall be a main object, the Tribunal will nevertheless determine the purposes for which the company was really formed, and will wind it up if it has abandoned them.[6]

In *Dunlop India Ltd.*, In re [2013] 31 taxmann.com 135 (Calcutta), respondent was a tyre manufacturing company; however, its two manufacturing facilities had not been functioning for a long period of time. Properties of value in excess of Rs. 2,300 crore had been removed from company without meeting debts of its creditors or even offering unpaid wages and salaries to its workmen and other employees. In such circumstances, instant petition was filed seeking winding up of respondent-company. It was noted that no workmen or employee of company had appeared to resist order of winding up. Further, company had been unable to show any prospects of it carrying on any business in near or distant future. Besides, conduct of management of respondent-company in fraudulently selling off assets estimated at Rs. 2,300 crore made it just and equitable for company to be wound up. Accordingly, the Court allowed petition for winding up of the company.

Where plant and machinery have been sold off and the company was not carrying on any business other than earning interest, a petition for winding up on the ground

2. Re German Date Coffee Co. [1882] 20 Ch. D 169.
3. Re Bleriot Manufacturing Aircraft Co. [1916] 32 TLR 253.
4. Re Varieties Ltd. [1893] 2 Ch. 235.
5. Re German Date Coffee Co. [1882] 20 Ch. 169; Re Kitson & Co. Ltd. [1946] 1 All ER 435.
6. *Cotman* v. *Brougham* [1918] AC 514 at 520, per Lord Parker.

of loss of substratum of the business can be admitted - *Pundra Investments & Leasing Co. (P.) Ltd.* v. *Petron Mechanical Industries (P.) Ltd.* [2000] 23 SCL 220 (Bom.). When the Debt Recovery Tribunal orders the sale of the properties of the Company (under RDBFI Act, 1993), it will be presumed that the substratum of the company has gone, unless the order is set aside by competent forum - *Prakash Hassaram Mahtani* v. *Official Liquidator of Nielcom Ltd.* (*supra*) Ch. 23.

Where a joint venture agreement between parties to construct and run a hotel falls a ground due to unilateral action by one of the parties and also the company promoted under that agreement failed to pay *bona fide* debt and accumulated huge losses, the Delhi High Court ordered winding up of the company as just and equitable - *International Caterers (P) Ltd.* v. *Manor Hotel (P) Ltd.* [2007] 79 SCL 234.

However, a temporary difficulty which does not knock out the company's bottom shall not be permitted to become a ground for liquidation - *Re-Shah Steam Navigation Co.* [1908] 10 Bom. L.R. 107. *In re, Kaithal and General Mills Co. Ltd.* [1951] 31 Comp. Cas. 461[7], the Court laid down the following tests to determine as to whether the substratum of the company has disappeared :

(*a*) where the subject-matter of the company has gone; or

(*b*) the object for which it was incorporated has substantially failed; or

(*c*) it is impossible to carry on the business of the company except at a loss which means that there is no reasonable hope that the object of trading at a profit can be attained; or

(*d*) the existing or probable assets are insufficient to meet the existing liabilities.

The Madras High Court in *K.S. Mothilal* v. *K.S. Kasimaries Ceramique (P.) Ltd.* [2004] 50 SCL 116 has held that winding up proceedings are not meant for settling personal scores among family members. The court rejected the petition as the company's liability was marginal compared to its net worth and the company can very well proceed with one or more objects stated in the memorandum even though its major business has been stopped. This does not suggest that company's substratum is lost.

In *Majestic Infracon (P.) Ltd.* v. *Etisalat Mauritius Ltd.*, [2014] 45 taxmann.com 76 (Bombay), the Bombay High Court held that inability of the company to carry on main business or undertake any other business in a commercially viable manner indicates that the company has lost its substratum and it is just and equitable to wind up the company. The telecom licences allotted to the company were cancelled by a judgment of the Supreme Court. The petition for winding up was filed on the grounds that it was just and equitable to wind up company, *inter alia*, on ground that substratum of company had almost completely been eroded that there was a deadlock in management of company and that there was a complete lack of *uberrima fides* between main shareholders of company.

In *Etisalat Mauritius Ltd.* v. *Etisalat DB Telecom (P.) Ltd.* [2015] 55 taxmann.com 271 (Bombay), the petitioner-company had validly acquired thirteen 2G licences which constituted main assets of company and invested a huge sum in company. However, those licences were subsequently cancelled by a judgment of Supreme Court

7. Also see *Virendra Singh Bhandari* v. *Nandlal Bhandari & Sons Ltd.* [1982] 52 Comp. Cas. 36 (MP).

rendering company unable to carry on its principal object, *viz.*, provision of second generation (2G) telecommunication services in India. Petitioner and respondent No. 2 were major shareholders who held about 45 per cent each of shareholding of company. Respondent No. 2 withdrew its two nominee directors from Board of company making board of directors dysfunctional. The petitioner, being other major shareholder of company, filed winding up petition under just and equitable clause which was opposed by the Respondent No. 2 who also submitted a scheme for the revival of the company. The Bombay High Court admitted the winding up petition on the grounds that the company had lost its substratum and that there was complete lack of faith and probity resulting in irretrievable breakdown between major shareholders of company. The court also noted that the liabilities of company had far exceeded its assets and scheme propounded by respondent No. 2 was unrealistic, speculative and unworkable.

The Karnataka High Court in *Arasor Corporation* v. *Xalted Information Systems (P.) Ltd.* [2015] 60 taxmann.com 445 (Karnataka), refused to admit a winding up petition by the petitioner as the petitioner's certificate of incorporation had become void because of failure to pay franchise taxes. It was held that the petitioner not being in existence on date of filing winding up petition had lost its right to be sued and heard and, therefore, winding up petition filed by it was not maintainable.

2. *Illegality of Objects and Fraud* - If any of a company's objects are illegal, or apparently, if they become illegal by a change in the law, the Tribunal will order the company to be wound up on the ground that it is just and equitable to do so.[8]

Similarly, if a company is promoted in order to perpetrate a serious fraud or deception on the persons who are invited to subscribe for its shares, the Tribunal will wind it up. Thus, a winding up order was made when the company's prospectus stated that it had agreed to purchase the business of an existing firm, together with the right to use the firm's name, for a very substantial sum, and subscribers for the company's shares were intentionally misled by the name and the amount of the purchase price into thinking that the firm was a different and reputable concern, whose business name the vendor firm had, in fact, successfully but illegally imitated for a number of years. Again, a winding up order was made against a company whose promoters sold a business to them at a gross overvalue, and when the deception was discovered, bought up at a very low price most of the shares subscribed for by the public, so as to prevent the company from suing them for their misfeasance, and so as to wind the company up voluntarily and distribute its assets among themselves[9]

When the defence raised by the respondent is based on falsity in terms of documents produced as regards the status of the debt claimed by the petitioner, the court held that the respondent is liable to be wound up not only for non-payment of debt but also for lack of commercial morality on the 'just and equitable' ground - *Friends Tea Co. Ltd.*, In re [2012] 112 SCL 45 (Cal.).

However, for winding up on this ground, fraud in the prospectus or in the manner of conducting company's business is not sufficient. It must be shown that the

8. *Princess Resuss* v. *Bos* [1871] LR 5 HL 176; Re International Securities Corpn. [1908] 25 TLR 31.

9. Re West Surrey Tanning Co. [1866] LR 2 Eq 737.

original object of creating the company was fraudulent or illegal - *Re T.E. Brismead & Sons Ltd.* [1897] 1 Ch. 45, 406 (C.A.).

3. *Deadlock in management* - If it becomes impossible to manage a company's affairs because the voting power at board and general meetings is divided between two dissenting groups, the court (now Tribunal) will resolve the deadlock by making a winding up order. The most obvious kind of deadlock is where the company has two directors who are its only shareholders and who hold an equal number of voting shares, if they disagree on major questions in respect of the management of the company, their disagreement cannot be resolved at a board meeting or by a general meeting, and management decisions will cease to be made. In this situation the Tribunal will make a winding up order, even though there is a provision in the company's articles that one director shall have a casting vote at board meetings,[10] or that disputes shall be settled by arbitration[11].

In the case of *Sumit Gupta* v. *MOD Serap Industries (P.) Ltd.* [2018] 96 taxmann.com 297 (NCLT - New Delhi), the Bench admitted the winding up petition as there was a dead lock situation in management of company and company was not engaged in business, and also it had sold all its assets for liquidating its liabilities.

There may also be a deadlock even though the voting power is not equally divided between the dissenting groups. Thus, where there were three shareholders with equal shareholdings, and two of them were the company's directors, one of the director-shareholders was held entitled to a winding up order when the other persistently refused to attend board meetings and make up a quorum to transact business. The reason for the other director's absence was his fear that the petitioner would insist on a general meeting being called at which, by the terms of the articles, the petitioner could require the other shareholders to purchase his shares, or if they were unwilling to purchase them, to join with the petitioner in passing a resolution to wind up the company voluntarily. It was held that the company's business could not be carried out at all and for this reason the court made a winding up order - *Re American Pioneer Leather Co.* [1918] 1 Ch. 556.

Plea for deadlock in management disallowed - In *Kapil N. Mehta* v. *Shree Laxmi Motors Ltd.* [1999] 19 SCL 420, the Gujarat High Court disallowed a petition for winding up pleading *inter alia* deadlock in management. In this case the petitioners managed the company before their displacement, for about twenty years and were facing charges for misappropriation of company's funds and mismanagement. The plea for winding up was viewed by the Court as a plea in despair. According to the judgment provision of section 443(2) [now Section 273(2)] is mandatory and alternative remedy should be availed of instead of coming for winding up. In this case, alternative remedy was available *i.e.* approach to CLB u/ss 397 and 398 [now section 241/242]. Similarly in *Ashutosh Sharma* v. *Torque Cables (P.) Ltd.* [2013] 37 taxmann.com 431 (Delhi) the Delhi High Court held that if there is alternative remedy available to the petitioner, winding up petition shall be dismissed. In this case due to a dispute between the directors, the petitioner (one of the directors) was denied access to the company's records. On a winding up petition filed the court held that the facts indicate that in the present case remedy under section 397 [now

10. Re Davis and Collett Ltd. [1935] Ch. 693, [1935] All ER Rep. 315.
11. Re Yenidje Tobacco Co. Ltd. [1916] Ch.426.

Section 241] for oppression and management is preferred and therefore winding up petition was premature and was not maintainable.

Since a petitioner should not have done anything to prejudice the company and create a deadlock, his petition would not be approved as he was found to have done the same - *Vishnu Kumar Agarwalla* v. *Sreelall Foreign Money Changers (P). Ltd.* [2008] 88 SCL 246 (Cal.).

Plea for deadlock in management allowed - In *Brown Forman Mauritius Ltd.* v. *Jagatjit Brown Forman (I.) Ltd.* [2004] 51 SCL 214 (Delhi), the court was convinced that deadlock in management was evident as the company was in a loss and there was need for fresh capital infusion and neither of the parties owning this joint venture company came up with any proposal to resolve the problems. Also neither was interested in buying the shares held by the other and the two parties were bogged down in litigations against each other. Also *see Draegerwerk Akkungesells Chaff* v. *Usha Drager (P.) Ltd.* [2007] 75 SCL 355 (Delhi). In this case animosity between contesting groups reached a stage beyond repair and criminal case was filed by one of the groups against the other.

4. *When the company is a 'bubble'* i.e. *it never had any real business - Re London and County Coal Co.* [1867] L.R. 3 Eq. 365. Such companies are commonly called as 'fly-by-night' companies.

5. *Oppression* - A winding up petition may lie where the principal shareholders have adopted an aggressive or oppressive policy towards the minority - *R. Sabapathy Rao* v. *Sabapathy Press Ltd.* AIR 1925 Mad. 489.

A winding up order will be made if the persons who control the company have been guilty of oppression toward the minority shareholders, whether in their capacity of shareholders or in some other capacity (*e.g.,* as director)[12]. Thus, a company was wound up on the petition of minority shareholders when the directors, who held a majority of the issued shares, had persistently refused to call annual general meetings, or to submit accounts to the petitioners, or to have auditors appointed, or to give the petitioners any information about the company's affairs, all these being part of a scheme to coerce the petitioners into selling their shares to the directors at a price somewhat less than quarter of their real worth[13]. Similarly, in Scotland, a winding up order was made at the instance of a minority shareholder who was a director, when the majority shareholder, who was the other director, excluded the petitioner from taking any part in the management of the company, refused to allow him to inspect the company's books and denied him any information relating to its affairs, and generally managed the company's undertaking as though it were the majority shareholder's own property[14]. In these two cases, the persons responsible for the oppression obviously knew that their conduct was improper, but malevolence or a desire on their part for an improper gain at the expense of the petitioner is not an essential part. Thus, a winding up order was made when the petitioner merely showed that for several years no annual general meeting had been held, and

12. *Ebrahimi* v. *Westbourne Galleries Ltd.* [1973] AC 360 (HL).
13. *Loch* v. *John Blackwood Ltd.* [1924] AC 783.
14. *Thomson* v. *Drydale* 1925 SC 311.

no annual audits had taken place, and assets which the company had bought from the majority shareholders had not been transferred to it[15]. The court reasoned that every shareholder is entitled to have the company's business managed properly according to law, and if the persons who control the company show a persistent unwillingness to do this, any minority shareholder is entitled to have the company wound up.

However, the court (now Tribunal) will order winding up only when it is satisfied that it is impossible for the business of the company to be carried on for the benefit of the company as a whole because of the way in which voting power is held and used. However, when factual matrix and circumstances, that were manifest from record, *prima facie*, went against petitioner's case and he could not invoke equitable jurisdiction seeking relief for winding up, the petition is liable to be dismissed - *M. Mohan Babu* v. *Heritage Foods (P.) Ltd.* [2002] 37 SCL 490 (AP).

Oppression in the conduct of the company's affairs may, now, often be remedied more effectively by the CLB (now Tribunal) exercising the powers given to it to relieve minority shareholders from the unfairly prejudicial conduct of the company's affairs.

A winding up petition, if made after a petition was made to the CLB (now Tribunal) under sections 397 and 398 [now Section 241/242], has to wait till disposal of the petition by CLB - *M. Senthil Kumar* v. *Sudha Mills (I) Pvt. Ltd.* [2001] 31 SCL 257 (Mad.). When the petitioner has an alternative and more efficacious remedy under sections 397 and 398 [Section 241/242] of the Act, the petition is not maintainable under section 433(*f*) [now Section 271(1)(*g*)] - *K. Venkateswara Rao* v. *Phoenix Share & Stock Brokers (P.) Ltd.* [2002] 35 SCL 561 (Bom.). Also *see Prashant Glass Works (P.) Ltd.* v. *Banaras Beads Ltd.* [2002] 39 SCL 314 (All.); *Takshila Hospital Ltd.* v. *Jagmohan Mathur* [2002] 39 SCL 423 (Raj.)

It may be noted that acts of oppression by those who promote or control a company must be of a serious character for the Tribunal to wind the company up. Isolated acts of misconduct by the directors will not suffice, nor will the application of the company's funds by them for *ultra vires* purposes[16] and the Tribunal will not make a winding up order merely because the promoters have issued a false prospectus or have made a profit out of the promotion of the company without the shareholders' consent[17].

A winding up order was also refused when the directors had issued bonus shares although the company had earned no profits, with the consequence that the value of all the company's shares was diminished, and the petitioner had suffered loss by buying shares from an existing holder at par[18]. In this case it was held that the directors had at most been guilty of a breach of duty owed to the petitioner personally, but it could not be inferred from that breach of duty that they were managing the company's affairs oppressively so as to justify winding the company up.

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15. *Baird* v. *Lees* 1924 SC 83
16. Re Diamond Fuel Co. Ltd. [1879] 13 Ch. D.400.
17. Re. Haven Gold Mining Co. [1882] 20 Ch. D. 151.
18. Re Gold Co. [1879] 11 Ch. D. 701.

6. *Grounds Analogous to Dissolution of Partnerships* - If the company is a private one and its share capital is held wholly or mainly by its directors, it is in substance a partnership in corporate form, and the Tribunal may will order its winding up in the same situations as it would order the dissolution of a partnership on the ground that it is just and equitable to do so[19].

In *Official Liquidator* v. *Ram Swarup* AIR 1997 All 72, the Allahabad High Court observed that the fact that a pre-existing firm had been converted into a private limited company comprising of the same persons who were partners in the firm, as directors of the newly formed company, did not mean that the company still retained its character as a partnership. When it becomes a company, it acquires a distinct legal personality of its own. The firm having been dissolved on the formation of the company, there was no longer any link between the company and the firm unless it could be established that the rights of the former partners as regards management of the affairs of the company remained unaltered and preserved.

Re Davis and Coltett Ltd. [1935] Ch. 693, one member improperly excluded the other who held half the shares from taking part in the company's business. Held, the company be wound up.

But a winding up order will not be made because a controlling director, who has by tacit consent always managed the company's business alone, refuses to allow a fellow director to participate in day-to-day management as distinct from attending and taking part in board meetings[20]. However, the exclusion of a fellow director who has taken a part in managing the company's business from doing so any longer will be cause for winding the company up if the company was formed on the understanding that he should participate in managing its business[21]. Likewise, the failure of the majority shareholders to appoint the petitioner to be a director when he subscribed for shares in the company on the understanding that he would be made a director, will justify a winding up order.

7. *Requirements for investigation* - Where directors were making allegations of dishonesty against each other in respect of defalcations of the funds of the company, the company was ordered to be wound up on the ground that it was a case in which the conduct of some of the officers of the company required an investigation which could only be obtained in a winding up by the Court (now Tribunal) - *Re Varieties Ltd.* [1893] 2 Ch. 235.

8. *Broad democratic legal principles of fairness* - In considering a petition on just and equitable ground, the Court (now Tribunal) will have regard to broad democratic legal principles - *N. Sundaraswamy* v. *Bangalore Turf Club Ltd.* [1999] 21 SCL 90. Winding up petition filed by the sole petitioner (shareholder), as also seeking stay on proceedings for sale of one of the properties of the company to meet financial liabilities, was entertained by the company court and various reliefs were granted to the petitioner though opposed by the company which had adequate assets but not

19. Re. Yenidje Tobacco Co. Ltd. (*supra*).
20. Re Fildes Bros. Ltd. [1970] 1 All ER 923 (Ch.D); [1970] 1 WLR 592; [1970] 2 Comp. L.J. 173.
21. Re Zinotty Properties Ltd. [1984] 3 All ER 754; [1984] 1 WLR 1249; [1986] 1 Comp. L.J. 278.

sufficient cash. It was held on appeal that the company judge failed to correctly consider the company's contentions and the winding up petition was not liable to be admitted on petition of a solitary shareholder.

9. Company lacking in commercial morality or incapable of maintaining or producing relevant records - *Howrah Mills Co. Ltd.* and *Jardine Henderson Ltd.*, In re [2011] 105 SCL (Cal.).

The company judge was not justified in interfering with Board of Directors' decisions to sell the company property to discharge its debts, which could be done only after getting further orders of the Debt Recovery Tribunal. The company court (now Tribunal), as a rule cannot adjudicate upon commercial judgment of the Board of directors and interfere with internal management of the company - *Cochin Malabar Estates & Industries Ltd.* v. *P.V. Abdul Khader* [2003] 45 SCL 170 (Ker.).

A company, though received a substantial sum from a foreign investor for allotment of its shares, it failed to get clearance of FIPB and could not allot the shares. It also, despite demand, did not pay back the money. The foreign investor applied for winding up of the company but the company contended that it is solvent. This contention could not be upheld and the court admitted the petition on just and equitable ground - *Beader Beteiligungs GMBH* v. *Parsoli Motor Works (P) Ltd.* [2012] 115 SCL 316 (Guj.)

Inherent powers of Tribunal under section 271 - In case of a company in respect of which winding up petition has been admitted and stage for evidence is reached, the applicant company can produce documents which were not produced at the time of filing of plaint or written statement - *Cable Corporation of India Ltd.* v. *Sanghi Industries Ltd.* [2003] 44 SCL 15 (AP).

Procedure for filing petition - Whether notice of admission of the winding up petition be served on the company concerned before advertising the same for public knowledge - It was held that in the normal course it should be so done. However, in exceptional circumstance, the court (now Tribunal) may order for simultaneous service of the notice to the company concerned along with advertisement. In a case involving inability to pay the debts, there will be no urgency as such to order simultaneous service. In such a case, normally the balance of convenience is with the company - *Soujanya Hotels (P.) Ltd.* v. *Nalla Satyanarayana Murthy* [2001] 31 SCL 315 (AP).

Concealment of facts in winding up petition - The petitioner did not disclose in the winding up petition about filing of summary suit, passing of interim order securing petitioner's claim and implementation of the above order. The application was dismissed without going into merits of the case - *Aggarwal Industries Ltd.* v. *Golden Oil Industries (P.) Ltd.* [1999] 21 SCL 34 (Bom.). Also see *P&O Container Ltd.* v. *Balwant Textile Mills Ltd.* [2000] 24 SCL 426 (Bom.). In this case it was further held that passing of the winding up order is at the discretion of the court (now Tribunal).

When court was satisfied that there was oblique motive and suppression of facts, the prayer for appointment of a provisional liquidator by dispensing with notice to the respondent company was turned down. However, in view of a decree order already having been obtained by the petitioner, winding up order could be made - *Nagarjuna Construction Co. Ltd.* v. *Sharat Industries Ltd.* [2001] 33 SCL 726 (AP).

Filing petition through power of attorney - While the petitioner bank authorised two personnel to initiate all legal proceedings against any person or firm, they in the instant case, further authorised two other persons through power of authority to initiate necessary legal proceedings against the defaulting respondent. Later two persons were signatories in the petition for winding up. The authority given in the power of attorney did not include power to make petition for winding up of the respondent the petition was dismissed for want of authority - *Deutsche Bank* v. *Prithvi Information Solutions Ltd.* [2012] 114 SCL (AP).

Withdrawal of Petition - In *M. Abdul Rauf* v. *Vintage Hotels (P.) Ltd.* - The High Court held - (*i*) that even though the original petitioner for winding up has withdrawn the petition after being paid off by the company, so long other undischarged creditors remain, the winding up proceedings have to continue, and (*ii*) where the company consciously remained absent from proceedings, it virtually meant that the company left it to the Court to pass whatever orders the Court found necessary and once the orders were passed, it was not open to the company to ask for a *postmortem* [2000] 26 SCL 17 (Kar.).

24.4 Who can make petition [Section 272]

A petition for the compulsory winding up of a company may be presented by:

1. the company; or
2. any contributory or contributories; or
3. all or any of the persons specified above; or
4. the Registrar; or
5. any person authorised by the Central Government in this behalf;
6. In a case falling under clause (*b*) of section 271, by the Central Government or a State Government.

24.4-1 The Company [Section 272(1)(a)]

A company may make a petition for its winding up, when the members of the company have so resolved by passing special resolution. However, it is not very common for companies to apply for winding up order since, if desired, they have only to pass a special resolution for voluntary winding up under section 304 of the Act. But, where the directors find the company to be insolvent due to circumstances which ought to be investigated by the Tribunal, they may file a petition for winding up order on behalf of the company. In such circumstances, a director may make a petition even without obtaining the sanction of the general meeting of the company- *State of Madras* v. *Madras Electric Tramway Ltd.* AIR 1956 Mad. 181.

A company whose name was not in the register of companies was not entitled to file winding up petition. [*Anubhav Gupta* v. *Inside Softwares (P.) Ltd.* [2019] 104 taxmann.com 104 (NCLT - Allahabad)]. In this case the name of the company had been struck off by the Registrar of Companies due to non-maintenance of various records and statutory registers. The company instead of seeking restoration of name in the register of companies under section 252, filed a petition for winding-

up under section 271. It was held that as the name of company was not in register of companies, it was not entitled to file winding up petition.

24.4-2 Contributory's petition [Section 272(1)(b)]

A 'contributory' means any person liable to contribute to the assets of a company in the event of its being wound up [Section 2(*26*)]. Except for this purpose, the term 'contributory' includes a holder of fully paid shares.

A 'contributory', however, may petition on any other ground, if the shares in respect of which he is a contributory or some of them were originally allotted to him, or have been held by him and registered in his name for at least six out of the eighteen months preceding the commencement of the winding up, or have devolved upon him through the death of the former holder.

Thus, *In Re Gattapardo Ltd.* [1969] 2 All ER 344, a transfer though executed and stamped in June 1967, was registered in October 1968. The shareholder presented a winding up petition in December, 1968. Held, the petition was not valid since she had not held shares for six months as required by the Act.

A holder of fully paid shares is a contributory for the purpose of a petition not because he is liable to contribute (which he is not) but because he may have an interest in the assets in a winding up. In Re *Othery Construction Co.* [1966] 1 All ER 145. *Buckley, J.* observed "In my judgment it remains a rule of this court that where a fully paid shareholder petitions for compulsory winding up, he must show, on the face of his petition, a *prima facie* probability that there will be assets available for distribution amongst the shareholders." *But in India* this judgment is not applicable in view of section 272(3). "A contributory shall be entitled to present a petition for winding up a company notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of the liabilities." This position presumably stems from the proposition that a shareholder as such has a stake in the affairs of the company irrespective of whether he is holder of fully paid shares. However, the Tribunal has complete discretion whether to order winding up on taking totality of circumstances into account.

Holder of forfeited shares - The holder of forfeited shares may apply for the winding up of a company within one year of the forfeiture of his shares provided he has held the shares for six months during the 18 months preceding the commencement of winding up - *Mumtaz Bank Ltd.,* Re [1932] 2 Comp. Cas. 350.

Legal representative - The legal representative of a deceased shareholder is a contributory for the purpose of section 439 [now Section 272] - *Bayswater Trading Co. Ltd.,* Re [1970] 1 All ER 608. The deceased shareholder has to be a natural person - *Chloro Controls (P.) Ltd.* v. *Seventrent Water Purification Inc.* [2006] 71 SCL 396 (Bom.).

The A.P. High Court in *Coromandal International Ltd.* v. *Chemical Biotech Ltd.* [2011] 110 SCL 580 has ruled that power granted by the petitioner company to its authorized representative for filing suits and/or proceedings for recovery of amount due does not cover power to institute winding up proceedings.

In *Severn Trent Water Purification Inc.* v. *Chloro Controls (India) Pvt. Ltd.* [2008] 82 SCL 435 (SC), it has been held that the phrase 'devolved on him through the death of a former holder' in section 439(4)(*b*) [now Section 272(3)] refers to only natural

person and not juristic entities. Where shares are held jointly by two persons, and one of them dies, interest of the deceased shareholder passes to the survivor and not to the heirs of the deceased shareholder. In such a case only the surviving shareholder is a contributory and is entitled to present petition for winding up - *Ram Govind Misra* v. *Allahabad Theatres (Pvt.) Ltd.* [1997] 4 CLJ 422.

A contributory whose call is in arrear, may not be permitted to present a winding up petition unless he pays the call in the Court (now Tribunal) or satisfies it that he is willing to pay the same - *Diamond Fuel Co. Ltd., In re* [1879] 13 Ch. D 400.

24.4-3 Joint petition [Section 272(1)(c)]

By all or any of the parties specified in (1) and in para 24.4. This means that any combination of the company and the contributories can present a petition for winding up.

24.4-4 The Registrar [Section 272(1)(d)]

The Registrar may file a petition on any ground mentioned in Section 271 except ground specified in clause (a)*. Hence a petition by the Registrar can be filed on the following grounds:

(*i*) Company acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

(*ii*) Affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith.

(*iii*) Default by the company in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years.

(*iv*) It is just & equitable that the company should be wound up.

Before making a petition due to inability of the company to pay its debts, it must appear to the Registrar that the company is not able to pay its debts. For this the Registrar will rely on the scrutiny of the balance sheet filed by the company or from the report of an inspector appointed under section 210. The Registrar cannot present the petition unless sanctioned by the Central Government. The Central Government shall give its approval only after an opportunity of being heard has been given to the company. Further, such petition must be filed within a reasonable time of the obtaining of the sanction, failing which the Court (now Tribunal) shall not recognise the sanction as valid - *Registrar of Companies* v. *All India Groundnut Syndicate Ltd.* 55 Bom. LR 312.

It may be noted that before the Amendment Act, 2019 the Registrar was not allowed to file a petition on the grounds of 'just and equitable'.

24.4-5 Person authorized by the Central Government [Section 272(1)(e)]

The Central Government may authorize any person to file a petition before the Tribunal.

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*Amended *vide* the Companies (Amendment) Act, 2019

24.4-6 Central Government's/State Government's petition [Section 272(1)(f)]

The Central Government may petition for winding up where it appears from the report of inspectors appointed to investigate the affairs of a company under section 213 on the grounds that it is just and equitable that the company should be wound up. The Government may authorise any person to act on its behalf for the purpose including the Registrar. The Central Government or the concerned State Government is empowered to file petition for winding up on the ground contained in section 271(b) [company acting against sovereignty and integrity of India or security of State etc.].

24.4-7 Section 69 of the Indian Partnership Act and Winding up

An obligation for winding up a company arises solely out of statutory rights given in section 433 [now Section 271] and not out of any contract - *Shree Balaji Steels* v. *Gontermann Peipers (I) Ltd.* [2003] 47 and 48 SCL 821 and 422 (Cal.). This case also affirmed that an unregistered partnership firm is entitled to file winding up petition under section 439 [now section 272] and it is not barred by section 69 of the Partnership Act.

24.4-8 Can a petition be made for winding up by workers' union of a company

The Supreme Court in *National Textile Workers' Union* v. *P.R. Ramakrishnan* [1983] 53 Comp. Cas. 184 observed as follows:

The right to apply for a winding up of a company being a creature of statute, none other than those on whom the right to present a winding up petition is conferred by the statute can make an application for winding up a company and no such right having been conferred on the workers, they cannot prefer a winding up petition against a company.

But, as to whether the workers have a right to appear and be heard on a petition for winding up of a company, the Supreme Court in the said case observed:

> "Although the workers have no right to present a winding up petition against the company, if a winding up petition is properly filed by any of the persons entitled to do so under section 439 [now section 272] the workers may still be entitled to appear and be heard in support of or in opposition to the winding up petition. That would depend upon whether their interest is likely to be affected by any order which may be made on the winding up petition."

The Gujarat High Court in *Textile Labour Association* v. *Official Liquidator of Vijaya Mills Ltd.* [2005] 62 SCL 53 has allowed the representative body of the workers to plead when workers' interest was involved in the matter of use of assets of the company.

In deciding whether the Tribunal should wind up a company or change its management, the Tribunal must take into consideration not only the interest of the shareholders and creditors but also, amongst other things, the interest of the workers.

Can a third party get impleaded in a petition for winding up - The Madras High Court held "No". Where the applicant was neither a necessary nor a proper party to the petition, even though he claimed to be in possession of certain information about

diversion of fund by the company, his application to be impleaded as a respondent, was turned down - *Dr. Subramanian Swamy* v. *RBI* [2001] 32 SCL 597.

24.4-9 Right of any other person to be heard

In *Keerat Kaur* v. *Patiala Exhibition (P.) Ltd.* [1991] 70 Comp. Cas. 728, the Punjab and Haryana High Court has held that the Company Court (now Tribunal) has the discretion in a petition for winding up a company to hear any person other than the parties to the petition who may be interested in the winding up on public grounds or otherwise. This discretion may be exercised by the court (now Tribunal) even at the stage of admission of petition. Also *see Hy-Line International* v. *C&M Hy-Line Farms (P.) Ltd.* [2004] 52 SCL 416 (Bom.)

24.4-10 Winding-up and the Arbitration and Conciliation Act, 1996

Section 8 of the Act as aforesaid imposes a mandatory duty on the judicial authority to refer the parties to arbitration in respect of which action is brought in a matter which is the subject matter of an arbitration agreement. This mandatory requirement has to be pleaded before filing Written Statement with the judicial authority. A company registered under the Companies Act can enter into an Arbitration Agreement if it is so authorized by its Articles of Association. The Supreme Court in *P. Anand Gajapati Raju* v. *P.V.G. Raju* [2000] 4 SCC 539 has held that the language of section 8 of the Arbitration Act is pre-emptory and, therefore, the court (now Tribunal) is obliged to refer the parties to arbitration in terms of the Arbitration Agreement, if any, of the parties to the dispute desires the same before the Court at the *Appropriate Stage*. In *Haryana Telecom* v. *Sterlite Industries (I) Ltd.* [1999] 22 SCL 156, the Apex Court has held that only such disputes or matters which an arbitrator is competent or empowered to decide can be referred to arbitration[22]. However, notwithstanding any agreement between the parties, an arbitrator has no jurisdiction to order winding-up of a company as that power rests only with the company court (now Tribunal). Also when a petition is before the company court (now Tribunal) notwithstanding any agreement between the parties, the arbitrator will not have any jurisdiction till that court (now Tribunal) takes a decision on the admissibility of the petition. Also *see Areva T&D (I) Ltd.* v. *Bheema Cements Ltd.* [2012] 111 SCL 475 (AP).

Similarly the Karnataka High Court in *Seven H Logistics (P.) Ltd.* v. *Deccan Cargo & Express Logistics (P.) Ltd.* [2014] 49 taxmann.com 423 (Karnataka) refused to allow the applicant to proceed with arbitration against the company in liquidation. It was held that it would be more appropriate for the applicant to lodge its claim before the Official Liquidator when the claims would be invited.

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22. Also see *J.G. Finance Ltd.* v. *Jamna Auto Industries* - Arbitration agreement as *per se* will not oust jurisdiction of a company court (now Tribunal) to entertain petition for winding up [2001] 29 SCL 325 (Punj. & Har.). The Calcutta High Court, in the case of *Ramkumar Radheshyam Kedia* v. *Subrata Sasmal & Co. (P.) Ltd.* [2001] 29 SCL 241 also has held that an application under section 34 of the Arbitration Act by itself would not be a reason for stay of an application for winding up even though an arbitration agreement subsists. The Bombay High Court also held similar views - *ABG Heavy Industries Ltd.* v. *Hindustan Shipyard Ltd.* [2001] 33 SCL 155. In *Pankaj Aluminium Industries (P) Ltd.* v. *Pankaj Extrusions Ltd.* [2009] 90 SCL 196, the Gujarat High Court dismissed winding up petition when arbitration award was pending before Bombay High Court.

While generally the jurisdiction of the Civil Court does not get ousted by a clause to refer disputes between the parties to the agreement for arbitration, a specific power has been conferred on civil court where the agreement provides for arbitration outside India, to decide whether such agreement is null and void, inoperative or incapable of being performed. Even an Arbitral Tribunal can decide whether the agreement to go for arbitration is *void ab initio*. In the case of international commercial arbitration, if arbitration clause itself is void or the subject matter of dispute does not fall within the scope of the arbitration clause, the court would not direct parties to go for arbitration - *GTC Ltd.* v. *Royal Consulting RV* [2003] 43 SCL 50 (Bom.)

Existence of an arbitration clause cannot oust jurisdiction of the company court (now Tribunal) exercising its discretionary powers under sections 433 and 434 (now Section 271). However, that does not lead to the only conclusion that in every case it must invariably exercise jurisdiction even though it would appear to it expedient and appropriate to refer parties to arbitration - *Prime Century City Developments (P) Ltd.* v. *Ansal Build Well Ltd.* [2003] 42 SCL 256 (Delhi). This case also held that where the respondent, while opposing winding up petition, denies the liability, taking palpably false and *mala fide* defence, notwithstanding the agreement to refer disputes among them to arbitration, the petition is to be admitted. Also *see Times Guaranty Fin. Services Ltd.* v. *Perfect Pipes (P.) Ltd.* [2004] 52 SCL 178 (Delhi).

The M.P. High Court in *ICDS Ltd.* v. *Kamar Trading Co. (P.) Ltd.* [2004] 49 SCL 600 has stated that the Arbitration Act is a complete code by itself. When a company after the arbitration award against it did not make payment to the creditor and the creditor files a petition under sections 433 and 434 [now Section 271], the petition need not be entertained as the creditor has his remedy in the Arbitration Act itself.

The Bombay High Court in *CDS Ltd.* v. *Asha Latex & Allied Industries (P.) Ltd.* [2004] 50 SCL 241 has held initiating winding up proceedings after resorting to arbitration is an abuse of the process of law.

Foreign Arbitration Award - Till the enforceability of a foreign arbitration award is decided by an appropriate civil court, a petition for winding up for non-payment of the amount of award cannot be admitted by the company court (now Tribunal) even though the amount is ascertained. The amount on the award as such is not a present debt - *Marina World Shipping Corporation Ltd.* v. *Jindal Exports (P.) Ltd.* [2004] 54 SCL 312 (Delhi). In *Vinayak Oil & Fats (P.) Ltd.* v. *Andre Trading Co. Ltd.* [2005] 64 SCL 277 (Cal.), it has been held that an winding up petition to enforce payment of an alleged debt, based on a foreign arbitration award, is not maintainable. The creditor is to ensure first that the requirements of sections 47 and 48 of the Arbitration and Conciliation Act, 1996 are met by the foreign award and then approach the appropriate court for enforcement of the award.

24.4-11 Procedure for making and service of the winding up petition

Once the petition has been filed the same is listed before the Tribunal. In case the petition is by a person other than the company, the Tribunal may require the notice of the petition to be given to the Company and provide an opportunity of being heard. A copy of the petition is also required to be served on every contributory or creditor. The petition is also required to be advertised in one daily English newspaper and one daily newspaper in the principal language circulating the state

where the registered office of the company is situated at least fourteen days before the date fixed for hearing. [Rule 5 (2, 4 and 5) of the Draft Companies (Winding Up) Rules, 2013]*. A petition may be allowed to be withdrawn by the Tribunal subsequently. The Tribunal may also permit substitution of a petitioner where a petitioner —

(*i*) is not entitled to present a petition, or

(*ii*) fails to advertise his petition within the time prescribed by these rules or by order of the Tribunal, or

(*iii*) consents to withdraw the petition, or to allow it to be dismissed, or the hearing to be adjourned or fails to appear in support of his petition when it is called on in Tribunal on the day originally fixed for the hearing thereof, or any day to which the hearing has been adjourned, or

(*iv*) if appearing, does not apply for an order in terms of the prayer of his petition, or,

(*v*) where in the opinion of the Tribunal there is other sufficient cause for an order being made.

In *Donghee Vision Industrial Co. Ltd.* v. *Tube Investment of India Ltd.* [2001] 32 SCL 602, the Madras High Court held that the requirements regarding notice are mandatory in nature and the same need to be fully complied with where possible and a public notice given through a newspaper is not a substitute, if even the notice served at the address of the registered office was returned as "Left", as fullest inquiry about the current address of the company was not made. Only when after fullest inquiry is made about the address (which in the instant case, was possible as the ROC's office had that), the judge can issue necessary direction. In this case, though rule 28 was not complied with (where it was possible to comply), the judge ordered in favour of the winding up. The High Court set aside the order. Also *see Nuchem Ltd.* v. *C.S. Modi & Co.* [2002] 38 SCL 113 (Punj. & Har.). Where the original notice duly served at the registered office address comes back with the postal remark 'unclaimed', it does not cease to have effect even though subsequent notices were sent at other addresses and if debt exists, the petition is to be admitted - *Ispat Industries Ltd.,* In re [2005] 58 SCL 485 (Bom.).

24.5 Commencement of winding up [Section 357]

The winding up of a company by the Tribunal shall be deemed to commence at the time of the presentation of the petition for the winding up. If no order for winding up is made and the winding up petition is dismissed, the date of presentation of the winding up petition has no relevance[23]. As such, until winding up order is made, the company will have to comply with the requirements of the Act as are required of a company not wound up. Also, the words 'shall be deemed to commence' indicate that although the winding up of a company does not in fact commence at the time of the presentation of the petition; it nevertheless shall be taken to commence from that time if and when the winding up order is made. In a case where two winding up petitions were filed in the same court at different points of time and the winding

*Not yet notified.

23. *Vide Sarbani Dey* v. *Howrah Motor Co. Ltd.* [2004] 50 SCL 422 (Cal.).

up order was issued based on the subsequent petition and the first petition was ordered to be closed the commencement of winding up has to be reckoned from the date when first petition was filed - *Administrator MCC Finance Ltd.* v. *Ramesh Gandhi*[2005] 63 SCL 326 (Mad.). The court also held that provision of sections 531 and 531A [now Section 328/329] in relation to fraudulent preference etc. are inapplicable to transfer of shares after commencement of the winding up as these provisions affect cases before the commencement.

Different winding up proceedings are impermissible for different benefits under the jurisdiction of the same High Court - *Tata Iron & Steel Co. Ltd.* v. *Kumardhubi Metal Casting and Engineering Ltd.* [2001] 34 SCL 982 (Pat.). Also *see Official Liquidator of Piramal Financial Services Ltd.* v. *RBI* [2004] 51 SCL 691 (Guj.). This decision held that once winding up order has been issued by the court, subsequent petition for winding up of the company would automatically attract section 441 [now Section 357]. On fraudulent preference, the decision held that giving a favoured treatment is essential to establish fraudulent preference.

24.6 Procedure for winding up order

24.6-1 Petition

The winding up petition must be presented to the Tribunal. If the petition has been filed by the Company, it shall be accompanied by a statement of affairs in the form and manner prescribed. In case the petition is filed by any person other than the company, the Tribunal will require the company to file its objections along with a statement of affairs within thirty days. Before passing an order as such; the Tribunal must be satisfied about the existence of a *prima facie* case for winding up. In case of special circumstances, the Tribunal may extend the period to file objections and statement of affairs by another thirty days.(Section 274)

Consent terms filed with the Tribunal - If the petitioner and the respondent company enter into MOU regarding repayment of debt during the pendency of the petition for winding up and the same is filed with the company court (now Tribunal), the consent terms contained in the MOU become order of the court under relevant rules - *SBI Commercial and International Bank Ltd.* v. *Badridass Gauridatt (P.) Ltd.* [2002] 35 SCL 723 (Bom.).

However, when the company judge passes order for winding up based on compromise petition filed by the parties without framing points for consideration and when parties were not permitted to adduce evidence, the same order is to be set aside and referred back to the company judge - *Cauvery Software Engineering Systems Ltd.* v. *Besto Clutches & Spares* [2011] 110 SCL 573 (Kar.)

24.6-2 Powers of the Tribunal [Section 273]

On receipt of the winding up petition under Section 272, the Tribunal may:

(*i*) dismiss it, with or without costs[24]; or

24. An application for winding up was dismissed on the ground "want of diligence" in prosecution as the petitioners themselves dragged on the proceedings and no one represented them on the date of hearing - *Aggarwal Granite Exports Ltd.* v. *South Indian Granite Co. (P.) Ltd.* [2000] 25 SCL 599 (Kar.)

(*ii*) appoint a provisional liquidator or the company till the making up of a winding up order; or

(*iii*) make any interim order that it thinks fit; or

(*iv*) make an order for winding up the company with or without costs; or

(*v*) make any other order that it thinks fit [Section 273(1)].

The Tribunal cannot, however, refuse to make a winding up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets or that the company has no assets. "Where the petition is presented on the ground that it is just and equitable that the company should be wound up, the court (now Tribunal) may refuse to make an order of winding up if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy" [Section 273(2)]. [*Vide Kapil N. Mehta* v. *Shree Laxmi Motors Ltd.* (*supra*)]

In all matters relating to the winding up of a company, the Tribunal may have regard to the wishes of creditors and/or contributories of the company as proved to it by any sufficient evidence and for the purpose may direct that their meetings may be held or conducted as directed by the Tribunal [Section 354]. The Tribunal may also appoint the chairman for the meeting, if any ordered to be held, who will report to the Tribunal the outcome of the meeting.

With a view to protecting the interests of various lenders and lending institutions, the court (now Tribunal) may order sale of respondent's assets even before actually passing the order of winding up-*Altos India Ltd.* v. *Bharti Telecom Ltd.* [2001] 30 SCL 347 (Punj. & Har.).

Tribunal's power is unrestricted - Section 273 of the Act contains no limitation or restriction on the Tribunal's power to pass any order it deems fit, especially because no other section also contains any restriction on the Tribunal's power under section 273. However, the order should be fit and necessary in interest of justice and in implementing and giving effect to provisions of the Act. In *NEPC Agro Food Ltd.* v. *Hindustan Thompson Associates Ltd.* [2001] 33 SCL 15, the Madras High Court passed an interim order appointing the auditor to verify the amount payable by the company in terms of the lending agreement. This order of the single judge bench was held to be in order by the Division Bench as the company had the opportunity to file its objection to the auditor's findings. As per judgment of Bombay High Court in *Sangli Bank Ltd.* v. *Official Liquidator* [2004] 55 SCL 40, a company court (now Tribunal) can order re-auction of property of the company in liquidation if there exists any material irregularity in the original auction and price therein is inadequate.

Power of the Tribunal to order payment of money to the petitioning creditor - The Bombay High Court in *Nilesh Lalit Parikh, In re* [2002] 37 SCL 531 held that the trying company court (now Tribunal) enjoys this power and when the order for payment is passed it will have the force of a decree passed by a court.

Power to recommend investigation - As per the decision in *MCC Finance Ltd.* v. *Reserve Bank of India* [2002] 37 SCL 517, the Madras High Court said that the court

(now Tribunal) has ample powers to recommend investigation and give directions for filing F.I.R. with regard to any apparent fraud by the company and those in-charge of the company.

While an application to the Official Liquidator to grant extension of time for payment of the sale consideration of the company property is inappropriate as the same need to be made to the concerned company court, the company court (now Tribunal) may grant *post facto* permission to the extension of time as the buyer had already made the payment to the *O.L.—J.N. Patel* v. *O.L. of Mrinal Dyeing & Mfg. Co. Ltd.* [2011] 105 SCL 48 (Guj.).

Power of the Company Court to reschedule payment - It was held in *Maheshwary Ispat Ltd.* v. *Tata Capital Financial Services Ltd.* [2015] 57 taxmann.com 195 (Calcutta) that Company Court is competent to re-schedule payment of sum due in a petition for winding up. In case the company paid instalments to a substantial extent and prayed for some respite, the court would be within its right to consider such prayer and would not be powerless to entertain such application for re-scheduling repayment.

24.6-3 Recall of winding up order

If on the date of passing the winding up order a reference was pending before BIFR, the order may only be recalled if the reference was genuine and not sham - *Real Value Appliances Ltd.* v. *Canara Bank* AIR 1998 SC 2064. Following the test of genuineness laid down by the Apex Court that the BIFR reference must have been registered, scrutinised and numbered, the application for recall was refused in *Miranka Ispat Ltd.* v. *Ispat Industries Ltd.* [2000] 24 SCL 10 (Kar.).

In a case where *ex parte* winding up order was issued, the petitioner prayed either a recall of the order or permanent stay on the order under section 466 [now section 289] and the prayer was rejected. On appeal, it was seen that petitioner for the winding up petition was not the creditor himself but purportedly was his constituted attorney. All throughout the proceedings all the paper including Vakalatnama were signed not by the creditor but by the attorney. A question arose as regards the life-status of the creditor; it was not on records whether he was alive. As per provisions of section 108 of the Evidence Act, 1972, he is to be presumed to be dead. The appeal Court held that the court (now Tribunal) has to be satisfied that the concerned creditor was alive at the time of initiation of the proceedings and there was no such satisfaction in this case. Therefore, the court granted permanent stay on the winding up order earlier passed by the court - *Parbati Dasgupta* v. *Official Liquidator* [2005] 64 SCL 169 (Cal.).

When a winding up order is issued based on wrong information, the same order can be recalled by the Court (now Tribunal) concerned and the parties would revert to their respective positions as they stood before the winding up order - *Amin Traders* v. *Textile Labour Association* [2008] 87 SCL 39 (Guj.). In *Venkateshwar Somani* v. *O.L. of Shree Niwas Cotton Mills Ltd.* [2009] 96 SCL 445 (Bom.), the court allowed revival of the company in liquidation based on the facts of the case and petitioner agreeing to comply with the conditions laid down by the court.

24.6-4 Can winding up order be passed without hearing the company concerned

Yes where the company judge (now Tribunal) had painstakingly and studiously gone into the whole financial aspects through a questionnaire and information regarding relevant transactions was sought and affidavits were filed showing company's financial position, order of the company judge for winding up could not be challenged on ground of non-hearing of the company - *M.C.C. Finance Ltd.* v. *Reserve Bank of India* (*supra*).

24.6-5 Admission of winding up petition does not necessarily lead to Winding up order

In *National Investors Forum* v. *Golden Forests (I) Ltd.* [2004] 51 SCL 669 (Punj. & Har.), the High Court, *inter alia*, ordered appointment of a provisional liquidator to take charge of defaulting company's assets and to dispose them for payment to creditors and investors. In view of the company having substantial assets, no winding up order was passed. Also, the Court ordered appointment of an auditor to investigate into the affairs of the company.

24.6-6 Stay of suits etc. on winding up order [Section 279]

At any time after a winding up order has been passed or a provisional liquidator has been appointed, no suit or proceedings against the company can be commenced without the leave of the Tribunal. Any pending suit or proceeding also cannot be proceeded with without Tribunal's leave. The Tribunal has a right to permit such proceeding to be commenced or proceeded with subject to terms and conditions as it may impose. The Tribunal needs to dispose of the application for such a leave within sixty days. The stay will not affect any proceeding pending in appeal before the Supreme Court or a High Court.

A company in respect of which winding up petition has been made, borrowed money concealing the above fact. When suit was filed for recovery, it made application for stay claiming winding up petition has been admitted and also a reference has been made to BIFR for stay of the suit. The application was dismissed as the company did not come to the court (now Tribunal) with clean hands - *Apollo Finance Ltd.* v. *GSL (I) Ltd.* [2001] 34 SCL 951 (Delhi). As against the above, as per section 446 [now Section 279], when the winding up order has been made or the official liquidator has been appointed as the provisional liquidator, no suit or other legal proceedings shall be commenced, or if pending at the date of the winding up order, shall be proceeded with, against the company except by leave of the Tribunal and subject to such terms as the Tribunal may impose. However, any proceeding pending before the Supreme Court or the High Court will not come within the above power of the Tribunal which has made the winding up order. In case leave of the Court (now Tribunal) has not been taken prior to institution of the suit, it may grant leave subsequently if approached, but the concerned proceeding should be considered to have commenced from the date the leave was granted - *Erach Boman Khavar* v. *Tukaram Sridhar Bhat* [2008] 81 SCL 416 (Bom.).

Section 280 provides for the Tribunal passing winding-up order an unhindered jurisdiction to entertain or dispose of : (*i*) any suit or proceedings by or against the company, (*ii*) any claim made by or against the company including claims by or

against any of its branches in India, (*iii*) any application made under section 233; and (i*v*) any question of priorities or any other question whatsoever, whether of law or fact, which may relate to or arise in course of winding up of the company. This provision is an unavoidable adjunct to the provision putting embargo on commencement of any new legal proceedings against the company or requiring leave of the Tribunal to continue any legal proceeding pending on the day of the winding-up order. The power of the Tribunal as contained in section 279 is exercisable irrespective of whether the matter had arisen before the winding-up order or after. Following this clear provision, the Rajasthan High Court in *Rajasthan Financial Corpn.* v. *Official Liquidator, Machhar Textile Mills (P.) Ltd.* [2002] 39 SCL 75, allowed the petitioner to retain possession of assets of the company obtained under section 29 of the SFC Act and for realizing its dues outside winding up proceedings. The court put the condition that the sale of the assets in possession of the petitioner and utilization of the sale proceeds shall be subject to the approval of the court (now Tribunal). Permission to a secured creditor could be granted to dispose of the assets of the company under its charge, by remaining outside the winding up proceedings. However, it should deposit the proceeds it receives on such disposal to the Official Liquidator and file with him its claim - *Lok Vikas Urban Co. Operative Bank Ltd.* v. *Lok Vikas Finance Corpn. Ltd.* [2003] 46 SCL 146 (Raj.)

Debt owed to a company in liquidation - The statement of affairs submitted by former directors of the company in liquidation showed the respondent as debtor. When asked by the liquidator to make payment, the respondent brought to his notice its suit for recovery already filed in a court (now Tribunal) against the company and that without the knowledge that the company is in liquidation. It was held that the respondent has to make the payment and the suit in question gets stayed by operation of section 446 [now Section 279]. The respondent can only place its claim against the company in liquidation to the liquidator - *Indo Engineering (Kota) (P.) Ltd., In Liquidation* v. *Maharashtra State Electricity Board* [2003] 44 SCL 587 (Raj.).

Effect of order for attachment - In terms of rule 54 of Order XXI of the Code of Civil Procedure, only effect of the order of attachment issued by a court, is that the property attached cannot be transferred, nor a third party right created therein. The order of attachment creates no interest in favour of the decree holders and consequently no charge can be created in favour of the decree holders. Thus, the prayer of a lender, who is the decree holder against properties of the company, to execute the decree and treat it as a secured creditor in the winding-up proceedings was not granted - *H.S. Oberoi & Associate* v. *Punjab Wireless* [2002] 40 SCL 216 (Punj. & Har.).

An arbitration proceeding is covered by section 279(1) - See British India Corpn. Ltd. v. *Star Spin & Twist Machinery Ltd.* [2001] 34 SCL 694 (Kar.). Also, proceedings under section 33C(2) of the Industrial Disputes Act is so covered - *Basavaiah* v. *Sri Krishnarajendra Mills Ltd.* [2001] 34 SCL 741 (Kar.). However, the expression other legal proceedings appearing in section 446(1) [now section 279(1)] does not cover criminal proceedings - *Pennar Peterson Ltd.* v. *Shikshak Sahakari Bank Ltd.* [2010] 101 SCL 290 (SC).

An arbitration award passed after admission of winding up petition but before winding up order is made by the court (now Tribunal), is sustainable as it does not need leave of the court (now Tribunal) to pass the award. But any further action on the award has to be stopped if leave of the court (now Tribunal) is not granted under section 446(1) [now Section 279(1)] - *Mrs. Vasantha Ramanan* v. *Official Liquidator* [2003] 47 SCL 710 (Mad.).

When winding up proceedings remain stayed, any sale transaction of the property of the company gets invalid in view of section 446 [now Section 279] - *Kailash Nath Bajpai* v. *Hind Housing & Construction Ltd.* [2001] 33 SCL 397 (All.).

Section 279 vis-a-vis RDBFI Act, 1993 and Securitization and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 - (SARFAESI, 2002).

Section 279 of the Act while carrying the provision of stopping or continuing any proceedings against the company in liquidation, provides the power to grant leave to proceed or continue any proceeding against such company on application by the party seeking the leave. This power of the Tribunal is essentially discretionary. In a case the company court (now Tribunal) granted *ex parte* leave to the lender banks to proceed against the defaulting company under the Recovery of Debts Due to Banks and Financial Institutions (RDBFI) Act, 1993. The appellant, who was the guarantor of the loans, prayed to that court to recall the order as no notice of hearing was served on him. The court declined to recall the order. On a reference to the Patna High Court, the order of the company court (now Tribunal) declining to recall the order was quashed and the company court (now Tribunal) was directed to hear the application of the appellant for revocation of the leave - *Sahu Jain Ltd.* v. *Rohtas Industries Ltd.* [2001] 29 SCL 163. The same High Court in *Rohtas Industries Ltd., In re* [2001] 30 SCL 459 has held that having regard to the clear provisions of sections 17, 18 and 34 of the RDBFI Act, there is no need to seek leave under section 446 [now Section 279]. Also, it is not open to the Company Court (now Tribunal) to get the suit transferred to itself. The Supreme Court in the case of *ICICI Ltd.* v. *Srinivas Agencies* [1996] 86 Comp. Cas. 255 did not hold that the provisions of sections 17 and 18 of RDBFI Act totally oust the jurisdiction of section 446 (now Section 279). Each case has to be decided on facts and circumstances. Palmer, in page 1187, para 85.77 of 23rd Edition of *Palmer's Company Law* has unequivocally opined that leave of the Court (now Tribunal) to proceed against a company in liquidation should not be granted *ex parte*.

When the Debt Recovery Tribunal (DRT) had directed sale of the properties of the company and the purchaser has deposited the amount involved, it will be presumed that the substratum of the company has gone and the proposed scheme of arrangement (opposed by certain creditors) for revival of the company cannot have effect unless the DRT order is set aside by a Competent Forum - *Prakash Hassaram Mahatane* v. *Official Liquidator of Nielcon Ltd.* (*supra*) Ch. 23.

In *IFCI* v. *Arihant Cotsyn Ltd. (In Liquidation)* [2010] 102 SCL 504, the Punjab and Haryana High Court has held that section 13 of SARFAESI Act does not override section 446 [now Section 279] of the Companies Act and hence leave of Company Court (now Tribunal) is necessary for taking possession of concerned assets from the Official Liquidator.

The Bombay High Court, however, in *ION Finance Ltd.* v. *Firth India Steel Co. Ltd.* [2001] 30 SCL 437 has held that following the Supreme Court decision of *Kondaskar (S.V.) Official Liquidator & Liquidator of Colaba Land & Mills Co. Ltd.* v. *V.M. Deshpande* [1972] 42 Comp. Cas. 1681 has held that the expression 'Suit or other legal proceeding' in section 446(1) [now Section 279] do not include criminal complaints filed under section 138 of the N.I. Act. Also *see Pennar Peterson Ltd.* v. *Shikshak Sahakari Bank Ltd.* [2008] 85 SCL 22 (SC).

If liquidation proceedings are to take a long period of time, then debt recovery suit already pending before the Tribunal cannot be stopped - *State Bank of Patiala* v. *Chhater Extractions Ltd.* [2000] 23 SCL 277 (Punj. & Har.). In *Bihar Sales (P.) Ltd.*, In re [1999] 20 SCL 235 (Pat.), it has been held that Debt Recovery Tribunal has exclusive jurisdiction to entertain and decree suits or other proceedings by banks or financial institutions. As such operation of section 446 [now Section 279] is stalled if reference is made to the Debt Recovery Tribunal, irrespective of commencement of winding-up proceedings. Section 34 of the Debt Recovery Act has overriding effect on section 446 [now Section 279]. However, the High Court of Calcutta has held that the Debt Recovery Act does not override provisions of section 529A [now Section 326] - *State Bank of India* v. *S.M. Oil Extraction (P.) Ltd.* [1999] 21 SCL 33. Where a creditor has already instituted proceedings before the Debt Recovery Tribunal, it would not be appropriate for the company court (now Tribunal) to exercise its jurisdiction under section 433 [now Section 271] - *Bank of Nova Scotia* v. *RPG Transmission Ltd.* [2003] 42 SCL 69 (Delhi).

The Punjab and Haryana High Court in *Aar Kay Concast Ltd.* v. *Reliance Capital Ltd.* [2011] 109 SCL 5 has taken a different view and held that petition for winding up is maintainable even when precedings before DRI are pending, because the objective of winding up petition is to wind up the company for its inability to pay its debts and not recovery of the dues.

Effects of section 279 of the Companies Act and sections 20, 22 and 22A of SICA - While the matter remained with the BIFR (which ultimately recommended winding up of the company), a secured creditor sold the security and realised its claim. The sale cannot be questioned as the same took place before section 279 could become applicable. Similarly, the directorial effect of section 22A of the SICA cannot be invoked except against the company. Its effect does not extend to the creditor - *T. Rajive (M.D. - Former), Annavaram Spinning Mills Ltd.* v. *A.P. State Financial Corpn. (supra).* When affairs of a company are before the BIFR, further proceedings for winding up is to be deferred in view of section 22 of SICA - *State of Andhra Pradesh* v. *Sol Back Bay Acqua Ltd.* [2001] 33 SCL 390 (AP). A company made a reference to the BIFR under section 15 of the SICA when a petition for winding up was pending. A prayer by the company for stay on the winding up proceeding and modification of an interim order passed on the winding up petition under section 22 of the SICA was not granted as that section leaves the company judge with no discretion except to adjourn the winding up proceedings to await final decision of the BIFR - *Industrial Cables (I) Ltd.* v. *Goyal M.G. Gases Ltd.* [2002] 39 SCL 220 (Punj. & Har.).

In contrast, when a civil suit was filed against the petitioner after lapse of more than two years of the cause of action arising and well after the winding-up petition was filed and pleading that the winding-up petition itself was an attempt to delay adjudication of claims in the civil suit, the company court (now Tribunal) noticing

reply to winding up petition was common to pleadings in the civil suit, stayed the civil suit as the subject matter of the civil suit had a bearing on the winding-up proceedings - *Brown Forman Mauritius Ltd.* v. *Jagatjit Brown Forman (I) Ltd.* [2002] 39 SCL 640 (Delhi).

Consumer Forum vis-a-vis *section 279 order* - Provisions of the RBI Act or of the Companies Act are not bars against approach to Consumer Forum by depositors under section 3 of the Consumer Protection Act, 1986. However, when winding up order has been passed by the company court under section 446 [now Section 279], proceedings pending before Consumer Forum have to be stayed. If any award has been given by the Consumer Forum after order under section 446 [now Section 279] has been passed, revision petition under Article 227 of the Constitution of India is maintainable in respect of the award - *Narendra Mohan Lakhotia* v. *Pinaki Bhushan Sinha* [2004] 45 SCL 423 (Cal.). Also *see Dr. V.P. Mainra* v. *Dawsons Leasing Ltd.* [2005] 58 SCL 254 (Delhi); *Prudential Capital Markets Ltd.* v. *Dipankar Gupta* [2007] 77 SCL 8 (Delhi).

24.6-7 Statement of affairs to be filed on winding up

Section 272(4) requires filing by the company of its statement of affairs along in case the petition is filed by the company in such form and manner as may be prescribed. The statement of affairs duly certified by a chartered accountant in practice, shall state facts up to the date not more than fifteen days prior to the date of making of the statement [Rule 5 of the Draft Companies (Winding Up) Rules 2013]*. In case the petition is filed by any person other than the company and there is a *prima facie* case for winding up in the opinion of the Tribunal, it may order the company to file its objections with a statement of affairs within thirty days of the order. The Tribunal may grant an extension for a further period of thirty days in case of exigency or special circumstances [Section 274(1)].

The objection shall be submitted through an affidavit not less than five days before the date fixed for hearing. A copy of the same along with the statement of affairs is required to be served upon the petitioner and also to any contributory or creditor coming in support of the petition. A rejoinder in reply to the affidavit shall be filed not less than two days before the hearing. [Rule 5 of the Draft Companies (Winding Up) Rules 2013]*

If the company fails to file the statement of affairs as ordered by the Tribunal under section 274(1), the company shall forfeit the right to oppose the petition. The directors and other officer of the company are required under sub-section (3) to submit the books of account of the company completed and audited up to the date of the order.

Penalty for contravention- Any director or officer in default under this section (failure to file the statement of affairs or books of account) is liable to imprisonment extending to six months or fine of not less than rupees twenty five thousands but which may extend to rupees five lakhs or both.

*Not yet notified.

24.6-8 Appointment of Company Liquidator

Section 275 of the Act provides that for the purposes of winding up by the Tribunal, it is authorized to appoint an Official Liquidator or a liquidator from the panel maintained amongst the insolvency professionals registered under the Insolvency and Bankruptcy Code, 2016, as the Company Liquidator. The Tribunal is also empowered to appoint a provisional liquidator till the making of a winding up order. Within seven days of the appointment of a company liquidator or provisional liquidator, the Tribunal shall intimate to the liquidator so appointed and the Registrar [Section 277(1)].

Remuneration of Company Liquidator - The terms and conditions for the appointment of provisional liquidator or Company Official Liquidator and the remuneration payable to him shall be fixed by the Tribunal. The fees shall be specified by the Tribunal taking into consideration the task required to be performed, size of the company and experience and qualification of the liquidator [Section 275(5)]. The provisional liquidator shall have the same powers as a liquidator unless the powers are restricted by the Tribunal by an order [Section 275(3)].

Removal and Replacement of liquidator [Section 276] - The Company Liquidator shall conduct proceedings in the winding up and perform such duties in reference thereto as the Tribunal may specify. The Tribunal, however, has the power to remove any Company Liquidator or provisional liquidator on sufficient cause on the grounds of misconduct, fraud or misfeasance, professional incompetence or failure to exercise due care and diligence in performance of the powers and functions, inability to act as provisional liquidator or as the case may be, Company Liquidator or conflict of interest or lack of independence during the term of his appointment after giving a reasonable opportunity of being heard. In case of death, resignation or removal of a liquidator, the Tribunal may transfer the work to another liquidator.

Any loss caused due to fraud, misfeasance or failure to exercise due care and diligence etc. by the liquidator may be ordered to be recovered from him by the Tribunal after giving a reasonable opportunity of being heard to such liquidator. [Section 276(3) and (4)]

24.6-9 Winding up Committee

Section 277(4) requires the Company Liquidator to make an application to the Tribunal for constitution of a winding up committee to assist and monitor the progress of liquidation. The application is required to be made within three weeks from the date of winding up order. The company shall have nominee of secured creditors, a professional nominated by the Tribunal and Official Liquidator attached to the Tribunal. The Company Liquidator is the convener of the Committee. The winding up committee shall monitor the following aspects relating to liquidation proceedings:

(*i*) taking over assets;

(*ii*) examination of the statement of affairs;

(*iii*) recovery of property, cash or any other assets of the company including benefits derived therefrom;

(*iv*) review of audit reports and accounts of the Company;

(*v*) sale of assets;

(*vi*) finalisation of list of creditors and contributories;

(*vii*) compromise, abandonment and settlement of claims and payment of dividends; and

(*viii*) any other function, as the Tribunal may direct from time to time.

A monthly report along with the minutes of the meeting duly signed by the members present is required to be placed before the Tribunal by the Company Liquidator. Upon completion of the winding up the Company Liquidator shall prepare the draft final report for consideration and approval of the winding up committee and the final report approved by the winding up committee is submitted by the Company Liquidator to the Tribunal before passing of a dissolution order.

24.7 Consequences of winding up order

The consequences of the winding up order by the Tribunal are as follows:

1. The Tribunal must, as soon as the winding up order is made, (within a period not exceeding seven days from the date of passing of the order) cause intimation thereof to be sent to the Company Liquidator or provisional liquidator and the Registrar [Section 277(1)].
2. The Registrar should then make an endorsement of the order in his records relating to the company and notify in the Official Gazette that such an order has been made. The Registrar shall also inform the stock exchange(s) where the securities of the company are listed [Section 277(2)].

   A copy each of the petition, statement of affairs and affidavit, in any, in support thereof is also required to be sent along with the winding up order. The order shall in the footnote state that the person responsible are liable to submit duly completed and audited books of account to the liquidator and handover possession of the property, books or papers, cash or other assets etc. to surrender the same to the company liquidator. The Tribunal may make further orders requiring the advertisement of winding up order of service of the same. [Rule 7 of the Draft Companies (Winding Up) Rules, 2013]*.
3. The order for winding up is deemed to be a notice of discharge to the officers and employees of the company except when the business of the company is continued for the beneficial winding up of the company [Section 277(3)]. The Bombay High Court in the case of *BIFR* v. *KMA Ltd.* [2016] 66 taxmann.com 243 affirms that contract of employment comes to an end on passing of winding up order and a winding up order is a deemed notice of discharge to all employees of company-in-liquidation. The court also held that bonus is not included in category of wages under sections 325 and 326 of the Act and cannot be accorded priority.

*Not yet notified.

4. The Tribunal gets jurisdiction to entertain or dispose of any suit or proceedings or claim made by or against the company before or after the winding up order. The Tribunal also has jurisdiction over any application made under section 233 (merger and amalgamation of specified companies). Any question arising out of or in relation to winding up including those relating to priorities assets, business, actions, rights, entitlements, privileges, benefits, duties, responsibilities and obligation shall be decided by the Tribunal (Section 280).

   Once the winding-up process of company-in-liquidation has been completed by Official Liquidator and funds were distributed among stakeholders, applications filed by ex-directors seeking leave to file some kind of scheme or arrangement for revival of company was held to be sheer abuse of process of law and was dismissed with exemplary cost. [*M. Raghunath Chowdhary* v. *Mysore Tools (P.) Ltd.* [2018] 100 taxmann.com 45 (Karnataka)]

5. All actions and suits against the company except cases on appeal pending before the Supreme Court or the High Court are stayed, unless the Tribunal gives leave to continue or commence proceedings [Section 279].

   An application under section 279(1) to the Tribunal for a leave to commence or continue any suit or proceedings shall also be notified to the Company Liquidator and parties to the suit or proceedings sought to be commenced or continued. Any such application is required to be disposed of by the Tribunal within sixty days [Rule 8 of the Draft Companies (Winding Up) Rules 2013]*.

   In *Official Liquidator* v. *Dharti Dhan (P.) Ltd. ASIL* [1977] 429, the Supreme Court held that a stay order is not mandatory and a stay should not be granted if the object of applying for it appears to be merely to delay adjudication on a claim and thereby to defeat justice.

   This section is very wide in its terms and is not restricted to any category of suits or any class of plaintiff. This section is wide enough to cover all suits and other legal proceedings whoever may be the plaintiff - *Sri Murugan Oil Industries Pvt. Ltd.,* In re [1970] 40 Comp. Cas. 77 (Mad.) and *Deutsche* v. *S.P. Kala* [1990] 67 Comp. Cas. 474 (Bom.). When liquidation proceedings have commenced against the company, even the Income-tax Department cannot proceed for the recovery of taxes against the company without the leave of the court (now Tribunal) - *Haryana State* v. *Maruti Udyog Ltd.* [1992] 75 Comp. Cas. 663 (Punj. & Har.) (DB). A State Financial Corporation, being a secured creditor, was likewise debarred from taking possession of the mortgaged/hypothecated assets pursuant to section 29 of the SFC Act, 1951 without the leave of the company court (now Tribunal) when winding up proceeding has started. It was held that the SFC has to prove its claim before the liquidator [*Indian Textiles* v. *Gujarat State Financial Corpn.* [1998] 2 CLJ 155 (Bom.). However, the Supreme Court in *Board of Trustees, Port Trust of Mumbai* [1998] 2 SCALE 714 has ruled that the provisions of Major Port Trusts Act, 1963 shall prevail to enable the Port Trust to recover its dues on the seized vessel and section 446 [now Section 279] will not have operation.

*Not yet notified.

The Supreme Court ruled that the jurisdiction of the Company Court (now Tribunal) is peripheral and it cannot entertain any claim in disguise, missing the substance. However, this jurisdiction is summary and exclusive. In this case the Supreme Court explained what should the term "rectification" stand for. According to the Court the word "rectification" connotes some error which has crept in, requiring correction. 'Error', in this context means that everything as required by law has been done, yet, by some mistake, the name is either omitted or wrongly recorded in the register. In order to qualify for 'rectification' every procedure laid down by the Act has to be complied with. [*Ammonia Supplies Corpn. (P.) Ltd.* v. *Modern Plastic Container (P.) Ltd.* [1998] 4 CLJ 211 (SC)].

In *Jose Antony* v. *Official Liquidator* [1998] 18 SCL 431 (Ker.), the question of law as regards the overriding position of section 138 of the N.I. Act, 1881 over the provisions of section 446 [now Section 279] has been confirmed. (Also *See Nagarajun Finance Ltd.* v. *Kanosika Laboratories Ltd.* [1999] 20 SCL 303 (AP). This decision further held that operation of section 446 [now Section 279] is restricted to violations of the provisions of the Companies Act). According to this decision the object of these two provisions are different; section 446 [now Section 279] is intended to safeguard the assets of the company under liquidation from wasteful and expensive litigation and the objective of section 138 of the N.I. Act is to safeguard and sustain credibility of commercial transactions. The court also emphasised the point that section 138 and related provisions were incorporated as special provisions when section 446 [now Section 279] was already present. (Section 138 of the N.I. Act relates to dishonour of cheques, which has been made punishable offence). The court also held that criminal proceedings which relate to assets of the company alone will come under the ambit of section 446 [now section 279].

Leasehold property is an asset in liquidation and the position of the lessor as landlord is entertainable by the Tribunal when the liquidator tries to dispose of such property. It was held that the leasehold right, though transferable by the liquidator as a going concern, has to be transferred by adhering with the provisions of any other law that has application. In the present case the other legislation was the Rent Control Act and the Official Liquidator was restrained from alienating the property independently [*Kanubhai H. Prajapati* v. *Official Liquidator* [1998] 18 SCL 569 (Guj.)].

In *Patel Engg. Co. Ltd.* v. *Official Liquidator,* the Bombay High Court directed the Official liquidator of a company-in-liquidation to handover quiet, vacant and peaceful possession of the land held in lease by the company in liquidation, when the Official Liquidator himself admitted that the land in question was not necessary for running the affairs of the company-in-liquidation, to the landlord. This direction was issued even after taking note of the fact that the landlord had already filed a civil suit for eviction of the company-in-liquidation for non-payment of rent. The workers' union of the company concerned challenged the application of the land lord but the same was not considered proper by the court. [2004] 52 SCL 603.

6. The order operates in the interests of all the creditors and all the contributories, no matter who in fact asked for it [Section 278] - *Vide TVS Finance & Services Ltd.* v. *Orient Vision Ltd.* [2004] 55 SCL 284 (Mad.). In this case the court denied right of repossession of property to a creditor when such property is in custody of official liquidator, without adjudicating claim of all creditors.
7. The Company Liquidator or provisional liquidator as the case may be, shall take possession and control of the assets of the company once the winding up order has been made or a provisional liquidator has been appointed. All the property and effects of the company shall deem to be in the custody of the Tribunal from the date of the order for the winding up. The Tribunal may order any contributory, trustee, receiver, banker, agent, officer or other employee of the company to pay, deliver, surrender or transfer any money, property or books and papers which the company is entitled to the Company Liquidator [Section 283].
8. On the commencement of winding up, the limitation remains suspended in favour of the company till one year after the winding up order is made [Section 358]. However, the benefit of this provision is restricted to such debts which were not barred by limitation on the day the winding up petition was made - *Karnataka Steel & Wire Products* v. *Kohinoor Rolling Shutters & Engg. Works* [2002] 40 SCL 516 (SC). Also see *Kasturi & Sons Ltd.* v. *F.D. Stewart (P.) Ltd.* [2004] 54 SCL 272 (Mad.).
9. Any disposition of the property of the company including actionable claims, and any transfer of shares in the company or alteration in the status of members made after the commencement of winding up shall, unless the Tribunal otherwise orders, be void [Section 334(2)]. It should be noted that the above is not a bar to any of the acts mentioned, but acts may be declared void if the Tribunal so orders. Accordingly, a company cannot withhold payment on dishonoured cheque citing the provisions of section 536(2) [now Section 334(2)] - *Stephen Aranha* v. *Jindal Leasefin Ltd.* [2004] 50 SCL 375 (Delhi). Once a winding up order is passed, the creditors cannot claim any new right over company property. The right as it stood on the date of winding up order shall persist - *Reserve Bank of India* v. *JVG Finance Ltd.* [2012] 111 SCL 21 (Delhi).
10. Any attachment, distress or execution put in force, without leave of the Tribunal, against the estate or effects of the company after the commencement of the winding up shall be void [Section 335(1)(*a*)]. This section however shall not apply to any proceeding for the recovery of any tax or impost or any dues payable to Government [Section 335(2)]. In *Titan Industries Ltd.* v. *Punwire Mobile Communication Ltd.* [2002] 40 SCL 117 (Punj. & Har.) High Court ruled the attachment of property of the company in winding up (in the hands of provisional liquidator) by the Registrar of Co-operative Societies, without leave of the company court (now Tribunal) as void. It also ruled that if Parliament has made an enactment on a subject matter referable to 'Union

List' in the Constitution of India, same will have over riding effect in case of conflict/overlapping/repugnancy *vis-a-vis* state legislation.[25]

11. Any sale held, without leave of the Tribunal, of any of the properties or effects of the company after the commencement of winding up shall be void [Section 335(1)(*b*)]. In *Employees, Elconmet Ltd.* v. *IPICOL* [2005] 64 SCL 288 (Ori.), it has been held that sale of assets held under section 20(4) of SICA on the order of BIFR cannot be declared null and void on the ground that leave of the company court (now Tribunal) was not taken before the sale. It also held that section 441(2) of the Act [now Section 357(2)] does not apply to a case where winding up process has started on the basis of opinion of BIFR.

12. Any floating charge created within 12 months immediately preceding the commencement of winding up is void unless it is proved that the company after the creation of the charge was solvent. However, any cash advanced at the time of or subsequent to the creation of, and in consideration for, the charge together with or to any interest on that amount @ 5% p.a. or such other rate notified by the Central Government in Official Gazette shall not be invalid [Section 332].

13. An order passed by the company court (now Tribunal) allowing possession of machinery already sold on auction and handed over to the auction purchaser, to the supplier of such machinery, was held invalid as once the right of the auction purchaser has crystallised, the same cannot be allowed to be prejudiced by allowing repossession of the machinery. However, the machinery supplier is entitled to prove his claim, as unsecured creditor before the Official Liquidator [now company liquidator] - *Thomas Cook (I.) Ltd.* v. *Hindustan Thermo Print Ltd.* [2000] 24 SCL 443 (Delhi).

14. When an order of the Supreme Court required that immovable assets of the company cannot be alienated, charged or encumbered without leave of the Supreme Court and such property, be made available to discharge the debts of the company to ONGC but the company entered into a sale agreement and handed over the possession of such property to the purchaser, the act of the company was held to be violative of injunction by the Supreme Court and as such opposed to public policy. Subsequent to entering into agreement to sale, winding up process was started against the company and such assets came in the hands of the official liquidator along with the burden imposed by the Supreme Court order - *Sunil Mills Ltd.* v. *Official Liquidator of Shri Ambica Mills Ltd.* [2000] 24 SCL 455 (Guj.)[26].

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25. This position should be distinguished from the provision of Section 279 regarding stay on proceedings. The Punjab and Haryana High Court in *Punjab Scheduled Castes Land Development & Finance Corpn.* v. *Punjab Wireless Systems Ltd.* [2004] 50 SCL 478 has stated that an order of attachment of property of a company issued before the winding up order does not give rights to the decree holder to actually take possession of the property. The order of attachment protects the property from transfer or creation of a third party right.

26. Also see *Y.S. Spinners Ltd.* v. *Official Liquidator of Shri Ambica Mills Ltd.* [2000] 25 SCL 26 (Guj.).

15. Employees Provident Act, 1952 and integrity of concerns - The Karnataka High Court in *Official Liquidator of Samrat Ashoka Exports Ltd.* v. *Recovery Officer, Employees PF Commissioner* [2012] 112 SCL 642 has held that exercise of right under EPF Act, 1952 to recover PF dues of an integrated sister concern by adjusting from excess balance lying in favour of company in liquidation cannot be assailed, by resorting to section 446 [now Section 279].

24.7-1 Does Board of directors become functus officio when a company is ordered to be wound up?

Though section 277(3) of the Act provides for deeming the order for winding up to be a notice of discharge to officers and employees of the company, the Apex Court in *Rishabh Agro Industries Ltd.* v. *PNB Capital Services Ltd.* [2001] 101 Comp. Cas. 284 has held that it cannot be said that after the order of winding up and appointment of the liquidator is passed, the Board does not have the jurisdiction to move the BIFR by passing a resolution. In a winding-up petition the liquidator is appointed to protect the assets of the company for the benefit of its creditors and others. It is not the function of the official liquidator [now company liquidator] to start the process of rehabilitation of the company. Despite appointment of the official liquidator, the Board continues to hold all the residuary powers for the benefit of the company. On the issue as to whether a company in respect of which winding up order has been passed and official liquidator appointed can be allowed to be revived by the company, the Punjab and Haryana High Court in *Kundanmal Dabriwala* v. *Dabriwala Steels & Engineering Co. Ltd. (In Liquidation)* [2009] 94 SCL 336 has held that when facts support a possibility of revival, same cannot be denied.

24.7-2 Directors and Officers of the company to submit to the Tribunal audited books and accounts

Section 274(3) imposes a specific duty on the directors and officers of the company in respect of which winding up order has been passed by the Tribunal to ensure that the books of account of the company is completed and audited up to the date of the winding-up order and submit the same to the Tribunal within a period of thirty days of such order. The expenses for this will be met by the company concerned. If the directors and officers fail to perform the task, they are liable to punishment with imprisonment for a term not exceeding six months and fine for an amount not less than rupees twenty five thousand but upto rupees five lakh. Though the incidence of the duty is on all the directors and officers of the company, it is obvious that the directors generally and officers in default will be exposed to the punishment.

24.8 Submission of report by Company Liquidator [Section 281]

The Company Liquidator must submit a preliminary report to the Tribunal within sixty days from the winding up order, as to:

(*a*) the nature and details of the assets of the company including their location and value, stating separately the cash balance in hand and in the bank and the negotiable securities held by the company. For this purpose the valuation of the assets shall be obtained from registered valuers;

(*b*) amount of capital issued, subscribed and paid-up;

(*c*) the existing and contingent liabilities of the company including names, addresses and occupations of its creditors, stating separately the amount of secured and unsecured debts. In respect of secured debts details of the securities given, whether by the company or an officer thereof, their value and the dates on which they were given;

(*d*) the debts due to the company and the names, addresses and occupations of the persons from whom they are due and the amount likely to be realised on account thereof;

(*e*) guarantees extended by the company;

(*f*) list of contributories and dues payable by them and details of any unpaid call;

(*g*) details of trademarks and intellectual properties owned by the company;

(*h*) details of subsisting contracts, joint ventures and collaborations

(*i*) details of holding and subsidiary companies;

(*j*) details of legal cases filed by or against the company; and

(*k*) any other information which the Tribunal may direct or the Company Liquidator may consider necessary to include.

The preliminary report shall also include the manner of promotion and formation of the company. The Company Liquidator shall also express his opinion as to whether any fraud has been committed by any person in its promotion or formation or by any officer in relation to the company since the formation [Section 281(2)]. In addition the views of the Company Liquidator regarding the steps to be taken to maximize the value of the assets of the company and viability of the business need to be included in the report [sub-section (3)]

The report made under section 281(1) is open to inspection by any creditor or contributory or his agent and they shall also have right to take copies or extracts from the report.

Within seven days of receipt of the report, the Tribunal shall fix a date for consideration thereof. The date shall be notified to the Company Liquidator, the company and also by putting the same on the notice board/website of the Tribunal. [Rule 9 of the Draft Companies (Winding Up) Rules, 2013]*.

On the consideration of the report submitted by the Company Liquidator, the Tribunal —

(*a*) fix a time limit within which the entire winding up proceeding shall be completed. However the time limit fixed may be revised at any state of proceeding after hearing the creditors, contributories, Company Liquidator or any other interested person [Section 282(1)].

(*b*) may order sale of the company as a going concern or its assets or part thereof after hearing the Company Liquidator, creditors, contributories and any other interested person. The Tribunal may also constitute a sale committee to assist the Company Liquidator in sale. The committee may consist of such

*Not yet notified.

member representing creditors, promoters and officers of the company as the Tribunal may decide [Section 282(2)].

(*c*) may order investigation under section 210 if the report indicates that a fraud has been committed in respect of the company. Based upon the investigation report the Company Liquidator may be directed under sections 339 to 343 to file a criminal complaint against the persons who committed the fraud [Section 282(3)]

(*d*) may order to take steps to protect, preserve and enhance the value of the assets of the company or any other direction as it considers fit [Section 282(4) and (5)].

It may be noted that the preliminary report by the Company Liquidator is an important step in the winding up proceedings. The details provided would help in assessing the financial position of the company in liquidation by taking stock of its assets, liabilities and contributories, fixing the time limit of winding up and the manner of sale of the company's assets.

24.9 Promoters, directors etc. to cooperate with the Company Liquidator (Section 284)

Section 284 casts a positive duty on the promoters, directors and employees, both present and past, to extend full cooperation to the Company Liquidator. Any failure will make the person in default punishable with imprisonment extending to six months or fine up to rupees fifty thousand or with both.

24.10 Advisory Committee [Section 287]

Section 287 provides that the Tribunal may, at the time of making an order for the winding up of a company or at any time thereafter, direct that there shall be appointed an advisory committee to act with the Company Liquidator and to report to the Tribunal on such matters as the Tribunal may direct. However, it is not obligatory for the Tribunal to make such order. The maximum number of members on the committee is twelve; being creditors and contributories in such proportion as the Tribunal may determine.

Where a direction is given by the Tribunal as aforesaid, the Company Liquidator shall, within two months from the date of such direction, convene a meeting of the creditors and contributories of the company (as ascertained from its books and documents) for the purpose of determining who are to be members of the committee.

The advisory committee shall have the right to inspect the books of account and other documents, assets and properties of the company under liquidation at reasonable time.

The Company Liquidator shall chair the meeting of the advisory committee.

24.10-1 Constitution and proceedings of Advisory Committee

Rule 11 of the Draft Companies (Winding Up) Rules, 2013* provides for the constitution and proceedings of Advisory Committee. The provisions are as follows:

*Not yet notified.

(*i*) *Membership* - The Advisory Committee would consist of not more than 12 members. How many of them will be from creditors and how many from contributories will be determined by the Tribunal, in case they themselves fail to determine the proportion. The meeting shall be convened by the Company Liquidator.

Within seven days of the meeting, the Company Liquidator shall inform the result of the meeting to the Tribunal.

(*ii*) *Right to inspect accounts of the liquidator* - The Committee shall have the right to inspect the accounts of the liquidator at all reasonable times.

(*iii*) *Frequency of meetings* - The Committee shall meet at such times as it may from time to time appoint, and the Company Liquidator or any member of the Committee may also call a meeting of the Committee as and when he thinks necessary.

(*iv*) *Quorum* - The quorum for a meeting of the committee shall be one-third of the total number of the members, or two, whichever is higher.

(*v*) *Rule of majority* - The Committee may act by a majority of its members present at a meeting, but shall not act unless a quorum is present.

(*vi*) *Resignation by members* - A member of the Committee may resign by notice in writing signed by him and delivered to the Company Liquidator.

(*vii*) *Office falling vacant* - If a member of the Committee is adjudged an insolvent, or compounds or arranges with his creditors, or is absent from five consecutive meetings of the committee without the leave of those members who, together with himself, represent the creditors or contributories, as the case may be, his office shall become vacant.

(*viii*) *Removal of a member* - A member of the Committee may be removed at a meeting of creditors if he represents creditors, or at a meeting of contributories if he represents contributories, by an ordinary resolution of which seven days' notice has been given stating the object of the meeting.

(*ix*) *Filling of vacancy* - On a vacancy occurring in the Committee, the Company Liquidator shall forthwith summon a meeting of creditors or of contributories, as the case may require, within seven days to fill the vacancy; and the meeting may, by resolution, reappoint the same, or appoint another, creditor or contributory to fill the vacancy.

However, if the Company Liquidator, having regard to the position in the winding up, is of the opinion that it is unnecessary for the vacancy to be filled, he may apply to the Tribunal and the Tribunal may make an order that the vacancy shall not be filled, or shall not be filled except in such circumstances as may be specified in the order.

The continuing members of the Committee, if not less than two, may act notwithstanding any vacancy in the Committee.

(*x*) *Dealing with company's assets* - The Company Liquidator or any member of the Committee shall not buy the assets of the company, either directly or indirectly except with the leave of the Tribunal. Any such purchase may be set aside by the Tribunal.

(*xi*) *Fiduciary position of the members* - A member of the Committee stands in a fiduciary relationship *vis-a-vis* the company/creditors and the contributories. Benami purchase of properties by a member of the Committee was, therefore, held to be bad - *Durga Prasad* v. *Official Liquidator, Benaras Bank Ltd.* AIR 1959 All. 196.

24.11 General Powers of Tribunal in case of winding up by Tribunal

24.11-1 Settlement of list of contributories [Section 285]

The Tribunal has the power to cause the assets of the company to be collected and applied in discharge of its liabilities. For this purpose, the Tribunal has the power to settle a list of such shareholders (called 'contributories') as are liable to contribute to the assets of the company.

In settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others [Section 285(2)].

It may be noted that sub-section (2) makes it incumbent on the Tribunal to make a distinction between contributories who are so on their own right and those who should be deemed to be so by reason of being the real persons who had put the name of others to conceal their identity and consequent liability.

Thus, where shares had been purchased in the name of the minors, the court (now Tribunal) shall be entitled to put the name of real purchaser on the list of contributories - *K.L. Goenka* v. *S.R. Majumdar* [1958] 28 Comp. Cas. 536 (Assam).

The Tribunal is, therefore, empowered under sub-section (1) to rectify the register of members. However, while rectifying the register of members, the Tribunal will take into consideration if the transferor had been guilty of any lapses. Where the Tribunal is satisfied that the transferor and the transferee had done all that they were required to do, the Tribunal will certainly rectify the register. Where, however, the transferor was at fault, his name would still appear in the register of members and he will be put on the list of contributories - *Darjeeling Bank Ltd.,* In re AIR 1959 Cal. 355/[1960] 30 Comp. Cas. 50 (Cal.).

Limitation Act: Will the law of limitation apply to a person who is deemed to be the real contributory? The court in *Art Reproduction Co. Ltd.,* In re [1951] 2 All ER 984, held that the law of limitation will apply.

24.11-2 Delivery of property to Company Liquidator [Section 283]

If any contributory, trustee, receiver, banker, agent, officer or other employee of the company is in possession of any money, property, books or papers of the company, the Tribunal may require him to deliver the same to the Company Liquidator. The purpose is to provide a summary procedure for quick collection of the company's assets avoiding expensive and dilatory litigation. Hence, the Court (now Tribunal) can in its discretion order restoration of the company's property on the basis of evidence showing *prima facie* title and need not embark into detailed enquiry - *Bala Financiers (P.) Ltd.* v. *Ujjar Singh* [1989] 65 Comp. Cas. 651, 653 (Punj. & Har.).

The Tribunal may also summon before it any officer of the company or person known or suspected to have in his possession any such property or books or papers of the company, or known or suspected to be indebted to the company or any person whom the Tribunal deems capable of giving information concerning the promotion, formation, trade, property or books or papers or other affairs of the company [Section 299(1)]. Any such person may be examined on oath orally or in writing. His oral statements may be reduced to writing and require him to sign them [Section 299(2)]. The Tribunal may also require him to produce any books and papers in his custody relating to the company. If he claims any lien on them, the production shall be without prejudice to the lien and the Tribunal shall have the power to decide the question [Section 299(3)]. The Tribunal may direct to the liquidator to file a statement detailing debt or property in possession of other persons [Section 299(4)].

Under section 299(5) the Tribunal has the power to a person indebted to the company to direct him to pay the amount indebted or any part thereof to the liquidator either in full or partial discharge. Similarly any person found to be in possession of company's property may be ordered by the Tribunal to deliver the same to the liquidator. Any order under section 299(5) for the payment of amount due or delivery of property shall be executed in the same manner as decrees under the Code of Civil Procedure, 1980 [Section 299(7)]. After having made the payment or delivered the property, the person shall stand discharged from all liability in respect of such debt or property.

24.11-3 Set off [Section 295]

Where, apart from his liability as a shareholder, any other money is due from a contributory to the company, the Tribunal may order him to pay the same. Suppose the company also owes some money to such a contributory, does he have the right to claim that the two debts should be mutually set off? Not in all cases, but a limited right to set off is given by the Act in the following cases:

(*i*) In the case of an unlimited company, a contributory may set off his debt against any money due to him or to the estate which he represents from the company on any independent dealing or contract with the company. But no set off is allowed for any money due to him as a member of the company in respect of any dividend or profit.

(*ii*) If, in the case of a limited company, there is any director, or manager whose liability is unlimited, he shall have the same right to set off or his estate, as is described in point (*i*) above.

(*iii*) In the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due on any account whatsoever to a contributory from the company may be allowed to him by way of set off against any subsequent call.

It may be noted the Tribunal may permit the above set off while making an order.

24.11-4 Power to make calls [Section 296]

The Tribunal may, at any time after making a winding up order, and either before or after it has ascertained the sufficiency of the assets of the company—

(*a*) make calls on all or any of the contributories for the time being on the list of the contributories, to the extent of their liability, for payment of any money which the Tribunal considers necessary to satisfy the debts and liabilities of the company, and the costs, charges and expenses of winding up, and for the adjustment of the rights of the contributories among themselves; and

(*b*) make an order for payment of any calls so made.

In making a call, the Tribunal may take into consideration the probability that some of the contributories may, partly or wholly, fail to pay the call.

24.11-5 Power to adjust Rights of Contributories [Section 297]

The Tribunal shall adjust the rights of the contributories among themselves, and distribute any surplus among the persons entitled thereto. While adjusting the right of contributories, the Tribunal will certainly take into consideration their *inter se* rights. This will be decided on the basis of provisions contained in the memorandum and articles of association.

In *Wakefield Rolling Stock Co.*, In re [1892] 3 Ch. 165, it was held that in distributing the paid-up capital, any money paid in advance of call must first be paid.

24.11-6 Power to order costs [Section 298]

The Tribunal may, in the event of the assets being insufficient to satisfy the liabilities, make an order for the payment out of the assets, of the costs, charges and expenses incurred in the winding up, in such order of priority *inter se,* as the Tribunal thinks just.

24.11-7 Power to Order Public Examination of Promoters, Directors, etc. [Section 300]

Where the Company Liquidator has made a report to the Tribunal stating that in his opinion a fraud has been committed by any person in the promotion or formation of the company, or by any officer of the company since its formation, the Tribunal may direct that the person or officer may appear before the Tribunal and be publicly examined.

The Calcutta High Court in *Lohar Valley Tea Co. Ltd.*, In re [1964] 2 Comp. L.J. 10 has laid down the necessary conditions for exercising the power to order public examination. These are:

1. that the Official Liquidator (now Company Liquidator) has made a further report;
2. that such report contains a finding of fraud;
3. the finding of fraud must be against the person whose examination is sought;
4. the individual must be one who has taken part in the promotion or formation of the company or who has been an officer of the company.

It may be noted that the Official Liquidator (now Company Liquidator) must plead for examination of specific person and the Court (now Tribunal) will not allow examination of all persons mentioned under section 478 [now Section 300] - *Official Liquidator* v. *Krishna Kamath* [1959] 29 Comp. Cas. 171 (Ker.).

However, where a director was not charged with fraud in the liquidator's report, but he filed an affidavit assuming responsibility for the act constituting the fraud, the Court (now Tribunal) ordered him to stand public examination.[27]

Any person charged for public examination may apply to the Tribunal to be exculpated from any charges made or suggested against him. In such a case, it shall be the duty of the Company Liquidator to appear on the hearing of the application and call the attention of the Tribunal to any matters which appear to him to be relevant [Section 300(5)].

24.11-8 Power to arrest absconding person [Section 301]

After making a winding up order and on proof of a probable cause to believe that a contributory or a person having property, accounts or papers of the company, in order to evade payment of calls or to avoid examination respecting the affairs of the company, is about to quit India or otherwise to abscond or to conceal his books or property, the Tribunal may order his arrest and detention until such time as is necessary, or the seizure of his books, papers or movable property until such time as may be necessary.

24.11-9 Power to modify the terms and conditions after confirmation of sale of properties

In *T. Velusamy* v. *Official Liquidator* [1997] 4 CLJ 82 (Mad.) it was held that though, the terms and conditions of the tender for sale were approved by the court, it does not preclude the Court (now Tribunal) from exercising discretionary powers to modify the same afterwards taking into account the facts and circumstances of the case. However, this power to modify the terms and conditions of sale does not extend to grant of leasehold rights to a tenant of a godown, already sold in court auction to the respondent - *New Tobacco Co. Ltd.* v. *R.D.B. Industries* [2000] 23 SCL 271, (Cal.). In this case, the godown belonged to a company under liquidation. The godown was auctioned under court's order.

24.12 Dissolution of company [Section 302]

When the affairs of a company have been completely wound up, the Company Liquidator shall make an application to the Tribunal for dissolution of the company.

In *Raj Kumar Sood* v. *Sood Tech. (P.) Ltd.* [2012] 24 taxmann.com 329 (Delhi), all claims of company (In liquidation) had been settled and no other assets were available for further realization and no useful purpose would have been served in continuing with winding-up process, it was held that the Official Liquidator (now Company Liquidator) be discharged and company be dissolved under section 481 [now Section 302].

Upon receipt of the report from the Company Liquidator or otherwise, the Tribunal on forming an opinion that it is just and reasonable to order dissolution, shall make an order for dissolution of the company. The company shall be dissolved effective from the date of the order [Section 302(2)].

27. *Central Tipperah Tec Co. Ltd.*, In re [1996] 2 Comp. LJ 82 (Cal.).

Within 30 days, the Company Liquidator should file a copy of the order with the ROC who shall make in his books a minute of the dissolution of the company. Failure to file a copy of the order of the Tribunal, as aforesaid, renders the Company Liquidator punishable with fine which may extend to rupees five thousand for every day during which the default continues.

24.12-1 Effect of order of dissolution

The company under liquidation continues to exist as a juristic personality until an order under this section dissolving the company is made by the Tribunal. It is only thereafter that the company can be said to have become non-existent in the eye of law.

When the company is dissolved, no suit or proceeding will lie against the company. This is because a dissolved company has no legal existence - *Pinto Silver Mining Co.,* In re [1878] 8 Ch. D 273, and *Whiteley Exerciser* v. *Gamage* [1898] 2 Ch. 405. The proper course to follow in such a case for a person who wants to proceed against a dissolved company is to make an application for setting aside the order of dissolution under section 559 [now section 356] - *London & Caledonian Marine Insurance Co.,* In re [1971] 11 Ch. D 140 and *Pinto Silver Mining Co.'s* case (*supra*).

Even a suit for recovery of money due to the dissolved company would not lie - *Coxon* v. *Gorst* [1891] 2 Ch. 73. Even misfeasance proceedings would abate on the dissolution of the company - *Lewis & Smart Ltd.,* In re [1954] 2 All ER 19.

24.13 Enforcement of and appeal from orders

24.13-1 Enforcement of Orders [Section 424(3)]

Any order made by a Tribunal may be enforced by the Tribunal in the same manner as if it were a decree made by a court in suit pending therein. For execution of the order, the Tribunal shall send the same to the court within the local limits of whose jurisdiction the registered office of the company is situated. If the order is against any other person, it shall be sent to the court considering the place of residence or work or business of the person concerned.

24.13-2 Appeals from Orders [Section 421]

An appeal against the order of the Tribunal lies before the Appellate Tribunal. However if the order was made by the Tribunal with the consent of the parties, no appeal is allowed [Section 421(2)]. Within forty five days of the order being made available to the person aggrieved an appeal can be made. The Appellate Tribunal however is empowered to entertain an appeal within an extended period of another forty-five days if sufficient cause is shown by the appellant for not filing the appeal within forty five days. The Appellate Tribunal after giving reasonable opportunity of being heard to the parties to the appeal, may confirm, modify or set aside the order of the Tribunal. A copy of the order is sent by the Appellate Tribunal to the Tribunal and parties to appeal.

Where a company judge (now Tribunal) rejected an application for inspection and production of certain documents on the ground that the petitioner creditor first had to prove certain facts, an appeal under section 483 [now Section 421] can be entertained against the order - *Horst Kurves GMBH* v. *Essar Oil Mills Ltd.* [2002] 39

SCL 288 (Guj.). In *U.P. Cement Vetanbhogi Sahkari Rin Samity Ltd.* v. *Official Liquidator*, the Allahabad High Court decided that an appeal, in the instant case is not maintainable in view of Rule 164 of the 1959 Rules and recently introduced section 100A in the Civil Procedure Code of 1908 - [2010] 97 SCL 196.

When a judge (now Tribunal) made adverse observations against the official liquidator (now Company Liquidator), without giving him an opportunity to explain his conduct, it affected the civil rights, especially when the case is not one where the court can invoke the technique of post-decisional hearing - *P.M. Subbarayulu* v. *Sri Ambuja Petro Chemicals Ltd.* [2002] 39 SCL 936 (AP).

24.14 Summary procedure for Liquidation [Section 361]

Section 361 prescribes a simpler process for winding up companies having assets of book value not exceeding rupees one crore of such other class of companies as may be prescribed. Rule 39 of the Draft Companies (Winding Up) Rules, 2013* makes this section applicable to One Person Company and Small Company. A company covered by section 361(1) may be ordered by the Central Government to be wound up using the summary procedure.

24.14-1 Appointment of Liquidator

For the summary procedure the Official Liquidator shall be appointed by the Central Government as the liquidator of the company. It may be noted that unlike the winding up by the Tribunal or voluntary winding, in a summary procedure the Official Liquidator only acts as the liquidator. The Official Liquidator shall take into his custody all assets, effects and actionable claims belonging to the company. [Sec 361(3)]

24.14-2 Report by the Official Liquidator

Within thirty days of his appointment, the Official Liquidator is required to submit a report to the Central Government with his opinion as to whether any fraud has been committed in promotion, formation or management of the affairs of the company or not. The Central Government, after further investigation as it may direct, may order the winding up to be proceeded under Part I (i.e. by the Tribunal). [Sec. 361(4)]

24.14-3 Realization of assets and payment of liabilities by the Official Liquidator

The Official Liquidator is required to serve a notice to the debtors or contributories of the company within thirty days of his appointment to pay the amount payable to the company within the next thirty days. He shall dispose of all the assets within sixty days of his appointment [Section 362]. Likewise all the creditors of the company are asked by the Official Liquidator within thirty days of his appointment to prove their claims within next thirty days. The Official Liquidator will prepare a list of claims clearly indicating the claims accepted or rejected citing the reasons for the same. Any creditor aggrieved by the decision may appeal to the Central Government within thirty days of decision. The Central Government after consulting the Official Liquidator may dismiss the appeal or modify the order of the Official Liquidator.

*Not yet notified.

All the claims accepted by the Official Liquidator shall be paid [Sections 363 and 364].

Under section 364(4) the Central Government is authorized to refer the matter to the Tribunal for necessary order at any stage during settlement of claims.

24.14-4 Dissolution of the Company

Once the affairs of the company are fully wound up the Official Liquidator shall submit a final report to the Central Government. The report is also required to be submitted to the Tribunal if any reference to it was made under section 364(4). On the basis of the report, the Central Government shall order dissolution of the company and the Registrar shall strike off the name of the company from the register of companies and publish a notification to this effect.

24.15 Liquidators

The commencement of winding up of a company does not put an end to the existence of the company. Its assets are to be realised and distributed among the debenture-holders, creditors, shareholders etc. For the purpose, somebody has to act as an agent of the company. Such agent is called liquidator.

Rules relating to their appointment, rights, powers and duties can be discussed under the following heads:

1. In winding up by the Tribunal.
2. In summary procedure for winding up.

24.16 Liquidators in winding up by the Tribunal

24.16-1 Provisional Liquidator

The Tribunal before which the winding up petition has been made, at its discretion, can appoint a provisional liquidator, before the winding up order is made. Before making appointment of the Provisional Liquidator, notice shall be issued to the company and reasonable opportunity shall be given to it to make representation, if any. The Tribunal may not issue the notice if special reasons exist to that effect but it will then record the special reasons in writing. [Section 273(1)(c)]. The objective of appointment of the provisional liquidator is to safeguard the assets of the company till Company Liquidator is appointed. Ordinarily, the provisional liquidator shall possess all the powers of a liquidator unless the Tribunal imposes restrictions/limitations on exercise of such powers by the provisional liquidator [Section 275(3)]. The Punjab and Haryana High Court in *Marigold Leasing (P.) Ltd.* v. *Shashi Bhushan* [2009] 90 SCL 229 allowed the provisional liquidator to sell property not only of the company concerned but also assets belonging to others but obtained with funds of the company lying in the company premise.

Under Rule 6 of the Draft Companies (Winding Up) Rules, 2013* a provisional liquidator may be asked by the Tribunal to furnish such security as it may direct at his own cost. All other costs, charges and expenses incurred by the provisional liquidator shall be paid out of the assets of the company.

*Not yet notified.

In the case of *Madura Coats Ltd.* v. *Dunlop India Ltd.* [2012] 112 SCL 765, the Calcutta High Court had appointed the Provisional Liquidator to safeguard the company assets. The respondent company's history in this regard appeared to be thoroughly *mala fide*. It first went to BIFR and at that stage the company petition for winding up of respondent was turned down in view of section 22(1) of the SICA, 1985. In the meanwhile, the controlling interest in the respondent changed hands and thereafter taking the advantage of SICA protection, the respondent started alienating its assets to entities close to the management at negligible consideration. The petitioner then sought permission from AAIFR constituted under SICA to file recovery suit against respondent for its claim exceeding Rs. 2.03 crore. At this stage the respondent revalued its assets to show an improved net worth to come out of BIFR. The respondents' plea to get deregistered from purview of BIFR was declined by AAIFR but the Madras High Court overturned it. The respondent did not make any payment to creditors or employee salary with whatever resources it had. Petitioner, then made again a petition for winding-up and the High Court allowed the petition and ordered appointment of Provisional Liquidator as the case was found fit for winding up as also for fraudulent management of the respondent company.

24.16-2 Appointment, removal and resignation of Company Liquidator

See para 24.6-8.

24.16-3 Advisory Committee to act with Company Liquidator

See para 24.10.

24.16-4 Powers and Duties of Company Liquidator in winding up by the Tribunal [Section 290]

The Company Liquidator can exercise certain powers subject to the directions and overall control of the Tribunal. The Tribunal may require the Company Liquidator to perform any other duty. The powers of the Company Liquidator as specified in section 290(1) are reproduced below:

(*a*) to carry on the business of the company so far as may be necessary for the beneficial winding up of the company;

(*b*) to do all acts and to execute, in the name and on behalf of the company, all deeds, receipts and other documents, and for that purpose, to use, when necessary, the company's seal;

(*c*) to sell the immovable and movable property and actionable claims of the company by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels;

(*d*) to sell the whole of the undertaking of the company as a going concern;

(*e*) to raise any money required on the security of the assets of the company;

(*f*) to institute or defend any suit, prosecution or other legal proceeding, civil or criminal, in the name and on behalf of the company;

(*g*) to invite and settle claim of creditors, employees or any other claimant and distribute sale proceeds in accordance with priorities established under this Act;

(*h*) to inspect the records and returns of the company on the files of the Registrar or any other authority;

(*i*) to prove rank and claim in the insolvency of any contributory for any balance against his estate, and to receive dividends in the insolvency, in respect of that balance, as a separate debt due from the insolvent, and rateably with the other separate creditors;

(*j*) to draw, accept, make and endorse any negotiable instruments including cheque, bill of exchange, hundi or promissory note in the name and on behalf of the company, with the same effect with respect to the liability of the company as if such instruments had been drawn, accepted, made or endorsed by or on behalf of the company in the course of its business;

(*k*) to take out, in his official name, letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot be conveniently done in the name of the company, and in all such cases, the money due shall, for the purpose of enabling the Company Liquidator to take out the letters of administration or recover the money, be deemed to be due to the Company Liquidator himself;

(*l*) to obtain any professional assistance from any person or appoint any professional, in discharge of his duties, obligations and responsibilities and for protection of the assets of the company, appoint an agent to do any business which the Company Liquidator is unable to do himself;

(*m*) to take all such actions, steps, or to sign, execute and verify any paper, deed, document, application, petition, affidavit, bond or instrument as may be necessary (*i*) for winding up of the company; (*ii*) for distribution of assets; (*iii*) in discharge of his duties and obligations and functions as Company Liquidator; and

(*n*) to apply to the Tribunal for such orders or directions as may be necessary for the winding up of the company.

Rule 17 of the Draft Companies (Winding Up) Rules, 2013* provides that for the purpose of acquiring and retaining possession of company's property, company liquidator shall be treated as the receiver of the property and the Tribunal may on his application enforce such acquisition or retention.

In *Kamani Tubes Ltd.* v. *Official Liquidator and Liquidator, Kamani Bros. (P.) Ltd. and Another* [1997] 4 CLJ 410 (Bom.), on the question of whether the Official Liquidator can sub-lease the premises of the company during winding up proceedings, the court answered that the arrangement contemplated by the Official Liquidator (now Company Liquidator) does not come under the purview of section 457 [now section 290]. As the business of the company has come to a standstill, entering into a caretaker's agreement is one of the ways of parting with the possession of the leased premises. The court held that the lessor (*i.e.,* the landlord) will be entitled to the premises if the O.L. does not require the same for the purpose of winding up of the company. In the instant case, the O.L. published an announcement in a local newspaper inviting offers to take over the leased premises on a

*Not yet notified.

caretaker basis. Also *see Saraswati Cooperative Bank Ltd.* v. *Chandrakanta Maganlal Shah* [2002] 35 SCL 410 (Bom.) and *Shivkaran Buhadia* v. *Official Liquidator* [2006] 67 SCL 349 (Raj.)

In *Model Financial Corpn.* v. *Montana International Ltd.* [2000] 28 SCL 153 (AP) the liquidator was ordered to handover possession of equipments purchased under hire - purchase terms, to the hire-seller who retained the ownership of the equipments till full payment has been received, when the respondent failed to make payment of the hire-purchase instalment. In this case a charge was created and registered in the name of the hire-seller. Also *see Gujarat Lease Financing Ltd.* v. *O.L. of Aryan Fine Fab Ltd.* [2004] 50 SCL 757 (Guj.). In *State of Gujarat* v. *Official Liquidator of GSTC Ltd.* [2008] 84 SCL 457 (Guj.), the Official Liquidator was ordered to handover the possession of the land to the State Government, which was the only shareholder and contributory of the company concerned as also the secured creditor when the State Government had met the outside liabilities including the outstandings payable to employees. In *TCI Distribution Centres Ltd.* v. *Official Liquidator,* the Madras High Court annulled the sale of a piece of land by the Official Liquidator and confirmed by the Court on 'as is where is' basis as the Official Liquidator sold the land in respect of which the company concerned did not appear to have title, as no title bearing paper of substance could be made available to the buyer. The 'as is where is' clause in sale offer document cannot cover a property, the ownership of which could not be proved to belong to the company by reference to title deed - [2011] 106 SCL 19.

Sealing of property by Company Liquidator - O.L. was ordered by the court to give vacant possession of the property as at the time of admission of the winding up petition. The concerned property was sub-tenanted by the company concerned to one of its sister concerns with the consent of the owner of the property. Occupation of the property by a sub-tenant does not amount to occupation by the tenant company (in the process of winding up) and the property in question was not in fact needed by the official liquidator (now Company Liquidator) for his purposes. The vacant possession was given to the sub-tenant while the prayer of the owner was turned down - *Vinayak M. Deshpande* v. *Official Liquidator, Ecoline Development Engineers Ltd.* [2001] 22 SCL 292 (Bom.). In *Sarigam Containers (P.) Ltd.* v. *Magatul Industries Ltd.* [2009] 90 SCL 321, the Bombay High Court ordered transfer back of company property given on lease after the winding up process started when such leasing out was not for the sake of revival of the company. The lessee was not entitled to retain the possession of the property as it seemed to be an arrangement not in the interest of the company.

In *Remu Pipes Ltd. (In Liquidation)* v. *IFCI* [2002] 35 SCL 358, it has been held by the A.P. High Court that the power of the liquidator (now Company Liquidator) under section 457 [now section 290] including the power to sell immovable property can be exercised only with the sanction of the court (now Tribunal). Property of a company being wound up is deemed to be vested in the court (now Tribunal) and the court has all the powers to issue necessary directions to subserve the interest of the creditors.

The Karnataka High Court in *Gromax Papers & Boards Ltd. [now Company Liquidator]* v. *Ramgopal Paper Mills Ltd.* [2005] 58 SCL 281 has held that the official liquidator (now company liquidator) does not have the power to give assurance to

buyer of the property of the company in liquidation, that any liability concerning the property being sold, will be paid from the sale proceeds of the property which was the security of the secured creditor concerned.

The A.P. High Court in *Haryana and Steel Centre* v. *Lakshmi Porcelains Ltd.* [2004] 50 SCL 669 has held that when significantly higher bid is made subsequent to original bidding, the court (now Tribunal) has to consider whether to confirm the sale on the basis of original biddings or to order resale to the party offering the higher sum, based on facts and circumstances of the case.

The same High Court, in *Vaishu Engineering Industries Ltd.* v. *A.P. Industrial Development Corporation* [2008] 81 SCL 368 has disallowed interference by the Official Liquidator (now Company Liquidator) in respect of properties of the company, auction purchased, *bona fide* by a party, which had no notice of pendency of the winding up proceedings, specially for liquidator's unreasonable delay to act in the matter and having regard to huge investment made by the party on such properties for improvement.

Exercise and control of Company Liquidator's powers [Section 292]- The Company Liquidator shall, in the administration of the assets of the company and the distribution thereof among creditors, have regard to any directions which may be given by resolution of the creditors or contributories at any general meeting or by the advisory committee. Any directions given by the creditors or contributories at any general meeting shall, in the case of conflict, be deemed to override any directions given by the advisory committee.

The Company Liquidator may summon general meetings of the creditors or contributories, whenever he thinks fit, for the purpose of ascertaining their wishes. He shall summon such meetings at such times as the creditors or contributories may, by resolution, direct, or whenever requested in writing to do so by not less than one-tenth in value of the creditors or contributories, as the case may be.

Subject to the provisions of the Act, the liquidator shall use his own discretion in the administration of the assets of the company and in the distribution thereof among the creditors.

A Liquidator, if circumstances justify, may be charged for theft of company property - *O.L. of Ahmedabad Mfg. & Calico Print Mills Co. Ltd.*, In re [2006] 67 SCL 306 (Guj.).

Any person aggrieved by any act or decision of the Company Liquidator may apply to the Tribunal, and the Tribunal may confirm, reverse or modify the act or decision complained of, and make such further order as it thinks just in the circumstances.

24.16-5 Duties of Company Liquidator in winding up by the Tribunal

The principal duties of a Company Liquidator may be summarised as follows:

1. He must conduct equitably and impartially all proceedings in the winding up according to the provisions of the law, and must perform such duties in reference thereto as the Tribunal may impose.
2. He must bring into his custody and control the property of the company [Section 283]. Supreme Court of *Indian Official Liquidator, U.P. & Uttarakhand* v. *Allahabad Bank* [2013] 31 taxmann.com 150 held that Company Judge

under Companies Act has no jurisdiction at instance of Official Liquidator to set aside auction or sale held by Recovery Officer under RDB Act.

3. He must submit a preliminary report to the Tribunal within sixty days from the winding up order.
4. Within thirty days from the date of the direction of the Tribunal, the Company Liquidator must call a meeting of the creditors and contributories for determining the persons who are to be members of the Advisory Committee, if such committee is to be appointed. The Company Liquidator shall chair the Advisory Committee [Section 287(3)].
5. He must keep all sums received by him, on behalf of the company into some scheduled bank, unless the Tribunal otherwise allows deposit in a non-scheduled bank [Section 350].

   Rule 32 of the Draft Companies (Winding Up) Rules, 2013* requires the money to be credited to a special account with the State Bank of India or any other nationalized bank. Petty cash of rupees five thousand may be kept to meet day to day expenses. Any bills, hundies, notes and other securities shall be deposited by the Company Liquidator in the bank. Any surplus money not immediately required by the company shall be invested in Government Securities or interest bearing deposits in the State Bank of India or any other nationalized bank [Rule 33 of the Draft Companies (Winding Up) Rules, 2013]*
6. The Company Liquidator shall keep, in the manner prescribed, proper books in which he shall cause entries or minutes to be made of proceedings at meetings and of such other matters as may be prescribed. Subject to the control of the Tribunal, any creditor or contributory may inspect any such books personally or by his agent [Section 293].

   Rule 20 of the Draft Companies (Winding Up) Rules, 2013* prescribes the books to be maintained by the Company Liquidator. The Company Liquidator is also under obligation to get the accounts of the company complete and bring them up to date. If he is also authorized to carry on the business of the company, separate books of account shall be maintained in respect of the business in conformity with the books usually kept by the company.
7. He must, at least twice in each year, present to the Tribunal an account of his receipts and payments as Company Liquidator. The account must be in the prescribed form and must be made in duplicate and verified by a declaration. The Tribunal gets the account audited, keeps one copy thereof in its records and delivers the other copy to the Registrar for filing. For the purpose of audit, the Company Liquidator shall provide vouchers and other information as may be needed. Each copy shall, however, be open to the inspection of any creditor, contributory or person interested. The Company Liquidator must also send a printed copy of the accounts so audited or a summary thereof by post to every creditor and to every contributory unless the Tribunal orders otherwise. In the case of a Government company, a copy of the audited accounts of the Company Liquidator shall be sent to the

*Not yet notified.

concerned Central or State Government or to both where both are concerned [Section 294].

Rule 20 of the Draft Companies (Winding Up) Rules, 2013* requires the accounts made up to the 31st March and 30th September shall be filed within the next three months (*i.e.* 30th June and 31st December respectively). However the final account shall be filed as soon as possible.

24.17 Liquidator in Summary Procedure

The official liquidators are whole-time officers of the Central Government. The Central Government may appoint as many Official Liquidators, Joint, Deputy or Assistant Official Liquidators as it may consider necessary for discharging the functions of Official Liquidator as it relates to the winding up of companies [Section 359].

24.17-1 Powers and Function of Official Liquidator [Section 360]

The power and duties of an Official Liquidator are prescribed by the Central Government. The Official Liquidator may exercise all the powers of a Company Liquidator under the provisions of this Act. In addition, he may conduct inquiries and investigation as ordered by the Central Government or the Tribunal on matters arising out of winding up proceedings.

24.17-2 Official Liquidator in a summary procedure [Section 361 to section 365]

See para 24.24.

24.18 Provisions applicable to every mode of winding up

The provisions contained in sections 324 to 358, both inclusive, shall apply to every mode of winding up.

24.19 Debts of all descriptions to be admitted to proof [Section 324]

In every winding-up (except in the case of insolvent companies), all debts payable on a contingency and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company; a just estimate being made, so far as possible, of the value of such debts or claims as may be subject to any contingency, or may sound only in damages, or for some other reason may not bear a certain value.

It may thus be noted that the provisions of section 324 which are applicable to all modes of winding-up are quite wide. All debts are admissible, be they certain, or contingent, ascertained or sounding only in damages. What is only required is that a just estimate is made of the debt, where it is not possible to arrive at a certain value of a debt. It may, however, be noted that the provisions of this section can be applied only where the company is solvent. In the case of an insolvent company, the provisions of section 325 become applicable. Under section 325, in the winding-up

*Not yet notified.

of an insolvent company the same rules shall prevail and be observed as are in force for the time being under the law of insolvency with respect to the estates of persons adjudged insolvent. However, in every case of claim, proof in support of the claim must be produced. A claim lodged with the Official Liquidator [now company liquidator] in respect of alleged unpaid deposit without the deposit receipt or any other proof is liable to rejection [*V. Srinivasan* v. *Official Liquidator of Fuel Injection Ltd.* [1999] 19 SCL 80 (Bom.)].

A secured creditor who is no party to the winding up petition. On a reference made by the BIFR appointed under SICA, a company judge ordered the company to be wound up and directed the appellant petitioner who is a secured creditor with power to takeover and sell assets to realise its dues to make deposit towards preliminary expenses and advertise the order of winding up. The appellant was indeed not a party to the winding up reference. The High Court, while allowing the appeal held that proviso to section 529(2) [now section 325] cannot be invoked to require the petitioner to pay for cost as it was not a party to the reference for winding up and the BIFR for all practical purposes was the petitioner for winding up - *Chairman & Managing Director, A.P. State Financial Corporation* v. *Chairman & Managing Director, Southern Transformers & Electricals Ltd.* [2000] 26 SCL 4 (AP).

It is incumbent on all secured creditors to notify their claim to the Official Liquidators. If it is not so done, the claim gets nullified - *ICICI Bank Ltd.* v. *Shivmoni Steel Tubes Ltd.* [2005] 62 SCL 421 (Kar.).

It is interesting to note that assets possessed by a company provided to it by a bank under hire-purchase agreement, remain as the assets of the bank in terms of the agreement till all payments have been made and accordingly, where default was there such assets do not form part of company properties that can vest with any other body including the Government of India - *DCM Daewoo Motors Ltd.* v. *O.L. High Court, Bombay* [2007] 79 SCL 1 (Bom.).

Rule 26 of the Draft Companies (Winding Up) Rules, 2013* requires that the Company Liquidator within seven days (from the date of winding up or from the date of his appointment in case of winding up by Tribunal and voluntary winding up respectively) fix a day and give a fourteen days' notice for proving debts. The notice shall be given in newspapers (English and regional language where the registered office of the company is situated) and by other mode of service as per section 20 of the Act. The rule further provide—

(*a*) In case of numerous claims for wages or accrued holiday remuneration by employees, claim may be made by any person on behalf of all such employees;

(*b*) Bill of exchange, promissory note, negotiable instrument or security in support of a claim shall be produced before the liquidator;

(*c*) Claims by creditors shall be net of trade discount;

(*d*) Overdue interest on any debt or sum payable on a particular date whereon the interest is not agreed for, the creditor may prove interest at a rate not exceeding six per cent;

*Not yet notified.

(*e*) Rent and other periodic payment for a proportionate period up to the date of winding up order is also admissible;

(*f*) Debt payable at a future date is admissible after deducting rebate at the rate of six per cent for the period between the date of declaration of dividend and date on which the debt would have become payable.

24.20 Preferential Payments

In the event of winding-up, certain payments are to rank in priority to others. The payments to be so made first are called as 'preferential payments'. Such payments, as per section 326 and section 327 are as follows:

Section 326(1)

In the winding up of the company, the following shall be paid in priority to other debts:

1. *Workmen's dues; and*
2. Where a secured creditor has realized a secured asset, so much of the dents due to such secured creditor as could not be realized by him or the amount of the workmen's portion in his security (if payable under the law, whichever is less, *pari passu* with the workmen's dues;

Workmen's portion in relation to the security of any secured creditor of a company means the amount which bears to the value of the security the same proportion as the amount of workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

To illustrate: The value of security of a secured creditor is Rs.1,00,000. The total amount of the workmen's dues is Rs.1,00,000. The amount of debts due from the company to its secured creditors is Rs. 3,00,000. The aggregate of the amount of workmen's dues and amount of debts due to secured creditors is Rs. 4,00,000. The workmen's portion of the security is therefore one fourth of the value of the security, that is Rs. 25,000.

Proviso to sub-section (1) states that if the workmen's dues include any sum towards salary or wages (payable for time or piecework or by way of commission), compensation payable under Industrial Disputes Act, 1947 and accrued holiday remuneration, which is outstanding for a period of two years preceding the winding up order, such dues shall be paid in priority to all other debts within a period of thirty days of sale of assets. These dues get priority even over the secured creditors and need to be paid in full even before any amount is paid to the secured creditors.

The aforesaid debts shall be paid in preference to all other debts in the winding-up of a company and shall be paid in full unless the assets of the company are not sufficient to meet them, in which case they shall be reduced in equal proportions. In *Central Bank of India* v. *Recovery Mamlatdar* [1996] 2 Comp. L.J. 322 (Guj.), the Court held that deductions from wages of ESI contribution by employers constitute money held in trust and proceedings by a secured lender in a civil action to have the security realised in its favour when the company goes under liquidation is not maintainable.

The Supreme Court, in *EPF Commissioner* v. *OL of Esskay Pharmaceuticals Ltd.* [2011] 110 SCL 528 has held that the claim of the Provident Fund Commissioner from the company is not subject to section 529A [now Section 326]. Section 529A (now section 326) cannot be interpreted to dilute the mandate of section 11 of the EPF Act.

A secured creditor who was holding a decree against the company was not compelled to stay realisation just only because certain workers who were entitled to *pari passu* participation had not yet finalised their claims.— *Auckland Holdings Ltd.* v. *Shree Ambica Jute Mills Ltd.* [1994] 2 Comp. L.J. 83 (Cal.). Workers who have been re-employed and have not lost their jobs because the company was sold as a going concern are not entitled to a *pari passu* distribution with secured creditors. They cannot prevent decree-holder creditors from realising their security. The purpose of section 529A [now Section 326] is to provide a special cushion for relieving workers of the distress caused by total displacement. Re-employed workmen would rank as ordinary creditors - *Abdul Hanif* v. *Shree Ambica Jute Mills Ltd.* [1994] 2 Comp. L.J. 86 (Cal.). However, the Supreme Court in the case of *Board of Trustees, Port of Mumbai* [1998] 2 SCALE 714 appears to have ignored the overriding provisions of section 529A [now Section 326], in allowing priority to the Port Trust over workmen and secured creditors. This decision of the Supreme Court places greater reliance on English law and cases and the Provision of Major Port Trust Act, 1963 of our country while the wording of section 529A [now Section 326] is unambiguous as it states that the provisions of this section will override any other provision in the Companies Act, 1956 [now Companies Act, 2013] or in any other law. This decision needs a review.

In *Al Champdani Industries Ltd.* v. *Official Liquidator* [2009] 90 SCL 271 (SC) in respect of claim of the municipality for arrear property tax on property sold in a court sale. The municipality was not a secured creditor and since winding-up order was issued before court sale, it can only rank as an ordinary creditor and the purchaser of the property cannot be made to pay arrears pending before court sale. The Kerala High Court in *Venad Pharmaceuticals & Chemicals Ltd.* (*In Liquidation*), In re [2001] 34 SCL 687 it was observed that the capital gains made by the Official Liquidator on sale of the company's property is incidental to the sale process and is not a debt due by the company on the date of the winding-up order or commencement of winding-up. Section 529A [now Section 326] only puts the claim of the workmen *pari passu* with the secured creditors. However, in view of divergent decisions of various courts on this point, the court referred the matter to the Division Bench. A Division Bench of the Kerala High Court earlier held in *ITO* v. *Official Liquidator, Swaraj Motors (P.) Ltd.* [1978] 48 Comp. Cas. 11 that the capital gains tax will be part of the cost, charges, etc. incurred in winding-up and hence to be paid off first. The Madras High Court in *ICICI Bank Ltd.* v. *Official Liquidator* [2005] 64 SCL 202 has held that the claim of secured creditor will prevail over claims of Income-tax Department and Sales Tax Department but subject to provisions of section 529A [now Section 326].

In case of winding up of company, relevant date for computing workmen's dues will be date of winding-up and not date of appointment of Official Liquidator [*Grand View Estates (P.) Ltd.* v. *Vishwanath Namdeo Patil* [2016] 66 taxmann.com 187 (Bombay)].

In *Vishwanath Namdeo Patil* v. *Official Liquidator of Swadeshi Mill* [2014] 41 taxmann.com 501 (Bombay), the Bombay High Court considered the questions relating to the workmen's dues in case of winding up of a company. The court held that the relevant date for computing workmen's dues will be date of winding-up and not date of appointment of provisional liquidator. If the claim of the workmen is rejected it is obligatory on the part of the Official Liquidator (now Company Liquidator) to give reasons for the rejection. The court also held that for the purpose of overriding preferential payment under Section 529A [now Section 326] the provisions of the Industrial Dispute Act shall apply. Accordingly payment of bonus shall not be included in priority charged but gratuity and retrenchment compensation would be so included.

The Gujarat High Court in *ONGC Ltd.* v. *Official Liquidator, Ambica Mills Co. Ltd.* [2005] 57 SCL 184 has unequivocally held that dues of workers and dues to secured creditors are to be treated *pari passu* and have to be treated as prior to all other dues. Section 529A [now Section 326] overrides all other claims of other creditors even where a decree has been passed by a Court. These also override preferential claims under section 530 [now Section 327]

In *Oil and Natural Gas Corporation Ltd.* v. *Official Liquidator of Ambica Mills Co. Ltd.* [2014] 44 taxmann.com 350 (SC), the Supreme Court of India held that claim for preferential payment as secured creditor merely on the basis of an undertaking given by company-in-liquidation would not amount to creation of charge. The application was denied preferential payment in priority to secured creditors and workmen and the claims would be payable as per provisions of sections 529 and 529A [now section 325/326].

In a significant judgment, the A.P. High Court has held that goods pledged by a company with bank are not assets of the company and is not available to the liquidator - *Vaishu Engg. Industries Ltd., In re* [2007] 80 SCL 171. Also *see* Para 24.31 of this Edition for a case of similar import.

In *Punjab State Power Corporation Ltd.* v. *Ceylon Biscuits (P.) Ltd.* [2015] 56 taxmann.com 116 (Delhi), it was held that amounts paid or payable to keep assets in good repair or protect them, cannot be characterized as secured debts so as to be covered by section 326 though the same were held to be expenses under section 298.

Section 326 of the Act vis-a-vis *State Financial Corporation Act* - The A.P. High Court in *Andhra Pradesh State Financial Corpn.* v. *Emgee Rubber (P.) Ltd.* [2000] 25 SCL 499, held that section 46B of State Financial Corporation Act does not have overriding effect on section 529A [now Section 326]. Similarly, section 11 of the Industrial Disputes Act will not have overriding effect on section 529A [now Section 326] and accordingly P.F. Contribution on salary awarded by Industrial Tribunal after passing of the winding up order will be a preferential claim *pari passu* with secured creditors - *P.V. Joseph* v. *Official Liquidator* [2001] 34 SCL 689 (Ker.). Also see *A.P. State Financial Corpn.* v. *Professional Grade Components Ltd.* [2004] 51 SCL 772 (A.P.). Once a company has been ordered to be wound up a State Financial Corporation cannot take possession of assets of a debtor company. The defendant sold some properties of the company-in-liquidation and but retained sale proceeds with itself claiming its right to appropriate it. The defendant was directed to deposit

the entire amount received by it from sale of assets of company-in-liquidation along with upto date accrued interest as it would not be entitled to receive amounts due to it in capacity of secured creditor - *Shield Shoe Co. (P.) Ltd. (In Liquidation)* v. *Rajasthan Financial Corporation* [2015] 60 taxmann.com 230 (Raj.).

Debt Recovery Proceedings and the powers of Official Liquidator - If the proceedings for recovery of debts have been initiated by Debt Recovery Tribunal and the process of sales of the assets of the company in liquidation has also been started, the Tribunal will carry on the sales, in spite of appointment of the Official Liquidator. However, the Tribunal has to pay off the dues of the workmen before passing on any amount to the lending bank in respect of which the recovery proceedings were started (*Vide* section 529A read with section 446) [now Sections 326 and 279] - *Remanika Silks (P.) Ltd., In re* [2001] 34 SCL 955 (Ker.).

With a view to harmonise provisions of section 529A [now Section 326] and section 34 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, it has been held that amount realised by the Debt Recovery Tribunal has to be distributed in accordance with order of the Debt Recovery Officer while amount realised by the liquidator shall be distributed in accordance of sections 529A [now Section 326] of the Companies Act - *U.P. Carbide & Chemicals Ltd., In re* [2005] 63 SCL 419 (Uttaranchal). Bombay High Court in *Divya Chemicals Ltd., In re* [2005] 64 SCL 429 has held when a recovery proceeding has started before Debt Recovery Officer, the Official Liquidator cannot claim the concerned assets for sale as the sale has to take place under order of Debt Recovery Officer.

Workmen of a company, because of the equal priority ranking in section 529A [now Section 326], cannot raise objection against proceedings initiated by secured creditors under section 13 of the SARFAESI Act, 2002 in respect of secured assets unless the company is ordered to be wound up or any proceedings for winding up is pending - *K.V. Sasidharan Pillai* v. *Indian Overseas Bank* [2012] 111 SCL 770 (Ker.). Also, until the winding-up order is passed, the workmen cannot claim priority in distribution of sale proceeds of assets under Debt Recovery Act, 1993.

Section 327 - On Preferential Payments - Order of priority, subject to section 326 is given hereunder:—

1. All revenues, taxes, cesses and rates due to the Central or a State Government or to a local authority. The amount should have become due and payable within twelve months before the winding-up order.
2. All wages or salary of any employee (including wages payable for time or piece work or earned as commission), in respect of services rendered to the company and due for a period not exceeding four months during the twelve months preceding the winding-up. The amount shall not exceed such sum as may be notified for any one claimant.

   The following points may be noted in this regard:

   (*a*) *Ex gratia* payments to employees are not entitled to priority - *Vijay Cardboard Co. Ltd.* v. *Collector, Hyderabad District* AIR 1957 A.P.

   (*b*) The expression 'wages' shall include bonus, wages accrued and due during a period of illegal lock-out - *Official Liquidator* v. *M. Chandra Sekaran* (1951) 2 MLT 185.

(*c*) Any advance by a bank to enable the company to pay wages to workmen shall rank in priority in the same manner as the wages of the workmen - *Rampgill Mill* [1967] 1 Comp. L.J. 262.

3. All accrued holiday remuneration becoming payable to an employee on the termination of his employment or in case of death to any other person claiming under him before, or by the effect of the winding-up or dissolution of the company.
4. All amount due in respect of contributions payable during the twelve months before the winding-up under the Employees' State Insurance Act, 1948 or any other law unless the company is being wound-up for the purpose of reconstruction or amalgamation.
5. All amounts due in respect of any compensation or liability for compensation under the Workmen's Compensation Act, 1923 in respect of death or disablement of any employee of the company.

   Retrenchment and lay-off compensation payable under the Workmen's Compensation Act shall, however, not qualify for preferential payment.
6. All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees maintained by the company.
7. Expenses of any investigation held in pursuance of section 213 or 216 insofar as they are payable by the company.

The rent payable to lessor of the premises of the company under liquidation as the same was retained by the liquidator even after termination of the lease, in company's interest, is an expense of liquidation and the same has to be accorded priority in payment - *S.P. Jain Official Liquidator* [2008] 81 SCL 27 (Punj. & Har.).

Advances made by a third person to pay wages or salary of an employee or holiday remuneration to him or to any other person on his death, shall have the same right of priority in winding-up, up to the amount by which the employee or other person in his own right would have been entitled to [Section 327(2)].

The aforesaid claims mentioned under (1) to (7) shall rank *pari passu*, *i.e.*, equally amongst themselves. In case assets are not sufficient to meet them fully, they shall abate (*i.e.*, be reduced) in equal proportion [Section 327(3)(*a*)].

Where the assets of the company available for payment of general creditors are insufficient to meet them, the aforesaid debts shall have priority over the claims of holders of debentures under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge [Section 327(3)(*b*)].

Order of Priority - Thus, the order of priority in paying off debts in a winding-up shall be as follows :

(*i*) Workmen's dues and debts due to secured creditors;

(*ii*) Costs and expenses of winding-up;

(*iii*) Preferential debts;

(*iv*) Floating charge; and

(*v*) Unsecured creditors.

Discharge of Sales Committee - Where in a winding-up proceeding a Sales Committee was set up by the Court (now Tribunal) and that Committee deposited the surplus money realised from sale of assets after paying up secured creditors and employees, the Committee stood discharged by the deposit made to the Court (now Tribunal). An unsecured creditor who sought payment from the Committee could get the payment from the Court (now Tribunal) on filing affidavit and indemnity papers with the Court (now Tribunal) to deposit entire amount withdrawn or part of it sufficient to satisfy any future claims being lodged by the unsecured creditors or employees within one year—*Space Age Industrial Projects Ltd.* v. *Syndicate Bank* [1998] 18 SCL 424 (Bom.).

It may be noted that Section 326 and 327 would not be applicable in case of liquidation under the Insolvency and Bankruptcy Code, 2016.

24.20-1 Overriding preferential payment

When the money in possession of the company is impressed with the character of a trust money or is itself a trust money - such money in the hands of the liquidator, has to be treated as trust money, not belonging to the company and accordingly to be paid to the trust/organisation/person concerned and cannot be pooled together as the money of the company in liquidation for making preferential payments - *Nutan Mills Employees' Co-operative Credit Society Ltd.* v. *Official Liquidator of Nutan Mills Ltd.* [2000] 23 SCL 230 (Guj.), *Baroda Spinning & Weaving Mills Ltd. (In Liquidation)* v. *Baroda Spinning & Weaving Mills Co-op. Credit Society Ltd.* [1976] 46 Comp. Cas. 1 (Guj.) Palmer's Company Law, 21st edition, page 775 has the following observation relating to property held in trust —

> "Property which can be identified as belonging to or held by the company in trust for other persons may be followed and recovered from the liquidator."

Other important cases on the property impressed with the character of trust are:

Central Bank of India v. *Recovery Mamlatdar* [1996] 87 Comp. Cas. 284, *Kshetra Mohan Dass* v. *Official Liquidator, East Bengal Sugar Mills Ltd.* [1943] 13 Comp. Cas. 54 (Cal.), *Bank of Baroda* v. *Nutan Mills Employees' Co-operative Credit Society Ltd.* [2004] 50 SCL 6 (Guj.).

24.20-2 Priority between unsecured creditors

The Bombay High Court in *Western Works Engineers Ltd.* v. *Official Liquidator* [1999] 2 CLJ 211 has held that the priority of the state claims is *qua* unsecured creditors and not *qua* secured creditors. Between the unsecured creditors, the claim of income-tax dues would have preference over all other claims in the category of unsecured creditors.

Initiator of the liquidation proceedings - The person on whose petition the liquidation proceedings had started, cannot claim any preference for payment to him merely because he was the initiator of the proceedings - *DCM Financial Services Ltd.* v. *Neel Kamal Plastics Ltd.* [2008] 86 SCL 127 (SC).

24.20-3 Fraudulent preference [Section 328]

The expression 'fraudulent preference' may be described to mean the giving of an improper benefit to a few in preference to others, leading to inequality between them—*Official Liquidator* v. *Victory Hire Purchasing Co. (Pvt.) Ltd.* [1982] 52 Comp. Cas. 88.

The term 'fraudulent preference' has been borrowed from the law of insolvency. According to that law, any transfer of property or payment made by a person who is unable to pay his debts in favour of a creditor with a view to giving him a preference over other creditors is regarded as fraudulent preference. If within three months an insolvency petition is presented against him and he is adjudicated insolvent, the transaction becomes invalid. As per section 328(1), any such transaction entered into by a company within six months before the commencement of its winding-up is deemed as a fraudulent preference of its creditors and accordingly invalid.

In *Re, M. Kushler Ltd.* [1943] 2 Ch. D 248, K and his wife were the sole directors and shareholders of a company. The company's overdraft with the bank was guaranteed by K. On coming to know that the company was unable to pay its debts, payments were made between 12th May and 21st May into the Bank at the instance of K to extinguish the overdraft. On May 23 a resolution for the winding-up of the company was passed. No payment to creditors was made between May 10 and 23. Held, there was fraudulent preference.

To establish a case of fraudulent preference under section 328, two conditions must be satisfied:

(*a*) that the transaction took place within six months before the commencement of the winding-up;

(*b*) that the dominant motive in the mind of the company acting through its directors was to prefer one creditor in preference to other creditors - *Sharp* v. *Jackson* [1889] A.C. 19.

Thus, to prove fraudulent preference it shall have to be established that the dominant motive was to commit an act of dishonesty. However, there is no fraudulent preference, if the transaction is not voluntary. For instance, where a company makes payment to a creditor under pressure of litigation or attachment of its properties, it cannot be regarded as a fraudulent preference - *Official Liquidator* v. *Venkataraman* [1966] 1 Comp. L.J. 243. Similarly, there is no fraudulent preference when a debtor's dominant motive is to benefit himself rather than to confer an advantage on the creditor - *Re, F.L.E. Holdings Ltd.* [1976] 1 WLR 1409. The Calcutta High Court in *Hindustan Development Corpn. Ltd.* v. *Shaw Wallace & Co. Ltd.* [2002] 35 SCL 397, has held that the question of fraudulent preference could arise only when the company was in liquidation or when the company surreptitiously sought to pay some creditors to the exclusion of others with intent to close its business. Clarifying further the court said that the payment should necessarily be sought to be made to some creditors, with intent to defraud others so that these others would have no opportunity or remedy left to them to recover their lawful debts or any portion thereof from the company. In a case the debtor company and one of its creditors entered into an agreement pursuant to which certain properties of the company were assigned to the creditor within six months of this agreement

the creditor filed petition for winding up of the company. The High Court ordered maintenance of *status quo* with regard to the agreement until disposal of winding up petition - *Tamil Nadu Newsprint & Papers Ltd.* v. *Express Publication (Madurai) Ltd.* [2003] 44 SCL 345 (Mad.). The Calcutta High Court in *Prudential Capital Markets Ltd. (In Liquidation), In re* [2008] 84 SCL 239 has fastened the onus on the Official Liquidator to prove that the impugned transaction was entered into by the company as debtor in a deliberate manner to single out the particular creditor ahead of other creditors. This decision relates to the situation of a transaction taking place before presentation of winding up petition. The Gujarat High Court in *Hawa Controls* v. *O.L. of Tirupati Foundry (P.) Ltd.* [2008] 87 SCL 106 has held that a *bona fide* purchaser of some items of properties of a company, without knowledge of the company being under winding up, cannot be considered as a beneficiary of fraudulent preference.

24.21 Avoidance of voluntary transfer [Section 329]

The same principles which apply in respect of avoidance of voluntary transfer in the case of an insolvent, apply in the case of an application made under section 531A [now section 329] for the avoidance of a voluntary transfer made by a company which goes into liquidation - *Sunder Lal Jain* v. *Sandeep Paper Mills (Pvt.) Ltd.* [1987] 60 Comp. Cas. 87 (Delhi).

According to section 329, any transfer of property, movable or immovable, or any delivery of goods, made by a company within a period of one year before presentation of a petition for winding up by the Tribunal, shall be void against the Company Liquidator. But, the following transactions are not covered by this rule:

1. A transfer of property or delivery of goods made in the ordinary course of business of the company; or
2. A transfer of property or delivery of goods in favour of a purchaser or encumbrancer in good faith and for valuable consideration.

The Madras High Court in *Sri Krishnasamy Reddiar Education Trust* v. *Official Liquidator* [2012] 114 SCL 577 has held that a renewal of lease against paltry consideration falling within one year prior to the presentation of petition for winding-up was hit by section 531A [now Section 329] and as such the renewal lease agreement became a nullity and the lease rent received by the Official Liquidator [now company liquidator] during this period has to be treated as damage payment as the renewal appeared to have been effected only to defeat the interest of secured creditors.

24.22 Transfer for benefit of all creditors [Section 330]

Any transfer or assignment by a company of all its property to trustees for the benefit of all its creditors shall be void.

24.23 Liabilities and rights of certain fraudulently preferred person [Section 331]

Where in the case of a company which is being wound up, anything made, taken or done is invalid under section 328 as a fraudulent preference of a person interested

in property mortgaged or charged to secure the company's debt, then the person preferred shall be subject to the same liabilities, and shall have the same rights, as if he had undertaken to be personally liable as surety for the debt, to the extent of the mortgage or charge on the property or the value of his interest, whichever is less.

The object of the aforesaid provision is to give protection to the creditor of a company which is being wound up. Where the creditor has been paid by the company with the fraudulent motive on the part of the company to relieve from liability or reduce the liability of a person who has stood surety or guarantor to the creditor on behalf of the company. For instance, where an ex-managing director has given guarantee on behalf of the company to a creditor and just before the company goes into liquidation, the company pays that particular creditor the whole or a good portion of the amount guaranteed by the ex-managing director with a view to relieve that guarantor of his liability as guarantor to the creditor. In such a case the creditor is fraudulently preferred by the company in order to benefit the person who stood surety or guarantor, and though in such a case the creditor to whom the payment is made may not have been a party to the fraudulent payment, the payment itself is a fraudulent preference for the benefit of the guarantor. In such a case, this section provides that the creditor who is obliged to refund to the liquidator the amount paid by the company, may recover the amount from the surety or guarantor, and the winding-up court (now Tribunal) has jurisdiction to determine the question and order payment to the creditor by the surety or guarantor, even though that subject-matter is unconnected with the winding-up. For this purpose, the surety or guarantor may be brought in as a third party in the same proceedings which relates to the recovery of the company's money paid to the creditor.

24.24 Effect of floating charge [Section 332]

Where a company is being wound-up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding-up, shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid.

However, the charge, as aforesaid, shall not become void where it relates to the amount of any cash paid to the company, whether at the time of or subsequently to the creation of, and in consideration for, a charge. The same can be recovered along with interest at the rate of five per cent per annum or such rate as may be notified by the Central Government.

24.25 Disclaimer of onerous property [Section 333]

The Company Liquidator may, with the leave of the Tribunal, disclaim onerous properties belonging to the company.

What is included in onerous properties? The onerous properties may consist of—

1. land burdened with onerous covenants;
2. shares or stock in companies;

3. any other property which is unsaleable or is not readily saleable, by reason of the fact that it requires its possessor to perform any onerous act or to pay a sum of money; or
4. unprofitable contracts.

Disclaimer to be in writing - The disclaimer shall be in writing and shall be made within 12 months after the commencement of the winding-up.

However, where any onerous property has not come to the knowledge of the Company Liquidator within one month after the commencement of the winding-up, the power of disclaiming the property may be exercised at any time within twelve months after he has become aware thereof or such extended period as may be allowed by the Tribunal.

The disclaimer shall operate to determine in respect of the property disclaimed, the right, interest and liabilities of the company as from the date of disclaimer. It shall also release the company and the property from liability; but it shall not affect the rights or liabilities of any other person in respect of that property.

Company Liquidator to decide disclaimer within 28 days. The Company Liquidator shall not be entitled to disclaim any property when he has not taken any action on the application of any person interested in the property within 28 days requiring the Company Liquidator to decide whether he will or will not disclaim [Section 333(4)].

Powers of the Tribunal - The Tribunal, before or on granting leave to disclaim, may require notices to be given to persons interested in the property and may impose such conditions, as it thinks fit [Section 333(3)].

The Tribunal may also, on the application of any person who is, as against the Company Liquidator, entitled to the benefit or subject to the burden of a contract made with the company, make an order rescinding the contract. The rescission shall be on such terms as to payment, by or to either party, of damages for the non-performance of the contract, or otherwise, as the Tribunal thinks just. Any damages payable under the order to any such person may be proved by him as a debt in the winding-up [Section 333(5)].

Further, the Tribunal may, on application by any person who claims any interest in any disclaimed property, make an order for the vesting of the property in the person entitled thereto [Section 333(6)].

However, where the property disclaimed is of a leasehold nature, the Tribunal shall not make a vesting order in favour of any person claiming under the company, whether as under-lessee or as mortgagee or holder of a charge by way of demise, except upon the terms of making that person—

(*a*) subject to the same liabilities and obligations as those to which the company was subject under the lease in respect of the property at the commencement of the winding-up; or

(*b*) if the Tribunal thinks fit, subject only to the same liabilities and obligations as if the lease had been assigned to that person at that date.

When a company court (now Tribunal) has jurisdiction to entertain and dispose of a suit or any claim by or against the company in liquidation, claim for eviction and

enforcement of right to re-enter leased property in terms of lease deed would be clearly within jurisdiction of such court. A disclaimer ought to be ordered by court (now Tribunal) only if it is essentially in interest of the company being wound-up and if retention of such property is required to effectively carry out winding-up proceedings; otherwise no disclaimer would be ordered - *In re, Board of Trustees for the Port of Kolkata* [2003] 44 SCL 81 (Gau.). Also *see Ashoka Ghose* v. *Official Liquidator of Remington Rand of India Ltd.* [2004] 51 SCL 572 (Cal.).

Injured party deemed to be a creditor - Any person injured by the operation of a disclaimer under section 333 shall be deemed to be a creditor of the company to the amount of the compensation or damages payable in respect of the injury and may accordingly prove the amount as a debt in the winding-up [Section 333(7)].

Under Rule 32 of the Draft Companies (Winding-Up) Rules, 2013* the application under Section 333 shall be posted before the Tribunal *ex-parte* for directions for serving the notice of application and fixing a date of hearing. Notice of the hearing needs to be served not less than seven days before the hearing along with a copy of the application and affidavit in support thereof. An affidavit is opposition shall be filed at least two days before the hearing and a copy simultaneously to be given to the Company Liquidator.

24.26 Avoidance of transfers, etc. after commencement of winding-up [Section 334]

Section 334 declares that in case of a winding up by the Tribunal any disposition of the property, including actionable claims made after the commencement of winding up shall be void. Further, any transfer of shares or alteration in the status of its members shall also be void. However, such disposition, transfer or alteration shall not be adversely affected where the same are made by the orders of the Tribunal**. The Calcutta High Court in *Prudential Capital Markets Ltd. (In Liquidation), In re* [2008] 84 SCL 239 (Cal.) has held that, pursuant to section 536(2) [now Section 334], it is irrelevant as to whether the transferee of the company's property was aware of presentation of winding up petition against the company. Such a disposition cannot be validated even if the transferee acted *bona fide*. The Madras High Court held that transactions undertaken to keep company operable while winding up process is on, can be validated if they are entered into in ordinary course of business. However, sales transaction entered to defeat interest of other creditors could not be validated by Court (now Tribunal). [*VGP Finances Ltd.* v. *Official Liquidator* [2018] 89 taxmann.com 209 (Madras)]

24.27 Avoidance of certain attachments [Section 335]

In case of winding-up by the Tribunal, section 335 declares that the following shall be void:

(*a*) any attachment, distress or execution put in force, without leave of the Tribunal, against the estate or effects of the company, after the commencement of the winding-up; or

*Not yet notified.

**Substituted by the Insolvency and Bankruptcy Code, 2016.

(*b*) any sale held, without leave of the Tribunal, of any of the properties or effects of the company after such commencement. In *R. Ranganathan* v. *V.T. Chit Funds (Pvt.) Ltd.* [1976] 46 Comp. Cas. 637 (Mad.), a decree was obtained by R against a company prior to its winding-up. Properties of the company which had earlier been attached were put to sale after the company was ordered to be wound up, without obtaining leave of the Court under section 537 [now Tribunal under Section 335] and the proceeds were handed over to R. *Held,* the sale was void. Similarly execution proceedings taken up by decree holders after the issue of the winding-up order (though initiated before the order) is void under section 537 [now Section 335], when done without taking the leave of the court - *Official Liquidator* v. *Andhra Pradesh State Financial Corpn.* [2001] 33 SCL 271 (AP). Also *see B. Suresh* v. *A.P. Mahesh Cooperative Bank Ltd.* [2001] 34 SCL 939 (AP). In this case even though the applicant's *locus standi* for making the application under sections 442 and 537 [now Section 335], opposing execution of a money decree obtained by the lending bank, was not determined but to prevent the illegal action of the bank, the application was admitted. The Karnataka High Court in *BPL Ltd.* v. *Inter Modal Transport Technology Systems (Karnataka) Ltd.* [2002] 35 SCL 773 has held that the principle of relating back the commencement of winding up proceedings under section 441 [now section 357] to the date and time of presentation of the petition though applicable to section 537 [now Section 335], but is inapplicable to a case where the winding-up order is passed under section 20(2) of SICA.

Section 335 does not apply to any proceeding for the recovery of any tax or impost or any dues payable to the Government [Section 335(2)].

24.28 Offences by officers of companies in liquidation [Section 336]

Section 336 contains a long list of offences for which officers (whether past or present) of a company in winding-up are made punishable with imprisonment which shall not be less than three years but may extend to five years or with fine which shall not be less than rupees one lakh but extend to rupees three lakh or with both. Following offences are covered by this section:

1. Failure to disclose to the Company Liquidator to the best of knowledge, fully and truly, all the property of the company and how and to whom and for what consideration the company disposed of any property. This does not include dispositions made in the ordinary course of business.[28]
2. Failure on the part of an officer to deliver up to the Company Liquidator any property of the company in his custody or control and which he is required by law to deliver up.
3. Failure to deliver up to the Company Liquidator books and papers of the company in his custody or control and which he is required by law to deliver up.

28. See Official Liquidator, *Golcha Properties* v. *P.C. Dhadda* [1980] 50 Comp. Cas. 175 (Raj.), where the three officers in charge were not able to account for the money which they had sent to the main office of the company and they were ordered to pay.

4. If any officer, within twelve months next before winding-up, conceals any property of the company of the value of rupees one thousand or upwards or conceals any debt due to or from the company.
5. Within twelve months next before commencement of winding-up or at any time thereafter, any officer fraudulently removes any property of the company of the value of rupees one thousand or upwards.
6. Any officer makes any material omission in any statement relating to the affairs of the company.
7. If an officer knows or believes that a false debt has been proved by any person under the winding-up, but fails within one month to inform the Company Liquidator.
8. After the commencement of winding-up, any officer prevents the production of any book or paper affecting or relating to the property or affairs of the company.
9. Within twelve months next before or at any time after the commencement of winding-up, an officer conceals, destroys, mutilates or falsifies any book or paper relating to the property or the affairs of the company. Liability shall also be incurred where he is guilty of making false entries in any book or paper affecting or relating to the company or fraudulently parts with, alters or makes any omission in any book or paper affecting or relating to the property or affairs of the company. Liability will again be incurred where he is privy to any of the aforesaid acts.
10. After the commencement of winding-up or at any meeting of the creditors within twelve months before winding-up, any officer attempts to account for any part of the property of the company by fictitious losses or expenses.
11. Within twelve months next before the commencement of winding-up or at any time thereafter, any officer by false representation or other fraud, obtains on credit, on behalf of the company, any property which the company does not subsequently pay for.
12. Under the similar circumstances as above, any officer, under the false pretence that the company is carrying on its business, obtains on credit on behalf of the company, any property which the company does not subsequently pay for.
13. Within the same time as above, any officer pawns, pledges, or disposes of any property of the company which has been obtained on credit and has not been paid for, except when it is done in the ordinary course of the business of the company.
14. Any officer is guilty of any false representation or other fraud for the purpose of obtaining the consent of the creditors of the company to an agreement with reference to the affairs of the company or the winding-up.

Proviso to Section 336(1) states that the accused person may prove that there was no intent to fraud or conceal the true state of affair or to defeat the law as a defence against the punishment.

Section 336(2) imposes punishment on a person who takes in pawn or pledge or otherwise receives the property of the company knowingly the same is being given in circumstances mentioned in point 13 above. The guilty shall be punishable with imprisonment from three to five years or with fine from rupees three lakh to rupees five lakh or with both.

24.29 Penalty for fraud by officers [Section 337]

Where any officer of a company, which is subsequently ordered to be wound up by the Tribunal, has :

(*a*) by false pretences or by means of fraud induced any person to give credit to the company; or

(*b*) with intent to defraud creditors of the company, made any gift or transfer of any property of the company or created a charge on any property; or

(*c*) with intent to defraud creditors of the company, concealed or removed any property of the company within two months before or since the date of any judgment for payment against the company;

he shall be punishable with imprisonment for a minimum term of one year which may extend to three years and shall also be liable to fine of not less than rupees one lakh but may extend to rupees three lakh.

24.30 Liability for not keeping proper books [Section 338]

If proper books of account have not been kept by a company *throughout the period of two years* before the winding-up of the company or for a shorter period if the company has not been in existence for a period of two years, every officer of the company who is in default shall be punishable with imprisonment for a term not less than one year but which may extend to three years and fine of not less than rupees one lakh but may extend to rupees three lakh or both. An officer may, however, show that he acted honestly and that in the circumstances in which the business of the company was carried on, the default was excusable [Section 338(1)].

For the purposes of sub-section (1), it shall be deemed that proper books of account have not been kept in the case of any company, if there have not been kept—

(*a*) such books or accounts as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day to day in sufficient detail of all cash received and all cash paid; and

(*b*) where the business of the company has involved dealings in goods, statements of the annual stock takings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and the sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified [Section 338(2)].

24.31 Liability for fraudulent conduct of business [Section 339]

In the course of the winding-up of a company, it might sometimes appear that the business of the company has been carried on with intent to defraud creditors of the company or any other persons or for any fraudulent purpose. In such a case the Tribunal, on the application of the liquidator or any creditor or contributory of the company, may declare that the persons who were parties to such business shall be personally responsible for such debts of the company as the Tribunal may direct.

Where a company seems to have carried on business and incurred debts in a time when, to the knowledge of the persons concerned, there was no reasonable prospect of the creditors ever receiving payments of these debts, an inference to defraud could be drawn - *South India Paper Mill (Pvt.) Ltd.* v. *Sree Rama Vilas Press* [1982] 52 Comp. Cas. 145 (Ker.). In *William C. Leitch Bros. Ltd., Re* [1932] Ch. 261, 'A' sold his business to a company promoted by himself. He took shares and debentures for the price. The debentures created a charge, on the company's property. 'A' was appointed Director by the company. The company came to be indebted for a sum of 6500 pounds which it was unable to pay. Even so, 'A', the Managing Director, ordered goods worth 6000 pounds on credit. Shortly thereafter, the company became insolvent and 'A' received payments in lieu of the charge in his favour. The court held him liable to pay 3000 pounds to the liquidator. *William Maugham J.* said:

> "If a company continues to carry on business and to incur debt at a time when there is, to the knowledge of the Directors, no reasonable prospect of the creditors ever receiving payments of those debts, it is in general a proper inference that the company is carrying on business with intent to defraud creditors."

This statement has been cited with approval by the Kerala High Court in *Nagendra Prabhu* v. *Popular Bank* [1969] ILR Ker. 340.

The Court added:

Although the section leaves the Court (now Tribunal) with a discretion to make a declaration of liability in relation to "all or any of the debts or other liability of the company", the order would in general be limited to the amount of the debts of those creditors who have been defrauded. Thus, there must be some nexus between the fraudulent trading or purpose and the extent of liability.

In one of the recent judgments, the Allahabad High Court has held that directors withdrawing huge amounts out of the capital of the company as interest free loans and also continuing to carry on the business of the company knowing fully well that the company was running in losses and owing large amounts to Government amounted to fraudulent conduct of business under section 542 [now Section 339] - *Official Liquidator* v. *Ram Swarup* AIR 1997 All. 72.

Every person who is knowingly a party to the fraudulent carrying on of the business shall be liable to action under section 447. [section 339(3)].

It may be noted that the liability under section 542 [now Section 339] arises only when the company is in winding-up and for offences committed before or during winding-up - *Regina* v. *Rollafson* [1969] 1 WLR 815.

The words "defraud" and "fraudulent purpose", which appear in section 542(1) [now Section 339(1)], are words which connote actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame. A fraudulent preference within the meaning of the Act may not involve moral blame at all. For example, there may be a discrimination between the creditors irrespective of pressure on grounds with which most people would sympathise. In exercising jurisdiction under section 542 [now Section 339], the Court (now Tribunal), however little, it may approve of the conduct of the Director who is being attacked, is bound to consider whether he has been guilty of dishonesty or fraud and the onus to so establish shall be on the person who makes the charge, whether he be the liquidator or a creditor or a contributory - *Patrick and Lyon Ltd., In re* [1933] 3 Comp. Cas. 449 Ch. D. In this case a company remained in business only to save certain debentures which otherwise would have become invalid, the Court held that this did not amount to an intention to defraud creditors.

It may be noted that the Company Court (now Tribunal) may only give its declaration under section 542(3) [now Section 339(3)] and may permit official liquidator or liquidator to make an application to the court of competent criminal jurisdiction based on its declaration. It itself cannot pronounce punishment - *P. Hema* v. *M. Muthusamy* [2008] 81 SCL 525 (Mad.).

24.32 Damages for misfeasance etc. [Section 340]

Section 340 empowers the Tribunal to assess damages and require the delinquent directors and other officers of the company to pay the amount to the company. In the course of winding-up of a company, it might come to light that some person who has taken part in the promotion or formation of the company, or any past or present Director, Manager, Company Liquidator or Officer of the company—

(*a*) has misapplied or retained any money or property of the company; or

(*b*) has been guilty of any misfeasance or breach of trust in relation to the company.

In such a case, the Company Liquidator, the Official Liquidator or any creditor or contributory of the company may apply to the Tribunal to examine into the conduct of the person or delinquent officer and compel him to repay or restore the money or property with interest at such rate as the Tribunal thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the Tribunal thinks just.

In *Babubhai Chandulal Mody* v. *Official Liquidator, Atlas Import and Export Co. Pvt. Ltd.* [1996] 23 CLA 123, the appellant and another person (since deceased) were directors of the company under liquidation. In a petition filed by the Official Liquidator under section 543(1) [now Section 340(1)] claiming that the appellant director was liable to account to the company for a sum of Rs. 30 thousand - odd, the appellant had contended that so long as no dishonesty was attributed to him, he was not liable to pay the amount and secondly the legal representatives of the deceased director having not been brought on record it was not open to the Official Liquidator to proceed only against the appellant. Rejecting the contentions, a single judge of the Andhra Pradesh High Court granted a decree against the appellant for

the sum claimed by the Official Liquidator. In appeal to a Division Bench the same contentions had been urged by the director.

Allowing the appeal in part, the Division Bench held that the proceedings instituted by the Official Liquidator under section 543(1) [now Section 340(1)] of the Act against the appellant director were valid and in accordance with law. A reading of section 543 [now Section 340] would indicate that in case the directors had become liable and accountable for any money or property of the company, they could be compelled to restore any money or property of the company. Liability of the directors under section 543 [now Section 340] was joint and several. In the instant case the surviving and deceased directors were jointly and severally liable for the property of the company misappropriated by them.[29]

Again, in *Official Liquidator* v. *Parthasarthi Sinha* AIR 1983 SC 188, the Supreme Court has held that a cause of action against a deceased director for misfeasance would survive even after his death and the assets of the deceased director were liable in the hands of his legal representatives. Proceeding under section 543 [now Section 340] might be continued against the legal representatives. Also *see Suganti Alloy Castings Ltd. (In Liquidation)* v. *Edupapganti Subba Rao* [2004] 50 SCL 605 (AP).

In *Official Liquidator of BPL Net Com Ltd. (In Liqn.)* v. *Anil Bhandary* [2013] 31 taxmann.com 9 (Karnataka), Company-in-liquidation was ordered to be wound up. Official Liquidator called upon respondent ex-directors to file statement of affairs and same was filed. Official Liquidator filed application under section 543 [now Section 340] contending that ex-directors did not handover original share certificates due to which Official Liquidator had not been able to recover said amount causing loss to shareholders and, thus, committed 'breach of trust'. *Held that*, since there was no wilful withholding of share certificates so as to cause financial loss to shareholders, it could not be construed that ex-directors had committed 'breach of trust' and as there were no ingredients to proceed against ex-directors and to direct them to pay amounts, application was rejected.

In the case of *Dr. J.S. Gambhir* v. *Millennium Health Institute and Diagnostics (P.) Ltd.*, [2014] 43 taxmann.com 319 (Delhi) the High Court of Delhi held that it is not necessary to make specific allegations against a person where liability is sought to be imposed on him for being a Director of Company at relevant time under Section 543 [now Section 340]. However in this case the ex-director has resigned much prior to the appointment of the provisional liquidator. He was held not liable to compensate the company under liquidation for non recovery of debt due to company by reason of insufficient records.

With regards to the liability of delinquent directors for acts of misfeasance and breach of trust under Section 543 [now Section 340], the High Court of Karnataka in *Official Liquidator of Vintek R.F. Products Ltd.* v. *S. Krishnamurthy* [2014] 42 taxmann.com 244 (Karnataka) held that in case the ex-director (respondent) had ceased to be a director much prior to the its winding up and records of company had been taken over by financial institution and income-tax department, complaint against respondent ex-directors for acts of misfeasance and breach of trust on basis

29. Also *see Official Liquidator, Janahitkari Rindayatri (P.) Ltd.* v. *Vishnu Kumar Pradhan* [2001] 31 SCL 147 (Raj).

of a truncated annual report was not maintainable and hence to be dismissed. The same court in *Official Liquidator of Rekha Cements & Chemicals Ltd. (In Liquidation)* v. *P.S.G. Krishnan* [2014] 41 taxmann.com 502 (Karnataka) dismissed the application by the Liquidator under Section 543 [now Section 340] as the claim made by the liquidator did not relate to the relevant period. The Liquidator's claims were based upon the Balance Sheet which was two years earlier to the winding up order. The court took the view that it did not reflect the state of affairs of the company on the date of the winding up and hence the application lack merit.

Sub-section (2) of section 340 requires the application to be made within 5 years from the date of the order for winding-up, or of the first appointment of the Company Liquidator in the winding-up, or of the misapplication, retainer, misfeasance or breach of trust, as the case may be, whichever is longer. The period can further be extended under section 358 of the Act. *See Ajay G. Podar* v. *O.L. Jaipur Spinning & Weaving Mills* [2009] 93 SCL 166 (SC). The Punjab & Haryana High Court in *Shivalik Savings & General Investment Ltd. (In Liquidation)* v. *C.J. Singh* [2010] 99 SCL 51 has held that the period of 5 years for limitation shall run from the date, the knowledge of misfeasance has surfaced.

Sub-section (3) of section 340 provides that the provisions of section 340 shall be applicable in spite of the fact that the matter is one for which the person concerned may be criminally liable.

It may be noted that an order under section 543 [now Section 340] can only be passed if some actual monetary loss is shown to have been caused to the company. If directors have subsequently made good the loss, court (now Tribunal) will not exercise the powers under this section - *First National Bank Ltd.* v. *Om Parkash Sharma* [1963] 33 Comp. Cas. 1043 (Punj.). Unless a director has done something wrong by misapplying or retaining in his own hands any money of the company or has done something by which company's properties has been wasted resulting in actual loss, there can be no misfeasance or breach of trust. [*Official Liquidator of Auto Electricals (India) (P.) Ltd.* v. *D.P. Gupta* [1998] 18 SCL 427 (Raj.)]. Also *see Ashoka Auto & General Industries (P.) Ltd.* v. *Inder Mohan Puri* [2005] 62 SCL 19 (Delhi)].

Misfeasance (section 340) - Acts of omission, commission or negligence caused with intent and knowledge to cause loss to company resulting in personal gain to a director, would fall within the scope of section 340. However, onus to bring evidence of the acts and prove the same against the person charged lies with the plaintiff-Official Liquidator - *Dhavalgiri Paper Mills (P.) Ltd.* v. *Chinubhai Khila Chand* [2003] 46 SCL 103 (Guj.). Also *see Official Liquidator* v. *Somdev Dasgupta* [2009] 96 SCL 45 (Cal.)

It may also be noted that the provisions of section 543 [now Section 340] are applicable to compulsory as well as voluntary winding-up - *Vemuri Parandhamiah* v. *R. Narsimah Rao* [1950] 20 Comp. Cas. 1 (Mad.). However, a simultaneous/joint petition under sections 397/398 and 543 [now section 241 and Section 340] is not maintainable *Sanjeev Kumar Bhardwaj* v. *Ghanashyam Das* [2001] 30 SCL 228 (Delhi).

A charge for misfeasance against a director or officer of the company has to be specific and should attack identified individuals. A general charge will not survive

- *Sajida Book Shop* v. *Kaumudi Exporters (P) Ltd.* [2007] 80 SCL 221 (Ker.). *See also Dewrance Macneill & Co. Ltd. (In Liquidation)* v. *Padam Kumar Khaitan* [2010] 97 SCL 236 (Cal.)

According to the decision of Karnataka High Court in Official Liquidator (O.L.) of *Mandya National Paper Mills Ltd. (In Liquidation)* v. *S.K. Sengupta*, proceedings u/s. 543 [now Section 340] cannot be initiated merely based on realisable value of assets. Entire claim against directors was made on the basis of statement of affairs submitted by directors which included realisable value of assets indicated in document and there was no other pleading or evidence with regard to misfeasance against them. Hence O.L's case was not sustainable [2012] 114 SCL 482. The same High Court in *O.L. of Star Spin & Twist Machineries Ltd. (In Liquidation)* v. *Suresh Monoharlal Mehta* [2012] 114 SCL 524 has held that mere allegation of misfeasance against directors in the absence of evidence of misfeasance to benefit themselves is not sustainable. Further, it held that role of each director should be pointed out.

Rule 27 of the Draft Companies (Winding Up) Rules, 2013* states that an application under Section 339 or 340 by summons served on every person against whom an order is sought at least seven days before the hearing of summons. On the return of the summons, the Tribunal shall give directions as to the delivery of claims and defence and taking of evidence and cross examination.

In a recent case, the Rajasthan High Court dismissed the application by the Official Liquidator alleging misfeasance, malfeasance or breach of trust by the respondent as OL failed to provide evidence to show that respondent ex-directors had retained current assets of company in liquidation. [*Official Liquidator of Lath Steels (P.) Ltd.* v. *Pawan Kumar Lath & Bimal Kumar Lath* [2016] 72 taxmann.com 59 (Rajasthan)]

24.32-1 Misfeasance, what constitutes

There is no distinct wrongful act known to law as "misfeasance". Though this term has not been defined in the Companies Act, 2013, the *Random House Dictionary* has provided its meaning in the legal context as "the wrongful performance of a normally lawful act." Section 340 does not create any new right or offence, but only provides a summary and cheap remedy for enforcing such rights as are otherwise enforceable by law. There are two conditions of liability under the section, *i.e.*, (*i*) an act in the nature of breach of trust, and (*ii*) an act which results in loss to the company.[30] Misfeasance, for the purpose of section 340, does not necessarily involve turpitude to comprehend any breach of duty by an officer of the company which involves a misapplication or wrongful retention of the company's moneys. The following are examples of misfeasance:—

(*i*) Payment of dividends otherwise than from distributable profits - *Re, National Funds Assurance Co.* [1978] 10 Ch. D 118.

(*ii*) Failure to take action for realisation of certain debts owing to the company and consequently debts becoming time barred - *Smart Advertising Co. (P.) Ltd. (In Liquidation)* v. *Ramesh K. Nanchahal* [1989] 65 Comp. Cas. 92 (P. & H.).

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*Not yet notified

30. *Official Liquidator* v. *Shailendra Nath Sinha* [1973] 43 Comp. Cas. 107 (Cal.).

(*iii*) Directors causing loss to the company by commencing business without fulfilling the requirements of commencement of business - *D. Doss* v. *C.P. Connell* [1937] 7 Comp. Cas. 429.

(*iv*) Accepting shares by way of gift for qualifying oneself as a director - *Rao Sahib* v. *Subbayya V.C.P. Machayya* [1942] 12 Comp. Cas. 102 (Mad.). Note that all the above acts are normally lawful acts, but becomes misfeasance when irregularly or illegally done.

(*v*) Inspection under section 209A [now Section 207] of a company under liquidation revealed that—

(*a*) the company, though a public company, was run by ex-directors as a private company;

(*b*) amounts were advanced to directors without interest;

(*c*) investments made and shares sold without seeking Boards approval, and all these cumulatively led the company to huge loss resulting into its going for winding up - *Parasrampuria Trading & Finance Ltd., In re* [2006] 70 SCL 342 (All.).

In respect of a company which was under winding-up, the Official Liquidator, based on a report by a Chartered Accountant, charged the directors of various acts falling within the ambit of misfeasance. On evidence, not a single act pertained to any director in his individual capacity and all were in fact Board's decisions. No proof in support of the charges also could be produced as the Chartered Accountant's report, *inter alia*, mentioned of non-availability of documents and records.

The court held that the application was filed presumably by the Official Liquidator to avoid limitation and all the acts, in the absence of proof, can be held to be in the interest of the company. The loss suffered by the company cannot also be held as emanating from acts or omissions of the directors. The application was rejected - *Official Liquidator of Gujarat Investment Trust Ltd.* v. *Kavasji Tehmurs Modi* [2003] 45 SCL 514 (Guj.).

24.32-2 Legal representatives, liability of

The cause of action in a misfeasance proceeding against the director or other delinquent officer initiated under section 340 survives against the legal representatives. In *Official Liquidator, Supreme Bank Ltd.* v. *P.A. Tendolkar* [1973] 43 Comp. Cas. 382, the Supreme Court held that the proceedings commenced against the delinquent director of a company in liquidation under sections 542 and 543 [now Section 339/340] can be continued after his death against his legal representatives and the amount declared to be due in such misfeasance proceeding can be realised from the estate of the deceased in the hands of his legal representatives. The Court further held that the legal representatives would not, however, be liable for any sum beyond the value of the estate of the deceased in their hands.

Action against foreign Directors - In *Karnataka Films Ltd.* v. *Official Liquidator, Chitrakala Movietone Ltd.* [1951] 21 Comp. Cas. 138 (Mad.), the Madras High Court held that the Court (now Tribunal) can pass a decree even against a director who is resident abroad. If such a director has some assets in India the decree can be enforced in India. If he has assets abroad, the decree may or may not be enforceable

but the Court (now Tribunal) may pass the decree even in such circumstances. However, a contrary view had been earlier expressed by the Patna High Court in *Bishadendu Gupta* v. *H. Langham Reed* [1937] 7 Comp. Cas. 165 (Pat.).

It may be noted that section 543 [now Section 340] does not empower the court (now Tribunal) to make an order *en masse* against all directors - *Central Calcutta Bank Ltd., In re* [1959] 29 Comp. Cas. 437 (Cal.).

Invoking section 340 against liquidator - The Kerala High Court in *L.K. Prabhu* v. *S.M. Ameerul Millath* [2002] 40 SCL 385 has held that proceedings against the official liquidator who was appointed as the liquidator of a company is maintainable provided the court (now Tribunal) is satisfied that there is a *prima facie* case under section 543 [now Section 340]. The case can proceed further if in addition to *prima facie* case, there is substance in the allegations. However, the Official Liquidator is entitled to protection under section 635A [now Section 456] for acts done in good faith and once that is proved, the proceedings have to stop.

24.32-3 Liability of Partners and Directors of Body Corporate [Section 341]

Where the declaration of liability under Section 339 or order under Section 340 is against a firm or a body corporate, section 341 empowers the Tribunal to declare that any partner in that firm or director in that body corporate at the relevant time shall also be liable.

24.33 Prosecution of Delinquent Officer and Members of the Company [Section 342]

Section 342 provides that if it appears to the Tribunal in the course of a winding- up by the Tribunal, that any past or present officer or member of the company has been guilty of any offence in relation to the company, the Tribunal may direct the Company Liquidator either himself to prosecute the offender or to refer the matter to the ROC. The Tribunal shall do so on the application of any person interested in the winding-up or of its own motion.

The liquidator and every person who has been an officer and agent of the company, would be duty bound to provide all assistance in connection with the prosecution.

24.34 Miscellaneous provisions

Under section 343 the Company Liquidator can exercise his powers to (*i*) pay any class of creditors in full (*ii*) make any compromise with creditors or present or future claimants and (*iii*) compromise any call, or liability to call, debt, and any liability capable of resulting in a debt including contingencies subject to the sanction of the Tribunal in case of winding-up by the Tribunal.

The Central Government is authorized under sub-section (2) to make rules enabling the Company Liquidator to exercise his powers as aforesaid without prior approval of the Tribunal. The rules may also specify terms and conditions in this regard. Any creditor or contributory may apply to the Tribunal is respect of the exercise of powers by the Company Liquidator and the Tribunal may, after giving the applicant a reasonable opportunity of being heard, make such order as it may think fit.

24.34-1 Statement that a company is in liquidation [Section 344]

Where a company is being wound up, whether by the Tribunal or voluntarily, every document (including invoice, order for goods or business letter) issued by or on behalf of the company or a Company Liquidator, or Receiver or manager of the property of the company or in which the name of the company appears, shall contain a statement that the company is being wound up.

In case of default, the company and every officer of the company, Company Liquidator and any Receiver or manager who wilfully authorises or permits the default, shall be punishable with fine which shall be not less than rupees fifty thousand but may extend to rupees three lakh.

24.34-2 Books and papers of company to be evidence [Section 345]

Where a company is being wound up, all books and papers of the company and of the Company Liquidators shall, as between the contributories of the company, be *prima facie* evidence of the truth of all matters purporting to be recorded therein.

24.34-3 Inspection of books and papers by creditors and contributories [Section 346]

At any time after the making of an order for the winding-up of a company by or subject to the supervision of the Tribunal, any creditor or contributory of the company may, subject to such rules as may be prescribed, inspect the books and papers of the company. Section 346 does not, however, exclude or restrict any rights conferred by any law for the time being in force—

(*a*) on the Central or a State Government;

(*b*) on any authority or officer thereof; or

(*c*) on any person acting under the authority of any such Government or any such authority or officer.

24.34-4 Disposal of books and papers of company [Section 347]

Section 347 provides for the period for which the books and papers of a company must be preserved after it has been completely wound up. The section provides that when the affairs of a company have been completely wound up and the company is about to be dissolved, its books and papers and those of the Company Liquidator may be disposed of in such manner as the Tribunal directs.

After the expiry of five years from the dissolution of the company, no responsibility shall rest on the company, the Company Liquidator, or any person to whom the custody of the books and papers has been committed, by reason of any book or paper not being forthcoming to any person claiming to be interested therein.

Sub-section (3) of section 347 empowers the Central Government, by making rules in this regard to —

(*a*) prevent for such period as the Central Government thinks proper, the destruction of the books and papers of a company which has been wound up and of its Company Liquidator; and

(*b*) enable any creditor or contributory of the company to make representation to the Central Government in respect of the matters specified in clause (*a*) and to appeal to the Tribunal from any direction which may be given by the Central Government in the matter.

If any person acts in contravention of any such rules or of any direction of the Central Government thereunder, he shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to rupees fifty thousand, or with both [Section 347(4)].

24.34-5 Information as to pending liquidations [Section 348]

If the winding-up of a company is not concluded within one year after its commencement, the Company Liquidator shall (except where he is exempted from so doing either wholly or in part by the Central Government) within 2 months of the expiry of such year, file a duly audited statement with respect to the proceedings in, and position of, the liquidation in the Tribunal.

This requirement is not applicable in a case covered by section 294 of the Act, where the audit is got done by the Tribunal itself.

Thereafter, the statement, as aforesaid, shall be filed until the winding-up is concluded, at intervals of not more than one year or at such shorter intervals, if any, as may be prescribed. The statement shall be in the prescribed form and contain the prescribed particulars. When the statement is filed in Tribunal, a copy shall simultaneously be filed with the Registrar who shall keep the same along with the other records of the company.

Where the statement relates to a Government company in liquidation, sub-section (3) requires the Company Liquidator to forward a copy thereof—

(*a*) To the Central Government, if that Government is a member of the Government company, or

(*b*) To any State Government, if that Government is a member of the Government company; or

(*c*) To the Central Government and any State Government, if both the Governments are members of the Government company.

Any contributory or creditor, himself or through agent, is entitled to inspect and receive a copy of the statement referred to in sub-section (1) by paying the fees as may be prescribed [sub-section (4)]. If it is found that the person has fraudulently represented himself as a contributory or creditor under sub-section (4), the Company Liquidator may apply for prosecution under section 182 of the Indian Penal Code [Section 348(5)].

If a Company Liquidator fails to comply with any of the requirements of section 348, as stated above, he shall be punishable with fine which may extend to rupees five thousand for every day during which the failure continues [Section 348(6)].

Further, if the Company Liquidator makes wilful default in causing the statement to be audited by a person qualified to act as auditor of the company, he shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to rupees one lakh or with both [Section 348(7)].

24.35 Deposit of money by the Official Liquidator and Company Liquidator [Sections 349 to 351]

Under section 349 it is obligatory for the Official Liquidator to pay the monies received by him in his capacity as Official Liquidator of any company, into the public account of India in the Reserve Bank of India. Every Company Liquidator is required to open a special bank account with a scheduled bank for this purpose [Section 350(1)]. The Tribunal however may permit the account to be opened in any other bank for the benefit of the creditors or contributories.

In case of the Company Liquidator retaining any money exceeding rupees five thousands (or such sum as may be authorized by the Tribunal) for more than ten days, he shall —

(*i*) pay interest on the amount so retained in excess, at the rate of twelve per cent per annum and be liable to penalty determined by the Tribunal;

(*ii*) be liable to pay any expenses occasioned by reason of his default; and

(*iii*) also be liable to have all or such part of his remuneration, as the Tribunal may consider just and proper, disallowed, or may also be removed from his office.

Section 351 prohibits the Official Liquidator and the Company Liquidator from depositing any monies received by him in his capacity as such into any private banking account.

24.35-1 Company Liquidation Dividend and Undistributed Assets Account [Section 352]

Section 352 prescribes the procedure to be followed by the liquidator if any money payable to any creditor or contributory remains unpaid. Accordingly if during the winding up, the liquidator has in his hands or under his control any money representing dividends payable to any creditor or assets refundable to any contributory but which had remained unpaid or undistributed for six months after the date on which they were declared or become refundable, the same shall be deposited into a separate special account to be known as the Company Liquidation Dividend and Undistributed Assets Account maintained in a scheduled bank. Similarly on dissolution any money representing unpaid dividends or undistributed assets in his hands is also required to be deposited into the Company Liquidation Dividend and Undistributed Assets Account. A detailed statement indicating the nature of sum, name and last known addresses of the person entitled to the sum and the amount entitled shall be submitted by the liquidator to the Registrar.

On application by any person claiming the money paid into the Liquidation Dividend and Undistributed Assets Account, the Registrar, if satisfied that the person claiming is entitled, shall settle the claim and make payment to the person. If the money remained unclaimed for a period of fifteen years, it shall be transferred to the general revenue account of the Central Government.

If the liquidator make a default in paying the money into the Company Liquidation Dividend and Undistributed Assets Account he shall be liable—

(*i*) to pay interest on the amount so retained at the rate of twelve per cent per annum and also pay such penalty as may be determined by the Registrar;

(*ii*) to pay any expenses occasioned by reason of his default; and

(*iii*) where the winding up is by the Tribunal, to have all or such part of his remuneration, as the Tribunal may consider just and proper, to be disallowed, and to be removed from his office by the Tribunal.

24.36 Default by the Company Liquidator to make returns [Section 353]

The Tribunal is empowered under section 353 to make an order directing the Company Liquidator to make good the default made in filing, delivering or making any return, account or other document, or in giving any notice which he is by law required to file, deliver, make or give. The order may be made by the Tribunal at the application by any contributory, creditor or the Registrar if the Company Liquidator has earlier failed to make good the default within fourteen days after the service on him of a notice requiring him to do so. The Tribunal in its order may provide that all costs of, and incidental to, the application shall be borne by the Company Liquidator. The Company Liquidator also remains liable to any penalties imposed under any other law for the time being in force.

24.37 Meetings to ascertain wishes of creditor and contributories [Section 354]

Section 354 reiterates that the winding up proceeding are for the benefits of the creditors and contributories and therefore the Tribunal may consider their wishes in all matters relating to the winding up. To ascertain those wishes the Tribunal may direct calling of meetings of creditors or contributories and appoint a person to chair the meeting. The chairperson so appointed shall report the result of the meeting to the Tribunal. While ascertaining such wishes the Tribunal shall consider the value of each debt of the creditors and number of votes each contributory has.

It may be noted that the expression used in this section is 'may' implying that convening the meeting is at the discretion of the Tribunal.

24.37-1 Rules relating to meetings of creditors and contributories

Rule 12 of the Draft Companies (Winding Up) Rules, 2013 lays down the procedure and rules to be followed for convening and conducting any meeting of the creditors and contributories. Accordingly -

(*i*) Notice of the meeting to be sent by the Company Liquidator at least fourteen days in advance by advertisement in an English newspaper and a newspaper in the regional language of the State where the registered office of the company is situated. Individual notices are required to be given so as to reach at least seven days before the meeting. The notice shall be sent at the address as per the books of the company or mentioned in the statement of affairs.

(*ii*) The place and time shall be fixed by the Company Liquidator as may be convenient to the majority of creditors or contributories or both and may be held at different time and/or place. An affidavit as an evidence of having sent the notice also need to be filed with the Tribunal.

(*iii*) Notice shall also be given to the officers of the company as in the opinion of the Company Liquidator ought to attend the meeting and a failure to attend shall be reported by the Company Liquidator to the Tribunal.

(*iv*) The cost of the meeting shall be met out of the assets of the company.

(*v*) The meeting shall be chaired by the Company Liquidator or his nominee. At least three creditors or contributories entitled to vote shall be the quorum for a creditors' or contributories' meeting respectively. If at a meeting the quorum is not present in half an hour, the meeting shall adjourn to the same day in the following week. At the adjourned meeting two creditors or contributories shall be the quorum. If the quorum is not present even at the adjourned meeting the Company Liquidator shall report the same to the Tribunal.

(*vi*) A resolution at a creditors meeting will be passed with a majority of creditors in number and value voting in favour either in person or by proxy. Contributories' resolution shall require votes of majority of contributories in number and value. A copy of every resolution shall be filed with the Tribunal as well as the Registrar.

(*vii*) The minutes of every meeting duly signed by the chairman of the meeting or the next meeting shall be kept. The result of the meeting shall be reported by the Company Liquidator within seven days to the Tribunal.

(*viii*) A creditor can vote when his proof of the debt has been submitted and admitted wholly or in part. A creditor whose debt is un-liquidated or contingent or any debt of which the value is not ascertained shall not vote. A secured creditor is entitled to vote only if he surrenders his security.

24.38 Power of the Tribunal to declare dissolution of a Company void

Where a company has been dissolved in any circumstance, the Tribunal may within two years of the date of dissolution, on application by the Company Liquidator or by any person who appears to be interested in the matter, make an order, upon such terms as the Tribunal thinks fit, declaring the dissolution to have been void and thereupon such proceedings may be taken as might have been taken if the company had not been dissolved. The person on whose application the order is made is duty bound to file a certified copy of the order with the ROC within 30 days or such extended time as allowed by the Tribunal. The ROC is to register the order. If the person fails to file the certified copy of the order with the ROC, he is punishable with fine which may extend to rupees ten thousand for every day of the default (section 356).

This provision gives the Tribunal a discretionary power to declare a dissolution to be void *ab initio* provided the application for such declaration has been made within two years of the date of the dissolution. There, however, rests a legal controversy on whether the Tribunal's order declaring the dissolution as void in fact is to be made within two years of the date of dissolution. In *ITO* v. *Vemulapalli & Sons (P.) Ltd.* [1967] 37 Comp. Cas. 686 (AP), following the interpretation given in *Sead Ltd., In re* [1942] 12 Comp. Cas. 30 (Ch.D.), the view was taken that only the application is to be filed within two years and the Court (now Tribunal) may pass orders at any

time thereafter. However, in *ITO Ernakulam* v. *Mambad Tea & Rubber Estates (P.) Ltd.* [1973] 43 Comp. Cas. 332 (Ker.) different view has been taken based on a literal interpretation of the provision. It has held that the court (now Tribunal) has no jurisdiction to pass an order after the expiry of two years from the date of dissolution.

Ordinarily a dissolution can be ordered as void if fraud is alleged and proved. Where a company was dissolved and amalgamated with another company, the court (now Tribunal) declined to pass the order declaring dissolution as void as the company was left with no undistributed assets - *ITO* v. *Mambad Timber & Estates (P.) Ltd.* (*supra*).

When a court (now Tribunal) declares a dissolution as void, all consequences resulting from the dissolution are avoided, including, proceedings taken during the interval between the date of the dissolution and the date of the order - *Morris* v. *Harris* [1927] AC 252, Re. Dixon (CGS) Ltd. [1947] 1 All E.R. 279. Also, properties deemed directly to have vested in the state as *bona facantia* would revert to the company. However, misfeasance proceedings are not revived by the order of the court - *In Re - Lewis Snart Ltd.* [1954] 2 All E.R. 19.

24.39 Contributory

24.39-1 Meaning of contributory

The term 'contributory' means a person liable to contribute to the assets of a company in the event of its being wound up, and includes the holder of any shares which are fully paid-up [Section 2(26)]. However a holder of fully paid up shares shall only have rights as a contributory but no liabilities of a contributory. As soon as may be after making a winding-up order, the Tribunal shall settle a list of contributories. The Tribunal is also conferred with the power to rectify the Register of members in all cases where rectification is required in pursuance of this Act.

The Tribunal is empowered to dispense with the settlement of the list of contributories when it appears to the Tribunal that it will not be necessary to make calls on, or adjust the rights of, contributories *[Proviso to sub-section (1) of section 285].*

In settling the list of contributories, the Tribunal shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of, others.

24.39-2 Contributory vis-a-vis Member

The terms 'contributory' and 'member' are not interchangeable. Section 285(2) distinguishes between those who are contributories in their own right and those who are representatives of or liable for the debts of contributories. While every member would become a contributory, the converse would not be true. For instance, a legal representative of a deceased member shall be regarded as contributory but he cannot be regarded as a member until and unless his name is entered in the Register of members - *Rajdhani Grains and Jaggery Exchange Ltd., In Re* [1983] 54 Comp. Cas. 166.

24.39-3 Persons liable as contributories

The following persons shall be liable as contributories on the winding-up of a company:

1. *Present and past members* - Every present and past member liable to contribute to the assets of the company for payment of debts, liabilities and costs of winding up and for adjustment of rights of the contributories is a contributory. A member of a limited company shall be liable to contribute the amount unpaid on the shares in respect of which he is a contributory, or the amount he has guaranteed to pay in the event of winding-up. A past member shall not be liable to contribute -

   (*i*) he ceased to be a member for one year or more before the commencement of winding-up; or

   (*ii*) in respect of any debt or liability contracted after he ceased to be member; or

   (*iii*) the present members are able to satisfy the contribution required.

2. *Directors and Manager whose liability is unlimited* - In the winding-up of a limited company, any director or manager, whether past or present, whose liability is unlimited, shall be liable as if he were a member of an unlimited company. But, a contribution from such a person shall require a Tribunal order, and he shall not be liable if he had ceased to hold office for a year or upward before the commencement of the winding-up [Section 286]. A past director or manager shall not be called upon to make payment as a contributory if the debt or liability of the company was contracted after he ceased to be the director or manager, as the case may be.

3. *Legal representatives of a deceased member* - If a contributory dies either before or after he has been placed on the list of contributories, his legal representatives shall be liable to contribute to the assets of the company in discharge of his liability and are contributories accordingly. But they are only liable to contribute to the extent of the assets, if any, which have come into their hands from the deceased shareholder - *Prayan Prasad* v. *Gaya Bank & Traders Assn. Ltd.* [1931] 1 Comp. Cas. 85.

   The expression 'legal representative' for the purposes of section 430 [now section 285] is not confined to the legal representatives of the person primarily interested but also includes the legal representatives of his legal representatives - *P.R. Krishnaswami, In re* [1947] 17 Comp. Cas. 189 (Mad.).

   In case shares are held jointly, the interest of the deceased shareholder passes on to the survivor and not to the heir of the deceased. The heir neither becomes a shareholder nor a contributory within the meaning of section 430 [now section 285] - *Ram Gobind Mishra* v. *Allahabad Theatres Pvt. Ltd.* (1986) Tax L.R. 1681 (All.).

4. *Assignee of a contributory* - If a contributory is adjudged insolvent, either before or after he has been placed on the list of contributories, his assignee in insolvency shall represent him for all the purposes of the winding-up, and shall be contributory accordingly.

5. *Liquidator of a body corporate which is a member* - If a body corporate which is a contributory is ordered to be wound up, either before or after it has been placed on the list of contributories, the liquidator of the body corporate shall represent it for all the purposes of the winding-up of the company and shall be a contributory accordingly.
6. *Subscribers to the Memorandum* - Subscribers to the Memorandum are deemed to be members of the company even though their names may or may not be entered in the Register of members. Accordingly, in the event of winding-up, in spite of the fact that their names are not entered in the Register of members, they shall be deemed as contributories for the amount remaining unpaid on the shares they agreed to subscribe for.

   In *J.H. Chandler and Co. Ltd., In re* (1926) 48 All. 580, a person agreed to purchase shares in a company and subscribed to the Memorandum of Association, but later asked the promoter to cancel his "requirements". His name was never entered in the register of members. It was held that he was liable as a contributory.

   Even allotment of shares is not necessary to create liability on the part of the persons who have subscribed to the memorandum - *Babulal* v. *Narayana Sugar and General Mills Ltd.* [1958] 28 Comp. Cas. 155 (Punj.); *Universal Transport Company Ltd.* v. *S. Jagjit Singh* [1958] 26 Comp. Cas. 36 (Punj.).
7. *Debtor - Whether a contributory ?* Held, no. The Himachal Pradesh High Court in *Shivalik Chit Fund & Machine Tools (T.) Ltd.* v. *Agricultural Industries & Others* AIR 1996, Aug., HP 83 held that 'Debtor' is not one of the persons mentioned in section 468 [now section 283], who may be asked to deliver, surrender, or transfer any money or property to the company through the liquidator. A debtor cannot be considered as a contributory.

Rule 10 of the Draft Companies (Winding-Up) Rules 2013 contains the procedure for settling the list of contributories. According the Company Liquidator is required to prepare a provisional list of contributories within twenty days of the winding-up order with their names and addresses and amount called up and paid up. The list is divided into two parts - contributories in their own right and in representative capacity. After fixing a date with the Tribunal for settlement of the list, a notice is given to all the persons on the list inviting objections if any. The objections are required to be filed with the Company Liquidator at least two days before the date fixed. The service of the notice shall complete at least fourteen days before the fixed date. The Tribunal after hearing objections if any shall settle the list. The notice of settlement of the list is given to all the persons on the list. Application for the variation in the list or removal of the name from the list shall be given within fifteen days of the date of service of the notice. The Tribunal has a right to include more persons in the list of contributories by following the same process as discussed. The list of contributories once settled cannot be altered except by an order of the Tribunal.

24.39-4 Liability of contributories (Section 285)

If the assets of a company in liquidation are insufficient to meet the debts and liabilities of the company and the expenses of the winding-up and to repay the

nominal value of the company's shares, the contributories may be called upon to make good the difference. In the event of a company being wound up every present and past member shall be liable to contribute to the assets of the company to an amount sufficient—

(*a*) for payment of (*i*) its debts and liabilities, and (*ii*) costs, charges and expenses of the winding-up, and

(*b*) for the adjustment of the rights of the contributories among themselves.

24.39-5 Liability of present members

The liability of a present member shall be limited—

1. In the case of a company limited by shares, to the amount remaining unpaid on the shares;
2. In the case of a company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up; and
3. In the case of a company limited by guarantee but also having share capital, to the amount undertaken to be contributed by him in the event of winding up as well as any sums unpaid on any shares held by him.

24.39-6 Liability of past members

A past member shall not be liable to contribute—

1. If he has ceased to be a member for one year or more before the commencement of the winding-up.
2. In respect of any debt or liability of the company contracted after he ceased to be a member.
3. If it appears to the Tribunal that the present members will be able to satisfy the contributions required to be made by them.

If a company goes into liquidation more than a year after the forfeiture of certain shares for non-payment of calls, the owners of such shares would be liable not as contributories, but as debtors of the company - *Ladies' Dress Association Ltd.* v. *Pulbrook* (1900) 2 QB 376. The only effect of forfeiture is that the shares pass out of their hands, but the liability incurred previously to pay the call money remains - *Shiromani Sugar Mills Ltd.* v. *Debi Prasad* [1950] 20 Comp. Cas. 296 (All.).

If transferees fail to pay the calls made in respect of the shares transferred to them, the shares will be forfeited for the benefit of the company; and the transferors will be liable to be placed on the list of contributories as past members of the company, if the shares were transferred within a year before the commencement of winding-up - *Accidental Marine Insurance Corpn., In re* (1869) 4 Ch. App. 266. Successive transfers of the same shares made immediately before one year of winding up would result in all the past owners of the said shares being treated as past members. However, their liability as contributories would arise only if it is apparent that the present members are unable to satisfy the debts of the company - *Land Credit Company of Ireland, Humby's* case, In re 20 WR 718 and *Kellock* v. *Enthoven* (1874) LR 9 QB 241.

It may be noted that the plea of voidability or illegality of contract to take shares cannot be taken after winding-up to avoid liability as a contributory. The contract so vitiated should be sought to be set aside before the company goes into liquidation. The original contract may supply the reason for his name having been placed on the register in respect of the shares, but after the winding-up his liability in respect of the shares arises *ex lege* and *ex contractu* - *Hansraj Gupta* v. *N.P. Asthana* (1932) 2 Comp. Cas. 543 (PC) and *Mahomed Akbar Abdulla Fazalbhoy* v. *Official Liquidator* (1950) 20 Comp. Cas. 26 (Bom.). On a winding-up order being made the liability of a contributory becomes an absolute statutory liability. The unpaid calls can be recovered even though barred by limitation when the winding-up order is made - *People's Insurance Co. Ltd.*, In re (1962) 32 Comp. Cas. 632 (Punj.) and *T.M. Mathew* v. *Industrial Bank Ltd.* (1972) 42 Comp. Cas. 55 (Ker.).

24.39-7 Nature of liability of contributory [Section 296]

Once the winding-up order has been passed, the Tribunal may call upon the contributories to pay to the extent of their liability, for payment of debt or liabilities of the company and the cost, expenses and charges of the winding-up for adjustment of rights of contributories. The Tribunal may also order for payment of any call so made.

Once a call has been made, the liability of the contributory to pay it becomes a statutory debt. A new liability to pay the unpaid balance commences. It is settled in a long course of decisions that the members of a company in liquidation are liable in respect of unpaid calls even though the calls were made by the company before it went into liquidation and the suit of the company for its realisation had become barred by time. As the debt under the statute is a new creation, quite distinct and apart from any creditor's claim to recover from the shareholder, as a contributory in the winding-up, the unpaid share money will not be affected by the fact that prior to the winding-up, the company had issued calls for the amount and allowed the recovery under these calls to become time barred - *East Bengal Sugar Mills Ltd.*, In re [1914] 11 Comp. Cas. 169 (Cal.). Since the power to make calls in a compulsory winding up is vested in the court (now Tribunal) under section 470 [now section 296], the statutory liability of a contributory to pay can arise only under a call validly made, that is, a call made by the court (now Tribunal) and not by the liquidator himself - *Associated Banking Corporation of India Ltd.* v. *Mahomed Akbar* AIR 1950 Bom. 386. The proper procedure seems to be that the Tribunal shall first make an order for calls to be made, and liquidator in pursuance of the order shall make the calls.

Ex contractu and ex lege liability - The liability of a member to be included in the list of contributories is not *ex contractu, i.e.*, it does not arise as a result of the contract of membership; his liability is *ex lege* which means that it arises by reason of the fact that his name appears in the Register of members. Before a company goes into liquidation, the liability of a member to contribute is measured by the contractual obligation arising from membership. But after liquidation a new liability is imposed on the shareholders in respect of calls made before or after the winding-up remaining unpaid. Such calls can be recovered even if they are barred by limitation before the order of winding-up was made.

24.39-8 Contributory's right of set off

In the following cases section 295 gives the right of set off to the contributory :

1. In the case of an unlimited company, the Tribunal may allow to the contributory by way of set off any money due to him or to the estate which he represents from the company on any independent dealing or contract with the company but not in respect of any money due to him as dividend or profit.
2. In the case of a limited company, the Tribunal may give the above allowance to any director or manager whose liability is unlimited.
3. In the case of any company, whether limited or unlimited, when all the creditors have been paid in full, any money due to a contributory from the company may be allowed to be set off against any subsequent call.

24.40 Unregistered Companies

24.40-1 Meaning of unregistered company [Section 375]

Section 375 of the Companies Act defines an unregistered company. The definition is given in two parts, *viz.,* (*i*) What the expression 'unregistered company' includes; and (*ii*) What it does not. Clause (*b*) of *Explanation* to section 375 provides that 'unregistered company' shall include any partnership, limited liability partnership, society, co-operative society, association or company consisting of more than seven members at the time when the petition for its winding-up is presented before the Tribunal. The expression, however, does not include (*i*) a railway company incorporated by any Act of Parliament or other Indian law or any Act of Parliament of U.K.; (*ii*) a company registered under the Companies Act, 2013; or (*iii*) a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden or Pakistan immediately before the separation of that country from India.

An illegal association is not an unregistered company, and, therefore, cannot be wound up under section 583 [now section 375] - *Raghubar Dayal* v. *The Sarafa Chamber* AIR 1954 All. 555.

The definition of 'unregistered company' as given under section 375 should, thus, be read along with section 464 of the Act. Accordingly, a partnership or association of person consisting of more that the prescribed number of persons needs to be registered as a company. The number of person prescribed shall not exceed one hundred.

As per Rule 10 of the Companies (Miscellaneous) Rules, 2014 no association or partnership shall be formed, consisting of more than fifty persons for the purpose of carrying on any business that has for its objects the acquisition of gain by the association or partnership or by individual members thereof, unless it is registered as a company under the Act or is formed under any other law for the time being in force. Accordingly an association or partnership with more than fifty persons shall be considered an illegal association.

Also, an association or company having less than seven members cannot be wound up by the Tribunal as an unregistered company.

Where petitioner failed to show that respondent-company had seven or more partners, *prima facie* it would have to be taken that it was not an *unregistered company - Makhan Singh Devinder Pal Singh* v. *Raja Oil Mills* [2000] 27 SCL 207 (Punj. & Har.).

24.40-2 Winding-up of an unregistered company [Section 375]

The rules relating to winding-up of unregistered companies are :

1. No unregistered company shall be wound up voluntarily [Section 375(2)]. Thus, an unregistered company can only be compulsorily wound up by the Tribunal.
2. The circumstances under which an unregistered company may be wound up are as follows :
   (*a*) If the company is dissolved or has ceased to carry on business or is carrying on business only for the purposes of winding-up its affairs.
   (*b*) If the company is unable to pay its debts.
   (*c*) If the Tribunal is of the opinion that it is just and equitable that the company should be wound up [Section 375(3)].

As per section 375(4) an unregistered company shall be deemed unable to pay its debts in the following circumstances :

(*i*) If a creditor, to whom the company is indebted in a sum exceeding rupees one lakh has served on the company a demand under his hand requiring the company to pay the sum so due, and the company has, for three weeks neglected to pay the sum or to secure or compound for it to the satisfaction of the creditor.

(*ii*) If any suit or other legal proceedings have been instituted against any member for any debt or demand due, or claimed to be due, from the company or from him in his character of member, and notice in writing of the institution of the suit or proceedings having been served on the company and the company has not, within ten days thereafter :
   (*a*) paid, secured or compounded the debt or demand; or
   (*b*) procured the suit or legal proceedings to be stayed; or
   (*c*) indemnified the defendant to his satisfaction against the suit or other legal proceeding and against all costs, damages and expenses to be incurred by him by reason of the same.

(*iii*) If execution or other process issued on a decree or order of any Court or Tribunal in favour of a creditor against the company or any member thereof is returned unsatisfied in whole or in part.

(*iv*) If it is otherwise proved to the satisfaction of the Tribunal that the company is unable to pay its debts.

Rule 47 of the Draft Companies (Winding Up) Rules, 2013* states that every persons liable to contribute to the payment of any debt or liability of the company, the cost, charges and expenses of winding up or for the adjustment of rights of the members among themselves shall be deemed to be a contributory. Contributory shall also

*Not yet notified.

include the legal representatives of deceased contributories and assignees of insolvent contributories.

24.40-3 Procedure for winding up of unregistered company

The legal provisions and procedure relating to compulsory winding-up by Tribunal will also apply in the case of winding up of an unregistered company.

24.40-4 Winding-up of a firm as an unregistered company

The Karnataka High Court has ruled, that if a partnership has more than seven members but upto twenty members at the time of presentation of the petition for winding-up, the firm can be wound up as unregistered company provided ingredients of section 583(4) [now section 375(3)] are present and no proceeding has been started under the Partnership Act, 1932 - *K.N. Eswara Rao* v. *K.N. Shama Rao & Sons* [2000] 23 SCL 307. The Bombay High Court in *Polaroid India (P.) Ltd.* v. *Nav Nirman Company* [2001] 33 SCL 1 held that section 583 [now section 375] has not made any distinction between a registered firm and an unregistered one and as such the respondent being a registered firm otherwise can be wound up under section 583 [now section 375] for non-repayment of security deposit it received from the petitioner company for a rental arrangement.

24.41 Winding-up of a Foreign Company

Where a company is incorporated outside India and which has been carrying on business in India ceases to carry on business in India, may be wound up as an unregistered company notwithstanding that the company has been dissolved or otherwise ceased to exist as such under the laws of the country under which it was incorporated [Section 376].

24.42 Removal of name of company from Register of Companies

Under section 248 the Registrar has the power to remove the name of a company from the Register of the Companies. In the circumstances mentioned in the section, a company's name can be removed from the Register of Companies without following the elaborate process prescribed for the winding up of companies. The registrar may remove the name in the following circumstances mentioned in section 248(1) —

(*i*) Failure by the company to commence business within one year of its incorporation;

(*ii*) Failure to make any application for obtaining the status of a dormant company under section 455 in case the company is not carrying on any business or operation for a period of two immediately preceding financial years.

(*iii*) Failure of the subscribers to the memorandum to pay the subscription which they had undertaken to pay at the time of incorporation and filing of declaration under sub section (1) of section 10A within one hundred and eighty days of incorporation; or

(*iv*) The company not carrying on any business or operation as revealed after the physical verification carried out under sub section (9) of section 12.*

Failure to file financial statements and annual returns for various financial years without showing any reasonable cause was held to be valid justification for ROC to strike off name of appellant company under section 248. [*Palaniandavar Benefit Fund Ltd.* v. *Registrar of Companies, Chennai* [2019] 101 taxmann.com 390 (NCL-AT.)]

24.42-1 Procedure for removing the name

The procedure regarding removing the name of a company from the Register of Companies as contained in section 248 of the Act may be noted as follows :

1. Where the Registrar has reasonable cause to believe that circumstances enumerated in sub-section (1) exists, he shall send a notice to the company and all directors of the company of his intention to remove the name of the company from the Register of Companies. The notice shall also request them to send their representation and relevant documents within thirty days of the notice [Section 248(1)].
2. The notice as aforesaid shall also be published by the Registrar in Form No. STK-5A** in the Official Gazette for the information of public [Section 248(4)].
3. At the expiry of the period mentioned in the notice, and if cause to the contrary is not shown by the company, the Registrar shall strike the name of the company off the Register and publish a notice to that effect in the Official Gazette. On the publication of this notice, the company shall stand dissolved [Section 248(5)].
4. The Registrar, before passing an order under sub-section (5), shall satisfy himself that sufficient provision has been made for the realisation of all amounts due to the company and for the payment or discharge of its liabilities and obligations by the company within a reasonable time. The Registrar may obtain an undertaking from the managing director, director or other persons in charge of the management of the company to that effect.

The assets of the company shall be made available for the payment or discharge of all its liabilities and obligations even after the date of the order removing the name of the company from the register of companies [Section 248(6)].

The Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016, prescribe the procedures and forms for the removal of names of companies under Section 248.

24.42-2 Removal of the name by special resolution by a company [Section 248(2)]

A company may pass a special resolution with the consent of seventy five per cent of members in terms of paid up capital and apply to the Registrar to remove the name of the company from the Register of Companies on grounds mentioned in

*Amended *vide* Companies (Amendment) Act, 2019.

** Inserted *vide* the Companies (Removal of Names of Companies from the Register of Companies) Amendment Rules, 2017, Notification G.S.R. 355(E), dated 12 April 2017.

sub-section (1). Before passing a resolution as aforesaid, the company needs to extinguish all its liabilities. Any company regulated by a special Act, approval of the concerned statutory body needs to enclosed with the application. The application needs to be filed in Form STK-2 with application fee of Rs. 5,000. A public notice shall be given by the Registrar on receipt of such application.

However a company registered under section 8 (for charitable purposes etc.) is not covered by section 248(2).

Every director, manager or other officer who was exercising any power of management, and of every member of the company dissolved under sub-section (5), shall continue to remain liable as if the company had not been dissolved.

Nothing in this section shall affect the power of the Tribunal to wind up a company the name of which has been struck off from the register of companies.

It may be noted that section 248 provides an easier exit option for the companies under the specified circumstances in lieu of going through the lengthy and tedious process involved in the winding up.

Effect of company notified as dissolved [Section 250] - From the date of notice under section 248(5) the Certificate of Incorporation issued to the company shall stand cancelled and it shall stand dissolved. However the dissolution shall not affect the realization of the amount due to the company or payment of the liabilities or obligations of the company.

24.42-3 Restriction on making application under section 248

Section 249(1) provides that an application under section 248 for the removal of the name from the Register of companies is not to be made if at any time during the previous three months —

(*a*) The company has changed its name or shifted its registered office from one State to another;

(*b*) The company has made a disposal for value of property or rights held by it, immediately before cesser of trade or otherwise carrying on of business, for the purpose of disposal for gain in the normal course of trading or otherwise carrying on of business;

(*c*) The company has engaged in any other activity except the one which is necessary or expedient for the purpose of making an application under that section, or deciding whether to do so or concluding the affairs of the company, or complying with any statutory requirement;

(*d*) The company has made an application to the Tribunal for the sanctioning of a compromise or arrangement and the matter has not been finally concluded; or

(*e*) The company is being wound up under Chapter XX of this Act or under the Insolvency and Bankruptcy Code, 2016.

It may be noted that the circumstances mentioned in section 249(1) are those that indicate that company has made some changes in the last three months and hence it is fair that a reasonable time should elapse before an application under section 248 may be allowed.

Any violation of sub-section (1) will make the company liable to fine which may extend to rupees one lakh and application need to be withdrawn by the company.

Fraudulent application under section 248(2) - Section 251 impose liability upon the persons in charge of the management of the company *for* making an application under sub-section (2) of section 248 with the object of evading the liabilities of the company or with the intention to deceive the creditors or to defraud any other persons. Accordingly the person in charge of management shall be jointly and severally liable to any person or persons who had incurred loss or damage as a result of the company being notified as dissolved. In addition he shall be punishable for fraud in the manner as provided in section 447.

The liability for fraudulent application is attached notwithstanding the fact that the company has been notified as dissolved. The Registrar may also recommend prosecution of the persons responsible for the filing of a fraudulent application.

Appeal to the Tribunal [Section 252] - The Tribunal under sub-section (1) of section 252 is empowered to order restoration of the name of the company in the Register of Companies if it is of the opinion that the removal of the name of the company from the register of companies is not justified in view of the absence of any of the grounds on which the order was passed by the Registrar. Such an order may be passed -

(*a*) On an application of any person aggrieved by the order of the Registrar under section 248; or

(*b*) On an application by the Registrar on the grounds that the name of the company has been struck off from the register of companies either inadvertently or on the basis of incorrect information furnished by the company or its directors, which requires restoration in the register of companies.

Application by the Registrar or any other person shall be made within a period of three years from the date of the order. The Tribunal after giving a reasonable opportunity of making representations and of being heard to the Registrar, the company and all the persons concerned may pass the order for restoration of the name.

A copy of the order passed by the Tribunal shall be filed by the company with the Registrar within thirty days. The Registrar shall cause the name of the company to be restored in the Register of Companies and shall issue a fresh certificate of incorporation [Section 252(2)].

Section 252(3) allows a company, member, creditor or workman of the company before the expiry of twenty years from the publication in the Official Gazette of the notice under sub-section (5) of section 248 to apply to the Tribunal for restoration of the name of the company in the Register of Companies. The Tribunal on such application, if satisfied that the company was, at the time of its name being struck off, carrying on business or in operation or otherwise it is just that the name of the company be restored, may by order restore the name of the company. Tribunal may also give such directions as may be necessary to place the company and all other persons in the same position as nearly as may be as if the name of the company had not been struck off from the Register of Companies.

In *Re, Portrafram Ltd.* (1986) BCLC 533 (Ch.D.), it was observed that before the court makes an order for restoration it must be satisfied that :

1. the applicant was a creditor or contributory at the time the company was dissolved;
2. the company is solvent;
3. on the date of striking off, the company was carrying on business, or otherwise it is in the interest of justice that the order of restoration should be made. *See Zalak Cold Storage (P.) Ltd., In re* [2009] 90 SCL 69 (Guj.).

It may be noted that Tribunal may restore the name if either the company was carrying on business at the time of its name being struck of or it is otherwise just to restore the name of the company. The Delhi High Court in *M.A. Panjwani* v. *Registrar of Companies* [2014] 44 taxmann.com 89 (Delhi) held that under Section 560(6) [now section 252(3)] these two conditions are given as alternatives. If either of them is satisfied the Court (now Tribunal) may order restoration of the name. In this case the name of the company has been struck of and the petitioner sued the company for certain losses suffered. It was contented that no effective remedy shall be available to the petitioner unless the name of the company was restored. The same court in *Shitiz Metals Ltd.* v. *Registrar of Companies* [2013] 37 taxmann.com 358 (Delhi) held any creditor in order for recovery of amount due from the company whose name was struck of can make application to the company court (now Tribunal) for restoration of the name within 20 years.

Wound up company can be revived unless barred by limitation and unless adequate asset existed- J.M.A. Mohd. Farook v. *Aziz Company (Pvt.) Ltd.* [1996] 1 Comp. L.J. 552 (Mad.). A scheme for reviving a company under winding-up could be sanctioned by the company court (now Tribunal), if it had been approved by the necessary majority and the company had adequate assets after paying all the creditors, provided the period for restoration of the company in the register as per section 560(6) [now section 252(3)] *i.e.* 20 years has not elapsed.

A person who acquires shares or debt of a company, the name of which has been struck off the register, and who has had knowledge of that fact at the time of the acquisition is not entitled to apply, as he is not a person aggrieved [*Re, New Timbiqui Gold Mines Ltd.* (1961) 1 All ER 865]. The court (now Tribunal) may also order that the company and all other persons affected by the striking off will be restored in the same position as nearly as may be as if the name of the company had not been struck off.

Upon a certified copy of the order of the Tribunal being delivered to the Registrar for registration, the company shall be deemed to have continued in existence as if its name had not been struck off.

In a series of cases that came up for restoration in recent years, an almost common plea has been advanced by the person urging restoration that the company continues to function and the defaults that gave rise to the ROC declaring the company as defunct were caused by the negligence of officers and/or professionals entrusted with the related tasks. The courts, while not finding any fault with the ROC's action, in most cases allowed restoration on conditions on the concerned company curing the defaults and payment of all fees and penalties payable thereon,

on court's (now Tribunal's) satisfaction that the company in fact was in operation. In all the cases, the court held, that primary responsibility of compliance with regulatory requirements of the Companies Act unquestionably, vests with the management and management plea that the responsibilities of defaults vest on relevant officer/professional is not acceptable. Vide - *Auto Kashyap India (P) Ltd.* v. *ROC*[2010] 100 SCL 418; *Vats Associates (P.) Ltd.* v. *ROC*[2010] 102 SCL 397 - both decided by Delhi High Court. These two cases are just illustrative. In another context also, the same High Court allowed restoration when the company's name was struck off by the ROC, as the company did not inform him about the change of its registered office and as a consequence notice under section 560 [now section 252(3)] was not received by it. In this case, though the company had stopped carrying on its main objectives but it held properties and holding of property was one of the objects in the memorandum of the company. The company was directed to pay exemplary cost and comply with all the required formalities - *Amarpreet Enterprises (P.) Ltd.* v. *ROC*[2010] 101 SCL 420. In another case also the Delhi High Court allowed restoration even though the company was functioning but never filed the statutory documents with ROC and did not care to inform ROC of the change of address of its registered office. Besides, in this case, the company was under litigation and the court felt that it would not be proper not to allow restoration when the litigation continues - *Kesinger Paper Mills (P.) Ltd.* v. *Ministry of Corporate Affairs* [2010] 101 SCL 321. Even when it was established that the statutory notice was duly served by ROC before declaring a company as defunct, the court allowed restoration as the company was in operation - *High Seas Mastics (I) Pvt. Ltd.* v. *ROC* [2010] 103 SCL 187 (Delhi). Also *see Mace Plastronics (P.) Ltd.* v. *ROC*[2010] 104 SCL 277 (Delhi).

In *Nitasha Gaurav Exports (P.) Ltd.* v. *Registrar of Companies NCT of Delhi & Haryana*[2014] 50 taxmann.com 456 (Delhi). The name of petitioner-company was struck off from register of Companies for non-filing annual returns and not furnishing other statutory compliances. The company submitted that lapse was inadvertent and on account of *bona fide* circumstances beyond control of Directors and Shareholders and agreed to statutory compliances. The Delhi High Court permitted the name of petitioner-company to be restored subject to payment of costs as the petitioner-companies had undertaken to make statutory compliances and file the requisite statutory records and accounts with ROC. Similarly, the NCLT, Hyderabad in *Sree Gayathri Leisure India (P.) Ltd.* v. *Registrar of Companies Andhra Pradesh & Telangana*[2018] 89 taxmann.com 34 (NCLT - Hyd.) permitted the name of the company to be restored upon filing all returns with the prescribed fees. Also see *D3R Gateway Logistics (P.) Ltd.* v. *Registrar of Companies, Tamil Nadu* [2018] 90 taxmann.com 77 (NCLT - Chennai).

The name of a real estate company was restored where the company has entered into MOU to purchase certain lands for purpose of development and had commenced its business activity. [*Vasudev Hemubhai Dabhi* v. *Registrar of Companies, Gujarat* [2018] 90 taxmann.com 75 (NCLT - Ahd.).] However, in another case the NCLT, New Delhi dismissed the petition for the restoration of the name as the company has not carried any business for the last 12 years. [*Rastogi Enterprises (P.) Ltd.* v. *Registrar of Companies* [2017] 85 taxmann.com 96 (NCLT - New Delhi).

In a case where ROC did not comply with section 560(3) [now section 252(3)] striking off name of the company was held infructuous—*Sitaram Singh Construction (P) Ltd.* v. *Union of India* [2011] 105 SCL 359 (Patna).

Petition against restoration of a company's name - In *ZTE Corporation* v. *Siddhant Garg* [2013] 32 taxmann.com 193 (Delhi), a foreign arbitration award had been passed against appellant and in favour of company whose name had been struck off from register of RoC. Creditors of company had filed petition for restoration of name of company in register of RoC and same was allowed by impugned order. The appellant filed a petition against the restoration of company's name because a financial loss would be suffered by appellant *qua* arbitration awards which had been passed against it. The learned High Court held that it was not a circumstance that could qualify as an exception seeking a refusal of restoration of company. Instead, if name of company was not restored, it would be deprived of its right to function as a going concern and to recover its dues accrued under award. It would, thus, be 'just' to restore name of company.

It was held in *Meghdoot Services Ltd.* v. *Registrar of Companies, West Bengal* [2016] 73 taxmann.com 281 (Cal.) that where name of company had already got struck off from Register of company on prayer of company or its directors, their subsequent, application to restore name of company in Register would not be allowed. The petition for restoration of name could be filed only by an aggrieved party.

In *Basant Kumar Berlia* v. *Registrar of Companies* [2019] 104 taxmann.com 83 (NCL-AT), the name of the company was struck off from register of companies due to non-filing of statutory returns. The company submitted that it was not deliberate or intentional and that it was in operation and had valuable assets, long-terms loan and advances. It was held by the New Delhi Bench of NCLT that it was just and equitable that name of company be restored in register of companies. Similar views were held by the Hyderabad Bench of NCLT in *Bran Etechnologies (P.) Ltd.* v. *Registrar of Companies* [2019] 104 taxmann.com 311 (NCLT - Hyd.) and by New Delhi Bench of NCLT in *G.S.C. Industries (P.) Ltd.* v. *Registrar of Companies, NCT of Delhi & Har.,* [2019] 101 taxmann.com 472 (NCL-AT). Also see *Bran Etechnologies (P.) Ltd.* v. *Registrar of Companies* [2019] 104 taxmann.com 311 (NCLT - Hyd.) and in *G.S.C. Industries (P.) Ltd.* v. *Registrar of Companies, NCT of Delhi & Har.,* [2019] 101 taxmann.com 472 (NCL-AT).

24.42-4 Effect of Restoration

The effect of an order under this section is that the company is to be deemed to have continued in existence 'as if its name had not been struck off'. The object is to put both the company and their parties in the same position as they would have occupied if the dissolution of the company had not intervened. Not only is the corporate existence of the company restored, but also it takes effect retrospectively, so that at the date of the restoration, it produces 'as you were' position - *Tyman's Ltd.* v. *Craven* (1952) 1 All ER 613.

Rights and liabilities of the company are not wiped out by its having been struck off in the interim period - *Purshottamdas* v. *Registrar of Companies, Maharashtra* (1986) 60 Comp. Cas. 154 (Bom.).

24.42-5 Position of creditors on restoration[31]

Where a company is restored to the Register, the Tribunal will make such order as will put the company and third parties in the same position as they would have occupied if no dissolution had intervened. As the name of the company can be restored at any time within twenty years, any contributory or other person interested, cannot try to defeat the creditors by keeping quiet for some years until the creditors' claims get time barred, and then apply to have the company restored, so that any available assets of the company may be taken by themselves without paying anything to the creditors.

In such a case the order restoring the company to the Register will also provide that in the case of claims of creditors which were not time-barred on the date of dissolution, the period between the date of dissolution and the date of restoration shall not be counted for purposes of the Limitation Act - *Re, Kenyon Donald Ltd.* (1956) 3 All ER 596.

24.43 Vanishing Company

Vanishing companies generally are companies that raise capital from the public by use of I.P.O.s and thereafter they become untraceable by the investors. This phenomenon has assumed a menacing proportion in recent days. The Ministry of Corporate Affairs has recently announced following criteria for identification of such companies :

A company would be deemed to be a vanishing company, if it is found to have—

(*a*) failed to file returns with RoC for a period of two years;

(*b*) failed to file returns with stock exchange for a period of two years;

(*c*) it is not maintaining its registered office at the address notified with the RoC/ Stock Exchange; and

(*d*) none of its directors is traceable.

All the above conditions would have to be satisfied before a listed company is declared as a vanishing company and in case of a delisted company the criteria mentioned in (*a*), (*c*) and (*d*) would require to be satisfied. (*Source:* SEBI & Corporate Laws - Page 23 of February 22, 2010).

Can a petition by the official liquidator to remove the Receiver appointed by another High Court, before passing of the winding up order, be entertained by the High Court before which the winding up petition has been made?—No, but the petition for removal can be moved before the High Court which has appointed the Receiver. The petition can seek possession of the properties in the hand of Receiver - *IDBI* v. *Official Liquidator of Madan Industries Ltd.* [2001] 31 SCL 308 (All.).

24.44 Transfer of winding-up proceedings to Tribunal

Section 434 requires transfer of all proceedings including those relating to arbitration, compromises, arrangements, reconstruction and winding up of companies

31. A. Ramaiya's Guide to the Companies Act, 1988 edn., p. 1387.

pending with any District Court or High Court or Company Law Board to the Tribunal from the date to be notified by the Central Government. On such transfer the Tribunal may proceed to deal with such proceeding form the stage before their transfer.

24.45 Some more cases on winding up—

1. When a company has duly notified the ROC about the change of address of its registered office, no fault lies with the company on that account even when the ROC records the change long after filing of the information. Therefore, sending the statutory notice by the lender at the earlier address of the company does not amount to compliance with the provisions of section 434(1)(*a*) [now section 271(2)] - *Black Sea Shipping Co.* v. *Viraj Overseas (P.) Ltd.* [2004] 49 SCL 627 (Delhi).
2. Where, after the issue of winding up order the promoters and directors want to revive the company, proper procedure for this is to file a petition with the scheme of revival with the court (now Tribunal) and not an application under section 466 [now section 289] of the Act for stay on winding up - *Shankar Lal Bansal, In re* [2004] 49 SCL 543 (Raj.).
3. *Conditional appointment of provisional liquidator* - The Bombay High Court in *Ms. Asha Bhosle* v. *Magnasound (I) Ltd.* [2004] 50 SCL 36 allowed conditional appointment of Official Liquidator as the provisional liquidator having regard to the respondent's willingness to make payment to the petitioner, her dues in instalments. If the respondent defaults in payment in terms of the court's (now Tribunal's) order, then the conditional appointment would become absolute and the Official Liquidator would take possession of assets of the company. In the event of respondent meeting the payment obligation in terms of the court's order, the conditional appointment of provisional liquidator would stand terminated.
4. The law does not contemplate that any money paid by the company, after commencement of its winding up, to its creditor is to be called back, unless such payment amounts to fraudulent preference. *Motorola India Ltd.* v. *DDS Mobile Communications Ltd.* [2004] 56 SCL 601 (Delhi).
5. *Overriding interest of small deposit holders* - The Court in *Basant Lal Agarwal* v. *Lloyds Finance Ltd.* [2005] 59 SCL 169 (Bom.) stayed the proceedings of secured creditors against the company after winding up order has been passed and as a special measure certain scheme was put to motion to repay the deposits of small deposit-holders as the secured creditors' proceedings will frustrate the scheme to repay the small depositors.
6. Another *inter se* bidding for sale of company property by the liquidator can be ordered by the court (now Tribunal) when report of confirmation of sale is filed with the court (now Tribunal). The court may give preference to a Government company as a buyer of such property even when its bid is marginally lesser - *Official Liquidator of Ahmedabad Mfg. & Calico Printing Mills Ltd.* v. *IDBI* [2005] 63 SCL 304 (Guj.).

7. Where leave under section 446(1) [now section 279] is obtained after institution of suit, proceedings would be regarded as having been instituted on date on which leave was obtained - *State of Jammu & Kashmir* v. *UCO Bank* [2006] 66 SCL 191 (SC).
8. In a case where the petitioner advanced money to company S on the basis of guarantees given by P, a company and one R and the money remained unpaid; the petitioner issued notices under section 434 [now section 271(2)] to the borrower and P. There was arbitral proceeding between the petitioner and S and P while the petition under section 433 [now section 271(1)] was pending and S and P agreed to make the repayment but failed. There is no need to again send notice under section 434 [now section 271] to S and P as the payability of the amount was established against both, notwithstanding any disagreement between S and P as regards the respective share in repayment - *Dolphin Investment (P) Ltd.* v. *C. Pinto Trade Commerce (P) Ltd.* [2008] 81 SCL 16 (Bom.).
9. When a civil suit precedes winding-up petition in a complexly woven situation, relegation of the matter to civil suit was justified taking into account circumstances of the case - *Star Textiles & Industries Ltd.* v. *Olive Tea Plantations (P.) Ltd.* [2009] 91 SCL 313 (Cal.).
10. A company was ordered to be wound-up pursuant to BIFR recommendation and its assets were offered on sale. Respondent made the highest offer of Rs. 5 crore and paid a token amount of Rs. 10 lakh and balance to be paid in instalments. But before the payment of first instalment became due, stay on the sale was granted by the Division Bench which was vacated after 6 years. Then respondent paid some more amounts with stipulation of making full payment within next 3 days. In the meanwhile, another party made a higher offer and the company judge ordered for re-invitation of quotations. Supreme Court on appeal held that the respondent was entitled to acquire the assets on payment of balance amount with interest as six years have lapsed since the acceptance of his offer - *IFCI Ltd.* v. *Vishnukant Gupta* [2009] 92 SCL 20.
11. When court (now Tribunal) direction for announcing sale proclamation was not properly followed and successive bidding by only few bidders and that too *inter se* brought a highest offer which was much lower than market value, the act of handing over the property to such highest bidder by the Official Liquidator has to be set aside - *Saraf Paper Mills Ltd. (In liquidation), In re* [2009] 92 SCL 232 (Delhi).
12. Even though the company judge ordered that the offer to buy properties of the company in liquidation by the appellant be accepted on the basis of terms and conditions then agreed but before the sale process was complete other buyers with better offers approached the Court. The company judge ordered re-auction of the properties as no finality of sale had taken place. On appeal, the decision of the company judge was upheld - *S.B. Overseas Ltd.* v. *Konark Jute Ltd.* [2009] 94 SCL 279 (Orissa), Also *see Shraddha Aromatics (P.) Ltd.* v. *O.L. of Global Arya Industries Ltd.* [2009] 94 SCL 288 (Guj.)

13. Once winding-up order is passed, it relates back to the date of commencement of the proceedings and if any amount is realized by secured creditors by sale of company assets after presentation of winding-up petition, the proceeds are always subject to claim of workers under section 529A [corresponding to section 326 of the Act] - *Indico Remedies Ltd.* v. *O.L. of Kay Packaging (P.) Ltd.* [2009] 96 SCL 384 (Guj.).

14. In *Superintendent of Central Excise and Customs* v. *Sri Vishnupriya Industries Ltd.* [2010] 97 SCL 27 (A.P.) - it was held that a company going into liquidation does not any way alter the rights of the company to properties (compared to pre-liquidation stage) (*ii*) the liability to pay customs duty does not get extinguished and (*iii*) the Customs Department has a prior right over the claim of secured creditors on goods lying unclaimed by the company.

15. Dues decreed under the Industrial Undertakings Act - The contention of the appellant that since the decree was obtained by the respondent under the Industrial Undertakings Act, the petition under section 433 [corresponding to section 271 of the Act] of the Companies Act is not maintainable, was not accepted and as the decreed amount remained unpaid for more than four years, there was no infirmity in ordering winding-up by the company court (now Tribunal) - *Bellary Power (I) Pvt. Ltd.* v. *Standard Industrial Engineering Co.* [2010] 97 SCL 138 (Kar.).

16. In *Laxman Yeswant Prabhudesai* v. *NRC Ltd.* [Appeal No. 461 of 2009, arising from Company Appl. No. 593 of 2008], the Bombay High Court, having regard to the nuance of the word 'void', mentioned in section 536(2) [now section 334(2)] of the Act, regarding company transactions after appointment of liquidator, has ruled that the Court (now Tribunal) in appropriate cases, can save a transaction alleged to be hit by section 536 [now section 334], which is for enabling the company to continue as a going concern and to protect the interests of shareholders and creditors. The provision in section 536(2) [now section 334(2) allows the court to view a transaction hit by section 536 [now section 334] as not void in absolute term.

24. Custody of Company Property - A land and building sale deal entered into by parties based on fraud prior to admission of winding up petition cannot be sustained and the property in question has to remain with the Official Liquidator - *Nasayam Mohammed Feroz* v. *Vijetha Agro Firms (India) Ltd.* [2010] 100 SCL 373 (AP).

25. When a suit has been decreed and the same decree is under appeal, a petition for winding up based on the decree is not tenable - *Kitti Steels Ltd.* v. *Sanghi Industries Ltd.* [2010] 102 SCL 308 (AP).

26. On a petition by trade union to annul the sale of mortgaged assets through *Stressed Assets Stabilisation Fund* (SASF) (order being issued under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002), the Company Court (now Tribunal) which ordered in favour of winding up, held that the sale through SASF cannot be questioned as the secured creditor opted to stand outside the winding up. However, the workers' claims can be proceeded with under the aforesaid Act - *Chemical Mazdoor Sabha* v. *IDBI* [2010] 101 SCL 329 (Mum.). In a different

case, the Court held that the aforesaid Act of 2002 overrides provision of section 537 [now section 335]. The section deals with avoidance of certain acts including sale of company properties after winding up order has been passed without leave of the Company Court (now Tribunal) - *Prime Industries* v. *B.S. Refrigerators Ltd.* [2010] 103 SCL 343 (Kar.). So, a secured creditor who has taken recourse to 2002 Act before passing of the winding up order, can proceed to sell secured assets without leave of the Company Court.

27. In the absence of a new contract in writing overriding the original contract under which financial support in the form of loan was given to the promoter of a company in USA and more specifically for a clause in the original contract to the effect that the loan repayment obligation cannot be assigned to a third party, failure of the promoter to meet the repayment obligation cannot be sustained by a subsequent MOU which remained unsigned by the parties to the contract. The plea of the promoter that the MOU resulted in novation of the original contract, cannot be sustained and the petition for winding up is maintainable - *Vasu Tech Ltd.* v. *Ratna Commercial Enterprises Ltd.* [2011] 106 SCL 59 Mag. (P&H).

28. When winding up petition is beset with many interrogatories in its flock, which could essentially be resolved by a civil court only, the winding up petition was to be dismissed - *ICICI Bank Ltd.* v. *Saurav Chemicals Ltd.* [2011] 106 SCL 191 (P&H).

29. A government company does not fall outside the purview of winding-up proceedings. Also, pendency of suit for recovery of money is not a bar to initiation of winding up proceedings, but the decision of the said suit is a matter to be taken into consideration before a winding up decision can be made - *Indo Swiss Jewels Ltd.* v. *HMT Watches Ltd.* [2011] 106 SCL 108 (Kar.).

30. Order of admission of winding up petition has to be a speaking and reasoned order. As the admission order of the court was non-speaking and unreasoned, appeal against that order is admissible as the interest of the company concerned can be affected - *Atalanta Pums (P.) Ltd.* v. *Mrs. Kunda J Majli* [2012] 114 SCL 516 (Kar.)

Test Your Knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST-QUESTIONS OF C.A. (FINAL), C.S. (INTER & FINAL) AND I.C.W.A. (INTER)] :

1. What do you understand by winding-up of a company?
2. When can a company be wound-up by the Tribunal? Who are the persons entitled to present petition for such winding-up and when? State the duties and powers of a Company Liquidator in case of compulsory winding-up of a company.
3. What are the consequences of a winding-up order by the Tribunal?
4. Write a note on 'Commencement of winding-up'.
5. Write short notes on (*i*) 'Declaration of Solvency' and (*ii*) 'Contributory'.
6. The Directors of a company who had paid nothing on their shares had them cancelled. On the commencement of winding-up of the company, their names were placed on the list of contributories. Advise them.

7. Write a short note on the summary procedure for liquidation.

8. Examine the following statement:—

"The liability of a contributory is legal and not contractual".

9. Write short notes on (*a*) 'Advisory Committee' (*b*) 'Overriding Preferential Payments'.

10. Write short notes on :—

(*i*) Preferential Payments;

(*ii*) Fraudulent Preference;

(*iii*) Custody of company's property on winding-up order passed by the Tribunal.

11. (*a*) What is a 'Statement of affairs'?

(*b*) State the contents of 'Statement of affairs'.

(*c*) By whom and within what time should it be made?

12. Comment on the statement "Liquidation, Winding up and dissolution are equivalent terms".

13. Veer Ltd. has a subsidiary company Zara Ltd. which is formed to carry out some of the objectives of Veer Ltd. Veer Ltd. suspended one of its several businesses by passing a resolution at the company's extraordinary general meeting with effect from 1st January, 2012. The business so suspended continued to be suspended until November 2013. On 1st December, 2013, a group of shareholders of Veer Ltd. filed a petition in the court for winding up of the company on the ground of suspension of business by the company. Having regard to the provisions of the Companies Act, 2013, decide —

(*i*) Whether the shareholders' contention is tenable?

(*ii*) What would be your answer in case Veer Ltd. had suspended all its business?

(*iii*) Can shareholders of Zara Ltd. file a petition in the court for winding-up of their company on the ground that the holding company, *viz.*, Veer Ltd. has suspended its entire business though Zara Ltd. has not suspended any of its business?

Hint : (*i*) No; (*ii*) If all the businesses remain suspended for a whole year, then Veer Ltd. may be would up at the discretion of the Tribunal, (*iii*) No

14. What are the circumstances in which a company may be wound up on the ground that it is 'just and equitable' to wind up a company?

15. State the grounds on which the Registrar of Companies may present a petition for winding-up of a company.

16. Define the term 'Contributory'. Discuss the liability of members of a company in the event of its being wound up.

17. Who may be held liable as a contributory at the time of winding-up of a company? When is a contributory entitled to present a petition for winding-up of a company?

18-19. State the liabilities of contributories as present and past members.

20. What are the powers of the Company Liquidator under the Companies Act?

21. Explain the powers of Company Liquidator which may be exercised by him with the sanction of the Court.

22. Explain briefly the powers of Company Liquidator to disclaim onerous property.

23. What is meant by 'disclaimer of onerous property' and how the same is exercised during winding up? Explain the circumstances under which such a disclaimer is not allowed.

24. Explain the circumstances in which the name of a company may be removed from the register of members without winding up proceedings. What is the procedure to be followed?

25. What is meant by the term 'Workmen's dues', as provided in the Companies Act? How are the workmen's dues protected in the event of a company being wound up?

26. What is meant by 'Fraudulent Preference'? Explain briefly the effects of such a fraudulent preference in the event of a company being wound up.

27. In what way does the Companies Act, 2013 regulate the appointment of an Advisory Committee, its composition, quorum at its meeting and filling a vacancy, if occurred after the appointment of the committee, for a company undertaking winding-up?

28. Explain the duties of a Company Liquidator of a company with regard to the following under the Companies Act, 2013:—

(*i*) The money in his hand representing the dividend payable to any creditor, which remained unpaid for a period of six months after the date on which the dividend was declared; and

(*ii*) Assets under his control, which were refundable to any contributory, and remained undistributed for 6 months after the date on which these became refundable.

29. How does the winding-up order affect the pending suits or other legal proceedings against the company?

30. State briefly the law enshrined in the Companies Act, 2013 in regard to the filing of the 'declaration of solvency'

31. What is meant by Misfeasance? Under what circumstances can the Company Liquidator initiate misfeasance proceedings against the Auditor of the Company? Is there any time limit for initiating such proceedings?

32. Distinguish between winding-up and dissolution of a company. Can a dissolved company be revived? If so, how?

33. Enumerate the position and powers of the Company Liquidator in winding-up proceedings.

34. A company was ordered to be wound up on a petition filed by the company even though the company's workers opposed the petition. The workers filed an appeal against the winding-up order. It is contended by the company that the workers have no right to appeal as they have no right to file winding-up petition under the Companies Act :

(*i*) Who can file a petition for winding-up by the Tribunal?

(*ii*) State with reasons whether the company's contention is correct.

35. (*a*) Comment - "On winding up, a company ceases to be a legal entity."

(*b*) Write short note on "contributories in winding up of an unregistered company".

36. (*a*) Zap Ltd. files a winding up petition against WAP Ltd. On being informed about a settlement between the companies, petition is allowed to be withdrawn. Subsequently, WAP Ltd. although pays part of the amount, eventually fails to honour the dues in full. Zap Ltd., then goes back to the Tribunal to restore the petition for winding up. Now, WAP Ltd. requests the Tribunal to direct refund of the amount paid to Zap Ltd. Will it succeed?

Hint : WAP Ltd. will not succeed.

(*b*) Comment - "Liquidator in a winding up of a company need not obtain Tribunal's approval for every act he is required to perform as liquidator of the company."

(*c*) What are the circumstances in which it will be deemed that proper books of account have not been kept by a company in respect of which winding up order has been passed?

37. Are liquidation, winding up and dissolution equivalent terms in the context of winding up of companies?

38. "Tribunal should decide a petition for winding-up of a company under the Companies Act, 2013 and not otherwise". Comment.

39. (*i*) What constitutes overriding preferential payments in a winding-up?

(*ii*) The liquidators of Lazy Ltd. have received Rs. 50 lakhs from disposal of assets which constituted security for creditors. Indicate how this amount will be distributed among the following dues :

Uncontested sales tax	Rs. 2 lakhs
Municipal taxes due	Rs. 2 lakhs
Unpaid wages for 3 months period preceding winding-up	Rs. 15 lakhs
Secured creditors	Rs. 60 lakhs

40. Action has been initiated against a director of your company for misfeasance and breach of trust. What advice would you give him so that he can obtain relief?

41. In the books of Halchal Ltd., a company under liquidation, there appeared a debt due from a debtor, recovery of which was claimed before the Tribunal; but other than the entry in books of account, no other supporting evidence was available. Discuss.

42. Comment on the following statements :

(*i*) The Board of directors of a company can apply to the Tribunal for winding-up without obtaining members' approval.

(*ii*) When the Tribunal is seized of a petition between the parties involving oppression and mismanagement, the winding up proceedings in respect of the company concerned can be entertained by the Tribunal and continued.

43. Assuming you are a director of a company which is under winding up, state the extent of your liability as a director.

44. "'Just and equitable' is one of the grounds under section 271 for compulsory winding-up of a company under the Companies Act, 2013. This ground is resorted to when no specific ground for winding up is efficacious." Elucidate the statement and cite circumstances that may be acceptable or unacceptable to the court in passing an order of winding on just and equitable ground. Support your answer with relevant case laws.

45. "An unregistered company may be wound up voluntarily." Do you agree?

PRACTICAL PROBLEMS

1. Company was incorporated for the purpose of manufacturing machine tools, implements, etc. It spent a substantial part of its subscribed capital on fixed assets. It borrowed a sum of Rs. 30 lakhs from a bank for providing working capital. As the company was unable to pay back this loan otherwise, the stock-in-trade, plant and machinery and all the fixed assets of the company were sold out in execution of a decree obtained by the bank, leaving no surplus for the company.

Would it be just and equitable to wind up the company in the circumstances?

Hint : In a case where the subject-matter (substratum) of the company has gone or the objects for which the company was incorporated have substantially failed, it was held In *re Kaithal General Mills Co. Ltd.* [1951] 31 Comp. Cas. 461 that it shall be just and equitable to wind up the company. The substratum of the company is deemed to have gone in such a case.

2. Y Estates Ltd. was incorporated with the object of developing land for residential houses as well as purchase and sale of flats. It had, therefore, purchased 5 acres of land near the airport at Calcutta. But Government acquired the same for defence purposes. The company would not replace the land as the prices of land of other places were prohibitive. Would it be just and equitable to wind up the company in the circumstances?

Hint : The company in question may be wound up on just and equitable grounds since its substratum is gone.

3. The Company Liquidator of a public company in liquidation instituted misfeasance proceedings against the Managing Director of the Company. During the pendency of the proceedings, the Managing Director passed away. What is meant by misfeasance? Can the legal representatives of the Managing Director be impleaded and the proceedings continued against him?

Hint : The facts of the case in question are similar to the case *Official Liquidator* v. *Parthasarthi Sinha* [1983] 53 Comp. Cas. 163 (SC), wherein it was held that misfeasance proceedings initiated under section 543 (corresponding to section 340 of the Act), against a director of a company in winding-up can be continued on his death against his heirs and legal representatives for the purpose of determining and declaring the loss or damage caused to the company. The expression 'misfeasance' means grave breach of duty or abuse of power usually associated with taking undue benefit or advantage at the cost of the company. However, any decision to recover money for the act of misfeasance will remain restricted to the value of the properties of the Managing Director in the hands of the legal representative.

4. R and W formed a private limited company in which they were the only directors and shareholders having equal voting rights. Differences arose between them. They were not even on speaking terms. One of them (shareholders) filed a winding-up petition. Will he succeed in getting a winding-up order?

Hint : Facts are similar to the case of *re Yenidje Tobacco Co.* [1916]. The company was ordered to be wound up because of dead lock in management. Such a ground will fall under just and equitable clause.

5. The Balance Sheet of an investment company J Ltd. as on 31st March, 2013, disclosed an accumulated loss of Rs. 3 lakhs against the paid-up capital of Rs. 28,000 and that whereas its tangible assets were worth Rs. 6 lakhs, its liabilities amounted to Rs. 8 lakhs. The Registrar of Companies filed a petition for winding-up of the company on the ground that the company was unable to pay its debts. The Managing Director had stated that the paid-up capital of the company had been increased and the business of the company was also increasing every year, with the result that the company was making profits and all the creditors, whose claims had matured, had been paid-off. Decide, giving reasons whether the Registrar's petition for winding-up of the company is tenable.

Hint : Registrar is allowed to make a petition for winding-up of a company, *inter alia*, where it is felt to be just and equitable that the company be wound up. Where the business of the company cannot be carried on except at a loss, it has been held to be a just and equitable ground for winding-up the company. However, merely the fact that the company has made losses, and is even likely to make further losses will not fall within the aforesaid ground and the Court shall not be justified in making a winding-up order [*Re Shah Steamship Navigation Co.* [1901] 10 Bom. L.R. 107].

Based on the above and the given facts, the Registrar's petition is not tenable.

6. M/s. Sunset Constructions Limited is being wound up by the court. The Official Liquidator after realisation of the assets has an amount of Rs. 28,00,000 at his disposal towards payment to the creditors of the company.

The list of creditors is given below :

		Rs.
(*i*)	Dues to secured creditors	20,00,000
(*ii*)	Dues to workers	15,00,000
(*iii*)	Taxes, etc., payable to the Government authorities	2,00,000
(*iv*)	Unsecured creditors	40,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act, 2013 assuming that the company has created a charge on all the assets of the company in favour of the secured creditors.

Hint. Section 327 of the Companies Act, 2013 lays down the procedure for payment of debts out of the available funds with the Company Liquidator. However, section 326 provide for overriding of the preferential payments as mentioned in section 327. According to section 326, notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding-up of a company,

(*a*) workmen's dues and

(*b*) debts due to secured creditors shall be paid in priority to all other debts.

The above debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

In the light of the legal provisions explained, the funds available with the Company Liquidator are not even sufficient to meet fully the dues payable to secured creditors and workers. Thus, tax dues to the tune of Rs. 2,00,000 payable to Government authorities will not get any payment even though they are to be considered as preferential payments as per section 327 of the Act. The secured creditors dues and workers dues will get abated in their respective proportion and they get Rs. 16 lakhs and Rs. 12 lakhs respectively. The other creditors will get nothing.

7. M/s. XYZ Limited was wound up with effect from 15-3-2013 by an order of the Court. Mr. A, who ceased to be a member of the company from 1-6-2012, has received a notice from the liquidator that he should deposit a sum of Rs. 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called a contributory and whether he can be made liable and whether there is any limitation on his liability.

Hint : Contributory is a term used in the case of winding up of a company. A contributory can be a past or present member and is liable to contribute to the assets of the company in the event of winding up. In the present case Mr. A ceased to be a member of the company when it went into liquidation from 15-3-2013. Thus, Mr. A will be treated as a past member. He will be required to contribute to the assets of the company only if the following conditions are fulfilled :

(*a*) If Mr. A had ceased to be a member of the company within a period of one year before the commencement of the winding up.

(*b*) If the debt or liability of the company was contracted or incurred while he was a member.

(*c*) If the present members are unable to meet the liabilities in respect of the debts incurred while he was a member (section 285).

In this case since one year has not elapsed, Mr. A will be liable to contribute to the assets of the company provided other two conditions are also satisfied.

In any case, the liability of the past or present member cannot exceed the unpaid amount on the shares and if the shares are fully paid-up, no contribution is required to be made by the members past or present [section 285 of the Companies Act, 2013].

8. OGC Ltd. was a supplier of raw materials to SAM Ltd., which could not make payment to OGC Ltd. owing to huge losses and financial constraints. Ultimately, SAM Ltd. went into liquidation and Company Liquidator was appointed. OGC Ltd. filed a suit for recovery of its dues. The Court awarded a decree in favour of OGC Ltd. Armed with the Court's decree, OGC Ltd. approached the Company Liquidator to pay the amount to it in preference overdues of the workmen. The workmen protested the demand of OGC Ltd. and contended that their dues rank *pari passu* with the Secured Creditors and will override all other claims of other creditors even where a decree has been passed.

You are required to ascertain the validity of the argument of the workmen in the light of the provisions of the Companies Act, 2013 and the decided cases on the subject.

Hints : Argument of workmen of SAM Ltd. is valid and shall be upheld under section 326 read along with section 327 of the Companies Act. *See* Gujarat High Court decision in *ONGC Ltd.* v. *Official Liquidator, Ambica Mills Co. Ltd.* [2005] 57 SCL 184. *Para 24.32.*

9. Referring to the provisions of the Companies Act, 2013 and the case laws, if any, examine whether a company incorporated under the Act can be wound up in the following situations :

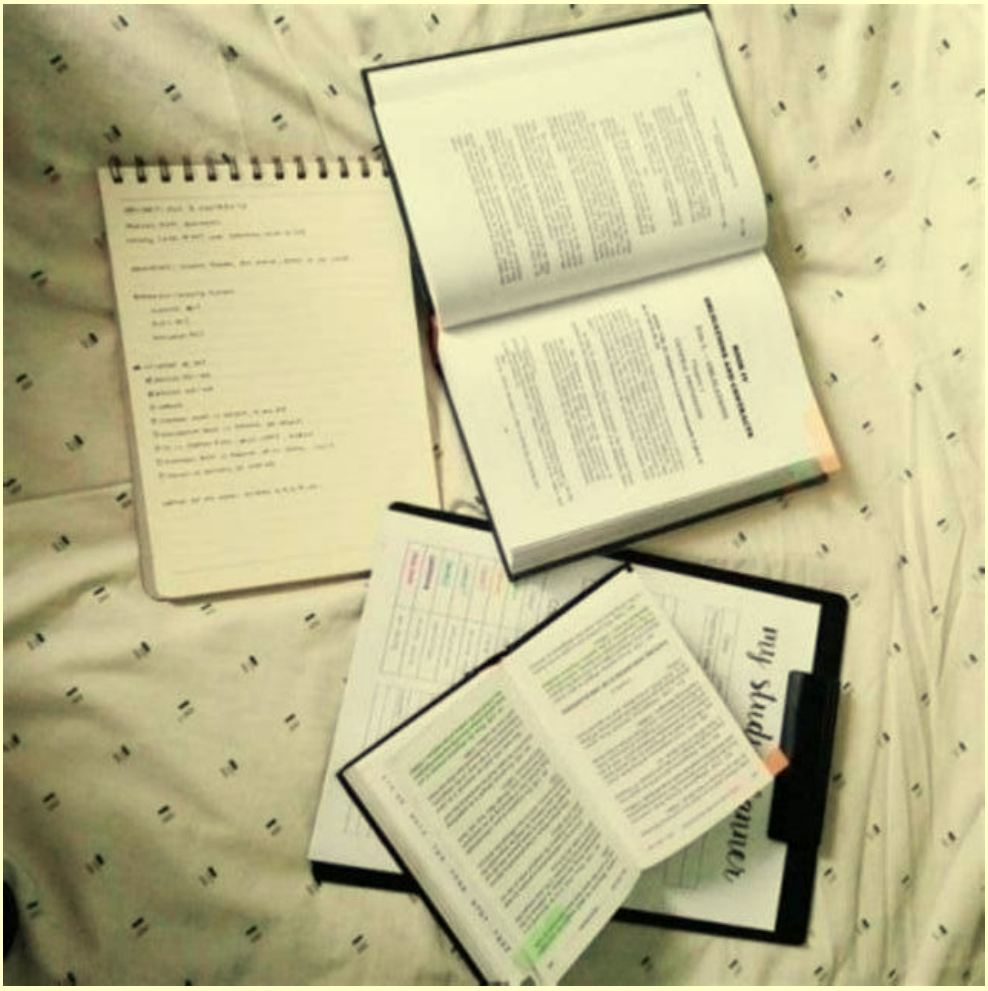
(*i*) E Ltd. has made all possible efforts to proceed with business but due to unforeseen circumstances, beyond its control, company could not proceed.

Hints:

(*i*) Depending on circumstances of the case and possibility of resumption, court may not order winding up - *Tanis Bhargava* v. *Sovintorg (India) Pvt. Ltd.* [1991] 71 Comp. Cas. 631 (Delhi);

10. Telly Tale Limited was allotted the telecom licence by the Government of India to offer mobile telephony services. The licence was subsequently cancelled by a judgment of the Supreme Court. Would it be just and equitable to wind up the company in the circumstances?

Hint: Yes, it was just and equitable to wind up company, *inter alia*, on ground that substratum of company had almost completely been eroded. See *Majestic Infracon (P.) Ltd.* v. *Etisalat Mauritius Ltd.* [2014] 45 taxmann.com 76 (Bombay), the Bombay High Court.



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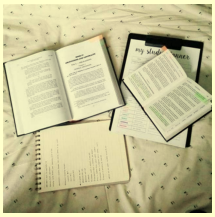

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25 Authorities under the Companies Act, 2013 and Miscellaneous Provisions

The Companies Act, 2013 specifies the following authorities, apart from the Courts, to overview and regulate the companies:

1. Registrar of Companies (R.O.C.) - Primary regulating authority.
2. Regional Director (R.D.) - Delegatee of some of the powers of the Central Government.
3. National Financial Reporting Authority (NFRA)
4. Serious Fraud Investigation Office (SFIO)
5. National Company Law Tribunal
6. National Company Law Appellate Tribunal
7. Special Courts

25.1 Registrar of Companies (R.O.C.)

25.1-1 Meaning

According to section 2(*75*) of the Companies Act, 2013 - 'Registrar' means a Registrar, or an Additional, a Joint, a Deputy, or an Assistant Registrar, having the duty of registering companies and discharging various functions under this Act. Section 396 of the Act empowers the Central Government to establish registration offices for the purpose of registration of companies and exercising other powers and functions under the Act.

R.O.Cs. are the field officers who deal directly with the companies registered or intended to be registered within their territorial jurisdiction. The Companies Act has vested in them wide powers and important responsibilities in connection with the administration of the Act.

The Central Government may appoint Registrars, Additional, Joint, Deputy and Assistant Registrars as may be appropriate and define their jurisdiction. There is a R.O.C. for each State of India. He is a full time officer appointed by the Central

Government and is responsible for the administration of the company law in that State. He may be assisted in his work by the other registration officers, *viz.*, Additional, Joint, Deputy and /or Assistant Registrars. The Companies (Registration Offices and Fees) Rules, 2014 prescribe the manner and conditions for filing with the Registrar, authentication of documents, procedure to be followed by the Registrar, filing fees and inspection of documents kept by the Registrar.

25.1-2 Duties of Registrar

The R.O.C. has certain duties after documents, etc., are filed with him by companies for registration, record, or filing. Under Rule 10 of the Companies (Registration Offices and Fees) Rules, 2014, after a document is filed with the R.O.C., he is required to examine or cause to be examined the document received in his office which is required under the Act to be registered, recorded or filed by or with the R.O.C. The R.O.C. needs to take a decision within thirty days from the date of filing of the document.

If any such document is found to be defective or incomplete in any respect, the R.O.C. shall direct the company to rectify the defect or complete the document within fifteen days. No such document shall be registered, recorded or filed until the defect is rectified or the document is completed by the company and the requisite filing fee is paid. If the document has been recorded invalid by the Registrar, it may be rectified by the person or company only by fresh filing with payment of fee and additional fee.

All the documents filed or registered with the R.O.C. are available for inspection by any person on payment of the prescribed fees. Any person may require a certificate of incorporation or a copy or extract of any document or part thereof to be certified by the R.O.C. on payment of fees.

25.1-3 Filing fees

Section 403 of the Act specifies that fees for filing various document with the ROC shall be payable as may be prescribed. Section 403 also permits late filing, submission, registration or recording of various documents, facts or information on payment of additional fees as may be prescribed. If default happens on two or more occasions, higher additional fees may apply. The company and officers in default will also be liable for penalty or punishment provided under this Act. The annexure to the Companies (Registration Offices and Fees) Rules, 2014 in pursuant of Rule 12 prescribe the fees and additional fees to be paid to the Registrar. But payment of additional fee does not bar incidence of any other liability leviable on the defaulting company *e.g.* criminal liability. Payment of additional fee only brings to end the effects of continuing defaults - *Flora International Ltd.* v. *ROC* [2003] 48 SCL 757 (Kar.).

25.1-4 Powers of Registrar (ROC)

Certain powers are vested in the R.O.C.s under various sections of the Act. In certain cases, the Central Government has delegated its powers to the R.O.C.s.

By notification of the Ministry of Corporate Affairs [S.O. 1353(E)/ F. No. 1/6/2014-CL-V] dated 21st May 2014, the powers and functions of the Central Government under the following sections have been delegated to the ROC—

(*a*) sub-section (2) of Section 4;

(*b*) sub-section (1) of Section 8;

(*c*) clause (*i*) of sub-section (4) of section 8, except for alteration of memorandum in case of conversion into another kind of company;

(*d*) sub-section (5) of section 8; and

(*e*) sub-section (2) of section 13.

Under section 96 of the Act, the R.O.C. is empowered to extend the time of holding the Annual General Meeting of a company (other than the first AGM), by a period not exceeding three months.

Under sections 206 and 207 of the Act, the R.O.C. is empowered to call the books of account and other books and papers of every company and to call on the company, by written order, to furnish in writing such information or explanation with regard to any document submitted to him under this Act, within such time, as may be specified in the order, if the R.O.C. on perusing the document is of the opinion that any information or explanation is necessary in respect of any matter to which such document purports to relate.

Under section 209 of the Act, the R.O.C. is empowered to apply to the Special Court for an order for the seizure of the books and papers of a company, where the R.O.C. has reasonable grounds to believe that such books and papers relating to the company may be destroyed, mutilated, altered, falsified or secreted.

Under section 248 of the Act, the R.O.C. has the power to strike the name of a company off the Register of companies, after complying with the procedure laid down in that section.

25.1-5 Disposal of Records in the Offices of Registrars

Under powers vested by the Destruction of Records Act, 1917, the Central Government framed the Disposal of Records (In the Offices of Registrars) Rules, 2003, which governed the maintenance of records at the offices of the R.O.Cs. The Rules specify the documents which are to be preserved permanently, as well as other categories of documents which are to be preserved for varying periods ranging from 3 years to 35 years, before they can be destroyed.

(1). *Documents to be preserved permanently* - Under Rule 3 of the aforesaid Rules, the following documents are to be preserved permanently : (1) The Register of Companies; (2) the Index to the Register of Companies; (3) the Chronological Index Cards of the Companies (4) the registered documents relating to a company in operation (specified in Schedule I to the Rules);

(2). Under Rule 4, subject to the previous order of the R.O.C., the following records may be destroyed after the expiry of the period of preservation :

(*i*) *Records to be preserved for 35 years.* (*a*) register of security bonds, (*b*) succession list of officers

(*ii*) *Records to be preserved for 21 years.* All papers, registers, refund orders and correspondence, relating to companies liquidation accounts.

(*iii*) *Records to be preserved for 5 years.* (*i*) Copies of Government orders relating to companies; (*ii*) All papers, registers, refund orders and correspondence

relating to payment from companies unpaid dividend account and all papers, statements, registers and abstracts relating to the amounts deposited in the Investor Education and Protection Fund (*iii*) Registered documents of companies which have been fully wound up and finally dissolved together with correspondence relating to such companies; (*iv*) Papers relating to legal proceedings from the date of disposal of the case and appeal; (*v*) Copies of statistical returns furnished to Government; (*vi*) All correspondence including correspondence relating to scrutiny of balance-sheets, prosecutions, reports to the Regional Directors and Company Law Board including inspections and the correspondence relating to complaints.

(*iv*) *Records to be preserved as per Schedule II.* Other registered documents relating to any company in operation, as specified in Schedule II to these Rules, are to be preserved for the periods indicated against them in the said Schedule.

(*v*) *Registered documents of foreign companies.* Registered documents of foreign companies which have ceased to have any place of business in India, are to be preserved for 3 years after such cessation. Such documents shall be destroyed after the expiry of 3 years from the date of such cessation in accordance with the following procedure:

The ROC, Delhi, shall intimate to the Registrar concerned his intention to destroy the documents and records of a particular foreign company by a certain date two weeks in advance thereof. On receipt of such intimation, the Registrar concerned shall destroy the documents at the same time and communicate to the Registrar of Companies, Delhi, the fact of such destruction.

(*vi*) *Records to be preserved for 3 years.* (*a*) All books, records and papers, other than those specified in sub-rules (1) to (5) above; (*b*) Routine correspondence regarding payment of fees, additional filing fees and correspondence about return of documents.

No record in the office of the R.O.C. shall be destroyed without R.O.C.'s previous order in writing. The R.O.C. shall maintain a Register in two parts in the forms set out in Appendix to the said Rules, wherein he shall enter brief particulars of the records destroyed and shall certify in his own hand the date and mode of destruction (Rules 5 and 6).

It may be noted that the Disposal of Records (In the Offices of Registrars) Rules, 2003 were framed in pursuant to the Companies Act, 1956. It appears that the corresponding Rules to that effect are not yet notified.

25.2 Regional Director

The Ministry of Corporate Affairs is empowered to appoint Regional Directors for the purpose of carrying out various functions under the Act. The powers and functions of the Central Government under various functions have been delegated to the Regional Director 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.

The jurisdiction of various Regional Directors is stated below:

Office and Location	*Jurisdiction*
Regional Director, North Region Directorate, Headquarter at New Delhi.	States of Haryana, Punjab, Jammu and Kashmir, Himachal Pradesh, Uttar Pradesh, Uttarakhand and Union Territory of Chandigarh and National Capital Territory of Delhi.
Regional Director, North Western Region Directorate, Headquarter at Ahmedabad	States of Rajasthan, Gujarat, Madhya Pradesh, Chhattisgarh and Union Territory of Dadra and Nagar Haveli.
Regional Director, Western Region Directorate, Headquarter at Mumbai.	States of Maharashtra, Goa and Union Territory of Daman and Diu.
Regional Director, Southern Region Directorate, Headquarter at Chennai.	States of Tamil Nadu, Kerala and Union Territory of Puducherry, Union Territory of Andaman and Nicobar Islands and Union Territory of Lakshadweep
Regional Director, Eastern Region Directorate, Headquarter at Kolkata.	States of West Bengal, Bihar, Jharkhand, Orissa
Regional Director, North Eastern Region Directorate, Headquarter at Guwahati*.	States of Meghalaya, Assam, Arunachal Pradesh, Nagaland, Mizoram, Manipur and Tripura.
Regional Director, South East Region Directorate, Headquarter at Hyderabad.	States of Karnataka and Andhra Pradesh.

Vide Notification F. No.1/16/2013 -CL-V dated 3 November 2015

By notification of the Ministry of Corporate Affairs [S.O. 1352(E) F. No. 1/6/2014-CL.-V] dated 21st May 2014 the power and functions of the Central Government under sections listed below were delegated to the Regional Directors at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong:

(*a*) clause (*i*) of sub-section (4) of section 8 (for alteration of memorandum in case of conversion into another kind of company);
(*b*) sub-section (6) of section 8;
(*c*) sub-sections (4) and (5) of section 13;
(*d*) section 16;
(*e*) section 87;
(*f*) sub-section (3) of section 111;
(*g*) sub-section (1) of section 140; and
(*h*) proviso (*i*) to sub-section (1) of section 399.

Vide another notification of the Ministry of Corporate Affairs [S.O. 1353 (E)/ F. No. 1/6/2014-CL-V] dated 21st May 2014 the powers and functions of the Central

*Substituted "Shillong" by "Guwahati" *vide* Notification No. F. No. 1/16/2013-CL-V dated 25 July 2019.

Government in respect of allotment of Director Identification Number under sections 153 and 154 stands delegated to the Regional Director, Joint Director, Deputy Director or Assistant Director posted in the office of Regional Director at Noida. The powers and functions of the Central Government under sub-section (5) of section 94 were further delegated to the Regional Directors at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong vide Notification F No. 1/6/2014-CL-V dated 31st March 2015.

Further the Central Government delegated its powers and functions vested in it under sub-section (2) of section 66 to Regional Directors at Mumbai, Kolkata, Chennai, New Delhi, Ahmedabad, Hyderabad and Shillong *vide* notification S.O. 2938(E)/[F. No. 1/06/2014-CL-V] dated 6th September, 2017. Powers of the Central Government under first proviso to clause (41) of section 2 and second proviso to sub-section (1) of section 14 were delegated to the Regional Directors at Mumbai, Kolkata, Chennai, New Delhi, Ahmedabad, Hyderabad and Shillong. [S.). 6225(E)/F No 1/06/2014-CL-V, dated 20 December 2018].

25.3 National Financial Reporting Authority [Section 132]

Under Section 132 the Central Government is authorized to constitute National Financial Reporting Authority (NFRA) as an apex body for the purpose of various matters relating to accounting and auditing standards. NFRA would be responsible for matter relating to formulation, monitoring and enforcement of accounting auditing standards.

25.3-1 Role of NFRA

The NFRA has the following functions to perform -

(*a*) Making recommendations to the Central Government regarding formulation and laying down of accounting and auditing policies and standards to be adopted by companies or class of companies or their auditors;

(*b*) Monitoring and enforcing the compliance with accounting standards and auditing standards;

(*c*) Overseeing the quality of service of the professions associated with ensuring compliance with such standards. NFRA shall also suggest measures required for improvement in quality of service.

(*d*) Performing such other functions relating to clauses (*a*), (*b*) and (*c*) as may be prescribed.

The mandate of NFRA as per section 132(2) is to make recommendation regarding the formulation of accounting and auditing standards, their implementation and monitoring and overall improvement in quality of service and profession of accounting and auditing profession.

Under section 133 while prescribing the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, the Central Government shall consult and consider the recommendations made by the National Financial Reporting Authority. It may be noted that the standards are authorized by the Central Government and NFRA only has recommendatory power.

25.3-2 Powers of NFRA

For effective discharge of its functions the NFRA shall have the following powers [sub-section (4)] —

(*i*) to investigate for such class of bodies corporate or persons, in such manner as may be prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants. The investigation may be initiated by the NFRA on its own or on a reference made to it by the Central Government. Once NFRA has initiated an investigation, other institutes or bodies will be debarred from initiating or continuing any proceeding in such matter.

(*ii*) as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, relating to —

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

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

c. inspection of any books, registers and other documents of any person at any place;

d. issuing commissions for examination of witnesses or documents.

(*iii*) To make order for penalty in cases involving professional or other misconduct. The penalty shall not be less that rupees one lakh, but which may extend to five times of the fees received, in case of individuals and not less than rupees five lakh, but which may extend to ten times of the fees received, in case of firms. The NFRA has the power to debar the member or the firm form being appointed as an auditor or internal auditor of undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate or performing any valuation as provided under section 247. The debarment would be for a minimum period of six months but may extend to ten years. [Section 132(4)(c)(B)]*.

Any person aggrieved by any order of the NFRA may prefer an appeal before the Appellate Tribunal in such manner and on payment of such fees as may be prescribed†.

25.3-3 Constitution and functioning of NFRA

The Central Government shall by notification constitute the NFRA. The NFRA consist of a Chairperson and not more that fifteen other members who may be either part-time or full-time. The chairperson shall be appointed by the Central Government and shall have expertise in accountancy, auditing, finance or law. The terms and conditions and the manner of appointment of the chairperson and members shall be such as may be prescribed.

To ensure independence of the chairperson and the members they are required to make a declaration that there is no conflict of interest or lack of independence in

*Amended *vide* the Companies (Amendment) Act, 2019.

† Amended *vide* the Companies (Amendment) Act, 2017.

respect of his or their appointment. Furthermore the chairperson and the full-time members shall not be associated with any audit firm or related consultancy firm during the course of their appointment and two years after ceasing to hold such appointment. A secretary and other employees may be appointed by the Central Government. The rules regarding the frequency and place of meetings of NFRA and the procedures to be followed shall be prescribed in this regards.

The Central Government has notified the National Financial Reporting Authority (Manner of Appointment and other Terms and Conditions of service of Chairperson and Members) Rules, 2018 dated 21st March 2018.

Pending constitution of NFRA, the Central Government may constitute a committee with representatives from the Institute of Chartered Accountants of India and Industry Chambers, special invitees from the National Advisory Committee on Accounting Standards and the office of the Comptroller and Auditor-General to hold consultation. The committee shall be headed by an officer of the rank of Joint Secretary in the MCA.*

The National Financial Reporting Authority was constituted on 1st October, 2018 vide Notification No S.O. 5099(E). The Government also laid down the rules relating to the functioning, powers, functions and duties of the National Financial Reporting Authority and processes for monitoring and enforcing compliance with accounting standards by the Authority.†

25.3-4 Books of account and annual report of NFRA

The books of account and other books to be maintained by the NFRA shall be prescribed by the Central Government may, in consultation with the Comptroller and Auditor-General of India (CAG). The CAG shall conduct periodical audit of the books of account maintained by the NFRA and forward a copy of the accounts with the audit report to the Central Government annually.

For each financial year the NFRA shall prepare an annual report giving full account of its activities during the financial year. A copy of the same shall be forwarded to the Central Government. The annual report and the audit report given by the CAG shall be laid before each House of Parliament.

25.4 Serious Fraud Investigation Office [Section 211]

Under Section 211 the Central Government is authorized to establish a Serious Fraud Investigation Office (SFIO) to investigate frauds relating to a company [Section 211(1)]. The SFIO established earlier by the Central Government vide resolution number 45011/16/2003 -Admn-I dated the 2 July 2003 has been designated as the SFIO for the purpose of this Act with effect from 21 July 2015.**

25.4-1 Role of SFIO

As stated in Section 211(1) the SFIO's primary role is to investigate frauds relating to a company. Section 212(1) states that where the Central Government is of the

*Vide Order No. F. No. 17/45/2015-CL-V dated 29 March 2016.

**Vide Notification No. SO 2005(E) [F.No.A-35011/09/2011-ADMN.III] dated 21 July 2015.

†National Financial Reporting Authority Rules, 2018. Vide Notification No G.S.R 1111(E) dated 13 November 2018.

opinion, that it is necessary to investigate into the affairs of a company by the SFIO, it may assign the investigation to the SFIO. The Central Government may make that assignment under the following circumstances -

(*a*) on receipt of a report of the Registrar or inspector under section 208;

(*b*) on intimation of a special resolution passed by a company that its affairs are required to be investigated;

(*c*) in the public interest; or

(*d*) on request from any Department of the Central Government or a State Government.

It may be noted that the SFIO under Section 212(1) can undertake an investigation only upon a reference being made to it by the Central Government and not *suo motu*.

25.4-2 Constitution of SFIO

The SFIO shall be headed by a Director (not below the rank of a Joint Secretary) and consist of such number of experts from the following fields to be appointed by the Central Government from amongst persons of ability, integrity and experience in banking, corporate affairs, taxation, forensic audit, capital market, Information technology, law or such other fields as may be prescribed. The Central Government is also authorized to appoint such experts and other officers and employees as it considers necessary for the efficient discharge of its functions.

25.4-3 Powers of SFIO

Under Section 212, the SFIO shall have the following powers -

(*i*) *Exclusive jurisdiction* - Once a case has been assigned to the SFIO, no other investigating agency of Central Government or any State Government shall initiate or proceed with investigation if a case has already been initiated in respect of any offence under this Act. The concerned agency shall transfer all the relevant documents and records in respect of such offences to SFIO.

(*ii*) *Powers of Inspector under Section 217* – The Investigating Officer shall have the power of the inspector prescribed under section 217.

(*iii*) *Power to seek information and explanation* – The company and its officers and employees, both present and, shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer for conduct of the investigation.

(*iv*) *Power to arrest* – Any person who SFIO believe is guilty of a specified offence may be arrested informing him the ground for such arrest. The offences specified are those that are covered under Section 447[1].

A copy of the arrest order and material justifying the arrest shall be kept in the SFIO in a sealed envelope. The person arrested shall be taken to a Judicial Magistrate or Metropolitan Magistrate having jurisdiction within twenty four hours excluding the time necessary for journey from place of arrest to the court.

1. Amended *vide* the Companies (Amendment) Act, 2015.

The Central Government has notified the Companies (Arrests in connection with Investigation by Serious Fraud Investigation Office) Rules, 2017, dated 24 August 2017.

(*v*) Notwithstanding anything contained in the Code of Criminal Procedure, 1973, the offences mentioned above shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless the Public Prosecutor has been given an opportunity to oppose the application for such release and where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail.

(*vi*) *Power and duty to cooperate* - Any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of offence being investigated by the SFIO shall be under obligation to provide all such information or documents available with it to the SFIO. The SFIO also has a reciprocal duty to share any information or documents available with it, with any such agency or authority.

25.4-4 Report of Investigation

The SFIO upon completion of the investigation assigned to it shall submit a report to the Central Government within such period as may be specified by the Central Government. If directed by the Central Government, an interim report shall also be submitted.

The Central Government may direct the SFIO to take steps for prosecution of the company and its officers or employees, (past and present) or any other person directly or indirectly connected with the affairs of the company. The investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973.

Any person concerned may obtain a copy of the report by making an application in this regard to the court

25.5 National Company Law Tribunal

Under section 408, the Central Government shall constitute a National Company Law Tribunal (hereinafter referred to as Tribunal). The Tribunal shall exercise and discharge such powers and functions as may be conferred on it by the Act or any other law for the time being in force. The Tribunal is a quasi-judicial body in the administration of the provisions of this Act.

Benches of the Tribunal - The Central Government by notification shall also constitute benches of the Tribunal. The Principal bench of the Tribunal shall be in New Delhi. The powers of the Tribunal shall be exercised by Benches consisting of two Members out of whom one shall be a Judicial Member and the other shall be a Technical Member. However for certain class of cases or matters pertaining to certain class of cases as may be specified by the President of the Tribunal a bench consisting of a single Judicial Member shall be competent [Section 419].

The Central Government constituted the National Company Law Tribunal (NCLT) with effect from 1 June, 2016. This effectively dissolves the Company Law Board (CLB) as constituted under the Companies Act, 1956 from the same day. The NCLT started functioning with eleven Benches - two at New Delhi and one each at Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. The Principal Bench of the NCLT is at New Delhi.*

25.5-1 Civil Court not to have jurisdiction [Section 430]

The Tribunal and the Appellate Tribunal shall have exclusive jurisdiction in respect of suits or proceeding relating to any matter which they are empowered to determine. No civil court shall be competent to have jurisdiction on such matters under this Act or any other law for the time being in force or to grant injunction in respect of any such action taken or to be taken by the Tribunal or Appellate Tribunal.

25.5-2 Expeditious disposal of applications, petitions or appeal [Section 422]

Every application or petition before the Tribunal and appeal before the Appellate Tribunal shall be disposed of expeditiously normally within three months. If it is not disposed of within three months reasons for the same shall be recorded by the Tribunal/Appellate Tribunal. The President of the Tribunal or Chairperson of the Appellate Tribunal may extend the time for a period not exceeding ninety days.

25.5-3 Qualifications of President and of Tribunal

Section 409 prescribes the qualifications for appointment of the President and members of the Tribunal.

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

Judicial Members: A person shall not be qualified for appointment as a Judicial Member unless he:

(*a*) is, or has been, a judge of a High Court; or

(*b*) is, or has been, a District Judge for at least five years; or

(*c*) has, for at least ten years been an advocate of a court.

In computing the period during which a person has been an advocate of a court, any period during which the person has held judicial office or the office of a member of a tribunal or any post, under the Union or a State, requiring special knowledge of law after he become an advocate shall also be included for the purposes of clause (*c*) above.

Technical Member: A person shall not be qualified for appointment as a Technical Member unless:

(*i*) he has for at least fifteen years been a member of the 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 is, or has been, in practice for at least fifteen years as a chartered accountant, cost accountant or company secretary;

*Notification Nos. S.O. 1932(E), 1933(E) & 1935(E).

(*ii*) is a person of proven ability, integrity and standing having special knowledge and experience, of not less than fifteen years, in law, industrial finance, industrial management or administration, industrial reconstruction, investment and accountancy.

(*iii*) is, or has been, for at least five years, a presiding officer of a Labour Court, Tribunal or National Tribunal constituted under the Industrial Disputes Act, 1947.

25.5-4 Order of the Tribunal

The Tribunal shall give a reasonable opportunity to the parties concerned and may pass such order as it may think fit. A copy of order shall be sent to all the parties concerned. The Tribunal is also competent to amend any order passed by it for the purpose of rectifying any mistake apparent from the record. The amendment may be made if the mistake is brought to the notice of the Tribunal by the concerned parties within two years from the date of the order [Section 420].

25.5-5 Transfer of Proceedings

MCA has notified that with effect from December 15, 2016, following matters shall get transferred to National Company Law Tribunal ("NCLT"):

(i) Pending proceedings relating to cases other than Winding up:

All proceedings relating to arbitration, compromise, arrangements and reconstruction, other than winding up have been transferred to the Benches of the NCLT having territorial jurisdiction with effect from December 15, 2016. All such proceedings shall be instituted and conducted under the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016.

(ii) Pending proceeding relating to Voluntary Winding up:

All applications and petitions of voluntary winding up of companies pending before a High Court as on December 15, 2016 shall continue with the High Court having Jurisdiction.

(iii) Pending proceedings of Winding up on the ground of inability to pay debts:

All the winding up petitions on the ground of inability to pay its debts pending before a High Court, in which the petition has not been served on the respondent have been transferred to the Bench of the NCLT having territorial jurisdiction. All such petitioner shall be deemed to have been filed under The Insolvency and Bankruptcy Code, 2016.

(iv) Pending proceedings of Winding up matters on the grounds other than inability to pay debts:

All winding up petitions filed on the grounds other than inability to pay debts which are pending before a High Court and where the petition has not been served on the respondent have been transferred to the Bench of the NCLT having territorial jurisdiction. All such petitions shall be deemed to have been filed under the provisions of the CA, 2013.

25.6 National Company Law Appellate Tribunal

Under Section 410, the Central Government shall constitute a National Company Law Appellate Tribunal (hereinafter referred to as Appellate Tribunal). The Appel-

late Tribunal shall hear appeals against the orders of the Tribunal or of the National Financial Reporting Authority. The Appellate Tribunal to consists of a chairperson and such number of Judicial and Technical Members, not exceeding eleven, as the Central Government may deem fit, to be appointed by the Central Government by notification.

The Central Government constituted the National Company Law Appellate Tribunal (NCLAT) with effect from 1 June, 2016.

25.6-1 Qualifications of Chairperson and members of the Appellate Tribunal [Section 411]

Chairperson: The chairperson shall be a person who is or has been a Judge of the Supreme Court or the Chief Justice of a High Court.

Judicial Members: A Judicial Member shall be a person who is or has been a Judge of a High Court or is a Judicial Member of the Tribunal for five years.

Technical Member: 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 or administration, industrial reconstruction, investment and accountancy.

25.6-2 Appeal to the Appellate Tribunal [Section 421]

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 Appellate Tribunal. If the person was prevented from filing the appeal within forty-five days due to sufficient cause, the Appellate Tribunal may extend the period by another forty-five days. The Appellate Tribunal 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 the Tribunal and the parties to appeal.

An appeal under section 421(3) was dismissed being barred by limitation. The appeal against order of Tribunal was filed 15 days after period of limitation of 45 days had expired and a further period of another 45 days had also expired. [*Rohan Packaging Products Ltd.* v. *Lakhmichand Gidwani* [2018] 96 taxmann.com 416 (NCL-AT)]

If the order was made by the Tribunal with the consent of the parties, no appeal to the Appellate Tribunal is possible.

25.6-3 Appeal to the Supreme Court [Section 423]

An appeal against the order of the Appellate Tribunal may be filed by the aggrieved person to the Supreme Court. An appeal to the Supreme Court can be filed only on any question of law arising out of such order. The appeal must be filed within sixty days of the receipt of the order extendable by another sixty days if the person was prevented by sufficient cause to file within time.

25.6-4 Procedure to be followed by the Tribunal and Appellate Tribunal [Section 424]

The Tribunal and the Appellate Tribunal shall be guided by the principle of natural justice and therefore have powers to 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 any rules made thereunder.

Right to Legal Representation - A party to any proceeding or appeal before the Tribunal or the Appellate Tribunal, has a right either to appear in person or through one or more duly authorized chartered accountants or company secretaries or cost accountants or legal practitioners or any other person to present his case before the Tribunal or the Appellate Tribunal [Section 432].

Limitation - The provisions of the Limitation Act, 1963 shall, apply to proceedings or appeals before the Tribunal or the Appellate Tribunal.

25.6-5 Powers of the Tribunal and Appellate Tribunal

The powers of the Tribunal and the Appellate Tribunal are described below:

(*i*) *Powers as a civil court under the Code of Civil Procedure, 1908* - The Tribunal and the Appellate Tribunal shall enjoy the same powers as a civil court on the following matters:

- (*a*) summoning and enforcing the attendance of any person and examining him on oath;
- (*b*) requiring the discovery and production of documents;
- (*c*) receiving evidence on affidavits;
- (*d*) subject to the provisions of sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or a copy of such record or document from any office;
- (*e*) issuing commissions for the examination of witnesses or documents;
- (*f*) dismissing a representation for default or deciding it *ex parte;*
- (*g*) setting aside any order of dismissal of any representation for default or any order passed by it *ex parte;* and
- (*h*) any other matter which may be prescribed [Section 424(2)].

(*ii*) *Execution of an order* - Any order made by the Tribunal or the Appellate Tribunal may be enforced in the same manner as a decree made by a court in a suit. The Tribunal or the Appellate Tribunal may send its orders for execution of to the court within the local limits of whose jurisdiction the registered office of the company is situated against whom the order is issued or in the case of an order against any other person, the person concerned voluntarily resides or carries on business or personally works for gain [Section 424(3)].

All proceedings before the Tribunal or the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193 and 228, and for the purposes of section 196 of the Indian Penal Code, and the Tribunal and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973 [Section 424(4)].

(*iii*) *Power to Punish for Contempt [Section 425]* - In respect of any contempt of an order of the Tribunal or Appellate Tribunal, they shall have the same powers and authority to punish for contempt as the High Court under the provisions of the Contempt of Courts Act, 1970.

(*iv*) *Power to seek assistance of Chief Metropolitan Magistrate etc. (Section 429)* - In any proceeding relating to winding up of a company or rehabilitation of

a sick company, the Tribunal may seek the help of the Chief Metropolitan Magistrate, Chief Judicial Magistrate or the District Collector for the purpose of taking into custody property, books of account or other documents.

25.6-6 Rules to be followed in proceeding before the Tribunal

The Companies (National Company Law Tribunal) Rules, 2016 and the Companies (National Company Law Appellate Tribunal) Rules, 2016 contain the rules and procedures to be followed in proceedings before the Tribunal and Appellate Tribunal respectively. The rules came into force with effect from 21 July 2016.

25.6-7 Meditation and Conciliation Panel

Section 442 requires the Central Government to maintain a panel of experts as the Mediation and Conciliation Panel. The panel will mediate between the parties during the pendency of any proceedings before the Central Government or the Tribunal or the Appellate Tribunal. On an application by any of the parties to the proceedings or *suo motu*, the Central Government or the Tribunal or the Appellate Tribunal, as the case may be, before which the proceedings are pending shall appoint one or more experts from the panel.

The panel shall dispose of the matter within three months and forward its recommendations to the referring authority. Any objection to the recommendation may be filed to the referring authority.

25.7 Special Courts

To provide speedy trial of offences under the Act, the Central Government my by notification, appoint or designate as many Special Courts as may be necessary. In case of offences punishable under the Act with imprisonment of two years or more, a Special Court shall consist of a single judge holding office as Session Judge or Additional Session Judge. In the case of other offences, the Special Court shall consist of a Metropolitan Magistrate or a Judicial Magistrate of the First Class.* [section 435]

The Special Courts however shall have jurisdiction to only those offences which are punishable under this Act with imprisonment of two years or more. 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[2].

25.7-1 Jurisdiction of the Special Court

Under Section 436(1) notwithstanding anything contained in the Code of Criminal Procedure, 1973, all offences specified under sub-section (1) of section 435.[3] shall be triable only by the Special Court established for the area in which the registered office of the company in relation to which the offence is committed. In case there are more than one Special Courts for such area offence shall be triable by one of them as may be specified in this behalf by the High Court concerned. When trying an offence under this Act, a Special Court may also try an offence other than an

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* Amended *vide* the Companies (Amendment) Act, 2017.

2. Amended *vide* the Companies (Amendment) Act, 2015.
3. Amended *vide* the Companies (Amendment) Act, 2015.

offence under this Act with which the accused may, under the Code of Criminal Procedure, 1973 be charged at the same trial [Section 436(2)].

Until a special court is established, the offences triable by a special court shall be tried by a Court of Session or the Court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be* having jurisdiction over the area [Section 440].

The Central Government designated the following Courts as Special Courts for the purposes of trial of offences punishable under the Companies Act, 2013 with imprisonment of two years or more.*

S. No.	*Existing Court*	*Jurisdiction as Special Court*
1	Courts of Additional Special Judge, Anti-Corruption at Jammu and Srinagar	State of Jammu and Kashmir
2	Presiding Officers of Court No's 37 and 58 of the City Civil and Sessions Court, Greater Mumbai	State of Maharashtra
3	Court of Principal District and Sessions Judge, Union territory of Dadra and Nagar Haveli at Silvassa	Union Territories of Dadra and Nagar Haveli and Daman and Diu
4	Court of District Judge-1 and Additional Sessions Judge, Panaji	State of Goa
5	Court of Principal District and Sessions Judge, Ahmedabad (Rural), situated at Mirzapur, Ahmedabad.	State of Gujarat
6	9th Additional Sessions Judge, Gwalior Madhya Pradesh	State of Madhya Pradesh
7	Court of Additional District and Session Judge, Port Blair, Andaman and Nicobar Islands.	Union territory of Andaman and Nicobar Islands
8	2nd Special Court, Calcutta	State of West Bengal
9	Additional District and Sessions Court-VII, Ernakulam	State of Kerala
10	District and Sessions Court, Kavaratti	Union territory of Lakshadweep
11	District and Sessions Judge, Cuttack	State of Odisha
12	Additional District and Sessions Judge, No.1, Kamrup (M), Guwahati	State of Assam
13	LIX Additional City Civil and Sessions Judge, Bengaluru City	State of Karnataka
14	XV Additional Court, XVI Additional Court of City Civil Court, Chennai	State of Tamil Nadu except Districts of Coimbatore, Dharmapuri, Dindigul,

*Amended *vide* the Companies (Amendment) Act, 2017.

S. No.	*Existing Court*	*Jurisdiction as Special Court*
		Erode, Krishnagiri, Namakkal, Nilgiris, Salem and Tiruppur.
15	Court of Additional District and Sessions Judge, Patna	State of Bihar
16	Court of District and Session Judge at Kohima	State of Nagaland
17	Court of District and Session Judge at Aizwal	State of Mizoram
18	West Session Division, Yupia	State of Arunachal Pardesh
19	Court of District Judge-1 and Additional Sessions Judge, Pune	State of Maharashtra

S.O. 1796(E) dated 18 May 2016, S.O. 2872(E) dated 31 August 2017, S.O. 3529(E) dated 3 November 2017, S.O. 3804(E) dated 4 December 2017, S.O. 528(E) dated 5 February 2018, S.O. 4285(E) dated 5 September 2018, and S.O. 2564(E) dated 17 July 2019.

25.7-2 Summary Trial by the Special Court

Any offence under the Act which is punishable with imprisonment for a term not exceeding three years may be tried by the Special Court in a summary way. This is notwithstanding anything to the contrary in the Code of Criminal Procedure. However in a summary trial maximum sentence of imprisonment is restricted to one year. If in the course of the summary trial it appears to the Special Court that the sentence of imprisonment 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. The Special Court in such case shall record the reasons thereof after hearing the parties [Section 436(3)].

25.7-3 Application of the Code of Criminal Procedure [Section 438]

The Special Court shall be deemed to a Court of Session or the Court of Metropolitan Magistrate or a Judicial Magistrate of the First Class, as the case may be* and the person conducting a prosecution a Public Prosecutor and the provisions of the Code of Civil Procedure, 1973 shall apply accordingly to proceeding before a Special Court.

25.7-4 Appeal and Revision [Section 437]

All the powers conferred by Chapters XXIX and XXX of the Code of Criminal Procedure, 1973 on a High Court, may be exercised by the High Court as if a Special Court within the local limits of the jurisdiction of the High Court were a Court of Session trying cases within the local limits of the jurisdiction of the High Court.

MISCELLANEOUS PROVISIONS

25.8 Offences to be non-cognizable [Section 439]

Every offence under the Act [except those referred to in Section 212(6)] shall be

*Amended *vide* the Companies (Amendment) Act, 2017.

deemed to be non-cognizable. Under sub-section (2), no cognizance of any offence alleged to have been committed by a company or any officer thereof shall be taken except on complaint in writing by the Registrar, a shareholder or a member** of the company or a person authorized by the Central Government. In case of a Government company the complaint can be filed only by a person authorized by the Central Government.* On matters relating to issue and transfer of securities or payment of dividend, cognizance may be taken on a complaint in writing by a person authorized by the Securities Exchange Board of India. This however will not apply to a prosecution by a company of any of its officers. In a case where shares were under transmission in favour of the son after the death of the shareholding father, the cognition of a complaint by a special judge for economic offences was quashed, as the son's complaint at that point of time had no validity under section 621 [now Section 439] - *S. Ashok Rao* v. *State of A.P.* [2001] 33 SCL 262 (AP). In case of a section 25 [now section 8] company, where there is no share capital, a member thereof is not eligible to file a complaint under this section - *Madras Cricket Club* v. *M. Subbiah* [2010] 102 SCL 143 (Mad.).

Where the complaint as aforesaid is filed by the Registrar or a person authorized by the Central Government, the presence of such officer before the Court trying the offences shall not be necessary unless the court requires his personal attendance at the trial. It shall also not apply to any action taken by the liquidator of a company in respect of any offence alleged to have been committed in respect of any of the matters in Chapter XX or in any other provision of this Act relating to winding up of companies. The liquidator of a company shall not be deemed to be an officer of the company within the meaning of sub-section (2).

Taking cognizance of sections 4 and 188 of the Code of Criminal Procedure, the Supreme Court in *A.V. Mohan Rao* v. *M. Krishna Rao* [2002] 39 SCL 413 has held that even if offence is committed by a citizen of India outside the country, the same is subject to jurisdiction of courts in India. Accordingly, the Supreme Court upheld the decision of the Andhra Pradesh High Court, declining to grant the prayer of the appellants for quashing the proceedings lying against them before the sub-judge, Economic Offences, Hyderabad filed by NRIs who were cheated large sum of money by way of share subscription etc. The Supreme Court also held that it is well settled that quashing of a criminal complaint on the strength of section 482 of the Code of Criminal Procedures or Article 226 of the Constitution should be allowed only in rarest of the rare cases.

In view of growing public concern on RoC's bringing in prosecution against directors, irrespective of whether they can be treated as officer-in-default under section 5(*g*) [corresponding to section 2(*60*) of the Act], the MCA by General Circular No. 8/2011, dated 25-3-2011 in Paragraph (3) requires the ROCs to verify following before bringing prosecution under section 621 [now Section 439]:

(*i*) The fact of the director concerned having actually resigned before the commission to alleged offence;

(*ii*) whether the director is a nominee director;

(*iii*) whether the director is a Special Director appointed by BIFR.

Besides, the timing of commission of offence is to be taken into account both for directors and other officers in default.

**Amended *vide* Notification No. F No. 1/2/2014-CL.V dated 5 June, 2015.

While considering any non-executive director as officer-in-default for any violation of the provisions of the Act, it should be examined whether the violation has taken place with his knowledge obtained through board process, with his consent or connivance and whether he acted diligently or not.

In case prosecution is required to be filed against any Government company, its directors/officers and Members of Parliament/State Legislators, prior authorization of Central Government should be sought. The presence of independent directors in relevant Board/Committee meeting should also be taken into account in initiating any prosecution (*vide MCA Master Circular No. 1/2011, dated 29-7-2011*).

25.8-1 Compounding of certain offences under the Companies Act [Section 441]

This section has given power to the Central Government to compound offences that do not invite imprisonment as penalty. It may be noted that an offence punishable with imprisonment only or punishable with imprisonment and also with fine cannot be compounded under this section. The compounding will be done only after payment or credit, by the offending company or the officer concerned, as the case may be, to the Central Government of such sum as may be specified. In case the maximum amount of the fine does not exceed rupees twenty five lakh*, offence may be compounded by the Regional Director or any officer authorized by the Central Government. In other cases (fine of rupees five lakhs or more) the Tribunal may compound the offence. The sum for compounding may be prescribed by the officer or authority compounding the offence. The sum shall not exceed the maximum amount of the fine that may be imposed for the offence. Also, additional fee paid u/s 403(2) shall have to be taken into account in specifying the sum. Section 403 deals with fees payable to the R.O.C. and additional fee payment in certain cases enabling the filing of document after the expiry of the normal period of filing. However, the facility of compounding is not available to a company or a concerned officer, if such company or the officer was previously allowed this facility within three years preceding the present offence.

The application for compounding is to be made to the R.O.C. who, in turn, will forward the same to the Tribunal or Regional Director or any other officer authorized by the Central Government together with his comments. The company, when allowed to compound, must, within seven days thereof send an intimation to the R.O.C. informing him of the compounding irrespective of whether any prosecution has been launched or not. On compounding, if no prosecution has already been started, no prosecution shall commence. On the other hand, if prosecution has been launched, it is the duty of the R.O.C. to inform the appropriate Court in writing, upon which the company or the concerned officer will stand discharged. The Tribunal or Regional Director or any other officer authorized by the Central Government while considering an application for compounding of an offence requiring filing or delivery of any document/return/account may at its/his discretion direct any officer/employee of the company to file or register the same on payment of applicable fee and additional fees payable under section 403. Any non-compliance of this direction by the officer/employee is punishable with imprisonment up to six months or with fine up to rupee one lakh or with both.

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*Amended *vide* Companies (Amendment) Act, 2019.

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence which is punishable under this Act with imprisonment only or with imprisonment and also with fine shall not be compoundable. [Section 441(6)]*

It was held in *Pahuja Takii Seed Ltd.*, In re [2018] 91 taxmann.com 256 (NCLT - New Delhi) that in relation to offences punishable with fine in excess of five lakh rupees, the Regional Director does not have any jurisdiction and only the Tribunal is the compounding authority.

The NCLT, Hyderabad refused compounding of offence committed under sections 129 and 133. The balance sheet of the company disclosed false particulars of issued share capital, which is punishable with fine and imprisonment. Submission by directors that default did not cause any prejudice to members, creditors or public interest was not allowed by the Tribunal. (*Jella Jagan Mohan Reddy*, In re [2017] 82 taxmann.com 422 (NCLT - Hyd.).

The Supreme Court in *V.L.S. Finance Ltd.* v. *Union of India* [2013] 120 SCL 16/33 held that the CLB (now Tribunal) is empowered to compound under Section 621A(1) [now Section 441(1)] the offence either before or after the institution of the criminal proceedings. The power to compound is not subject to the provisions of sub-section (7) of section 621A [now Section 441(6)]. The court held that both the powers are parallel and exercise of one power is not dependent on the other.

It has been clarified by Master Circular No. 1/2011, dated 29-7-2011 that while considering prosecution/compounding of offence against the following persons adequate care must be exercised. The persons are: (*i*) directors designated as independent director under SEBI requirements, (*ii*) directors nominated by Public Financial Institutions or banks or any financial institution; (*iii*) directors nominated by the Central/State Governments in PSU; (*iv*) directors nominated by Public Sector Financial Institutions participating in equity of the company and (*v*) directors nominated by Government under section 408 of the Companies Act, 1956.

Can a corporate entity be imprisoned? - This issue is highly contentious as the Supreme Court in *Velliappa Textiles Ltd.* [2003] 46 SCL 808 has held that since a corporate entity is not a natural person, it cannot be imprisoned. Where the punishment is 'imprisonment and fine', there also imprisonment is not possible. But as the punishment is composite *i.e.* 'imprisonment and fine', the court cannot award only 'fine' as punishment and as such the offending corporate body cannot be given any punishment, howsoever, the offence may be grave, because that discretion is not vested in the court. However, the Supreme Court in *Standard Chartered Bank* v. *Directorate of Enforcement* [2005] 59 SCL 217 has reversed that position and held that corporates having committed grave offence cannot escape punishment and court is to fill the gap/omission left in the law. A view, however, can be taken that the court has no discretion to interpret a clearly written law. The gap in the law, can only be filled by amending the concerned penal provision as has been done in the Income-tax Act, 1961 *vide* section 278B(3). An issue came on whether a company, being an artificial entity, can have *mens rea* in a case involving fraud and cheating. The Supreme Court held that the High Court judgment based on inapplicability of *mens rea* factor cannot be sustained and the company committing fraud etc. under I.P.C. can be prosecuted - *Iridium India Telecom Ltd.* v. *Motorola Incorporated* [2011] 106 SCL 28.

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*Amended *vide* Companies (Amendment) Act, 2019.

As per Delhi High Court decision in *V.L.S. Finance Ltd.* v. *Union of India* [2003] 48 SCL 742 has upheld parallel proceedings being held where compounding was done by CLB and another proceeding under Code of Criminal Procedure was on. Both are independent proceedings.

Compounding of offences committed during different financial years - In respect of any offence either committed by a company or any officer thereof which are punishable with fine only, and where maximum amount of fine does not exceed five lakh rupees, Tribunal is empowered to compound offence. Additionally, there is no bar on preferring a single application for compounding same offence committed during different financial years by company and its officers. [*Pahuja Takii Seed Ltd.* v. *Registrar of Companies, NCT of Delhi & Haryana* [2018] 98 taxmann.com 424 (NCL-AT)]

25.8-2 Application of fines

At the direction of the court imposing fine under this Act, the whole or any part of the fine may be applied towards payment of the costs of proceedings or towards payment of a reward to the person on whose information the proceedings were instituted (Section 446).

As per Section 446A, the court or the Special Court, while deciding the amount of fine or imprisonment under this Act shall consider size of the company, nature of business carried on by the company, injury to public interest, nature of the default and repetition of the default.*

If a One Person Company or a small company fails to comply with the provisions of sub-section (5) of section 92, sub-section (2) of section 117 or sub-section (3) of section 137, such company and officer in default of such company shall be liable to a penalty which shall not be more than one half of the penalty specified in such sections. (Section 446B)*

25.9 Punishment for Fraud [Section 447]

This section provides penalty for fraud in relation to the affairs of a company or any body corporate. Any act, omission, concealment of facts or abuse of position with intent to deceive, to gain undue advantage or to injure the interest of the company or its shareholders or its creditors or any other person will construe within the meaning of this section. A person who connives with another with such intent is also guilty of fraud. The person guilty of fraud involving an amount of at least ten lakh rupees or one per cent of the turnover of the company, whichever is lower* shall be punishable with imprisonment at minimum of six months but may extend to ten years and fine not less than the amount involved in the fraud but may extend to three times the amount of the fraud. The minimum imprisonment for a fraud involving public interest shall be three years. It may be noted that it is not necessary that the alleged act or omission must lead to any wrongful gain or wrongful loss, a mere intent is sufficient. In case of a fraud that involves an amount less than ten lakh rupees or one per cent of the turnover of the company, whichever is lower, and does not involve public interest, the punishment shall be imprisonment for a term which

* Inserted *vide* the Companies (Amendment) Act, 2017 and amended vide Companies (Amendment) Act, 2019.

may extend to five years or with fine which may extend to fifty lakh rupees or with both.*

25.9-1 Penalties for false statements made and false evidence given [Section 448]

As per section 448 of the Act, if in any return, report, certificate, financial statement, prospectus, statement or other document required by or for the purposes of any of the provisions of the Act, any person makes a statement, (*a*) which is false in material particular (knowing it to be false) or (*b*) which omits any material fact (knowing it to be material), he shall, be liable under Section 447.

Under Section 449 prescribes punishment for any person that intentionally gives false evidence upon any examination on oath or solemn affirmation, authorised under this Act or in any affidavit, deposition or solemn affirmation, in or about the winding up of any company under this Act or otherwise in or about any matter arising under this Act. The person giving the false evidence shall be punishable with imprisonment for a term which shall not be less than three years but which may extend to seven years and with fine which may extend to rupees ten lakh.

25.9-2 Penalty where no specific penalty is provided elsewhere in the Act [Section 450]

A fine of rupees ten thousand has been provided in aforesaid situation. If the contravention of the provision of the law is of the nature of a continuing one, then further to the sum of rupees ten thousand, a fine not exceeding rupees one thousand per day of continuing default shall be levied.

25.9-3 Punishment in case of repeated default [Section 451]

A company or an officer of a company who commits an offence punishable either with fine or with imprisonment and where the same offence is committed for the second or subsequent occasions within a period of three years, then, that company and every officer thereof who is in default shall be punishable with twice the amount of fine for such offence in addition to any imprisonment provided for that offence. It may be noted that Tribunal does not have power to compound repeated offences as detailed in section 451[*Pahuja Takii Seed Ltd.*, In re [2018] 91 taxmann.com 256 (NCLT - New Delhi)]

25.9-4 Penalty for wrongful withholding of property [Section 452]

If any officer or employee of a company wrongfully obtains possession of any property (including cash) of the company or having any such property (including cash) in his possession wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the Articles and authorised by the Act, he shall, on the complaint of the company or any creditor or contributory thereof, be punishable with fine which shall not be less than rupees one lakh but may extend to rupees five lakh. The Court trying the offence may also order such officer or employee to deliver up or refund, within a given time, the property including cash in question and the benefits derived from such property or cash. In case of non-

* Inserted *vide* the Companies (Amendment) Act, 2017 and amended *vide* Companies (Amendment) Act, 2019.

compliance with the Court order, such officer/employee is further punishable with imprisonment upto two years. The Supreme Court in *Jagdish Chandra Nijhawan* v. *S.K. Saraf* [1999] 19 SCL 385 has held that when the officer was placed in possession of the property under certain involved terms and conditions, his refusal to handover the property on ceasing to be an officer of the company does not fall within the ambit of section 630 [now Section 452]. In this case, the property did not belong to the company and the officer concerned had already bought up the property. In *Petlad Bulakhidas Mills Co. Ltd.* v. *State of Gujarat* [1998] 18 SCL 438, the Gujarat High Court held that the provisions of section 630 [now Section 452] is to protect company's properties and are not arbitrary, discriminatory or contrary to Article 21 of the Constitution. When the nexus exists between employment and occupation of the company property, it is expected that the premise is returned to the company on termination of employment or superannuation. The employee, during the occupation of the premises is not a tenant. Article 21 of the Constitution is concerned with right to life and property.

No director, officer or any employee of the company can refuse to vacate the company's accommodation after he has been removed from the office.

Incidence of section 452 on family members of the officer or employee when such officer is alive and when he is no more - The Supreme Court of India in several cases considered these aspects and ruled that :

(*i*) No member of the family of the officer/employee concerned can be proceeded against or prosecuted when the officer/employee is alive - *J.K. (Bombay) Ltd.* v. *Bharti Mata Mishra* [2001] 29 SCL 303 (SC).

(*ii*) A petition under section 630 [now Section 452] is maintainable against the legal heirs of the deceased officer or employee for retrieval of the company's property wrongfully withheld by them after the demise of the employee concerned - *Smt. Abhilash Vinod Kumar Jain* v. *Cox & Kings Ltd.* [1995] 3 SCC 732.

Once right of an employee or officer of company to retain possession of property, either on account of termination of services, retirement, resignation or death gets extinguished, persons in occupation are under an obligation to return the property back to company and on their failure to do so, they render themselves liable to be dealt with under section 630 [now Section 452], for retrieval of possession of property - *Gopika Chandrabhushan Saran* v. *XLO India Ltd.* [2009] 90 SCL 281/148 Comp. Cas. 130 (SC).

(*iii*) The expression "officer or employee of a company" appearing in section 630(1) [now Section 452(1)] of the Act includes past officer/employee when such person wrongfully obtains possession of any property of the company or wrongfully withholds the same after termination of his employment - *Baldev* v. *Krishna Sahi* v. *Shipping Corpn. of India* [1987] 4 SCC 361.

Section 630 [now Section 452] covers within its ambit not only employee or officer but also past employee or past officers or heirs of deceased employee or anyone claiming under them in possession of property - *Gopika Chandrabhushan Saran* v. *XLO India Ltd.* [2009] 90 SCL 281/148 Comp. Cas. 130 (SC).

(*iv*) Members of the family of the deceased officer/employee other than the legal heirs cannot be proceeded against or prosecuted. The position of the legal heirs of the deceased cannot be equated with the family members of an erstwhile employee against whom, admittedly, the criminal prosecution is launched and pending. In criminal cases which entail conviction and sentence, liberal construction with the aid of assumption, presumption and implication cannot be resorted to for roping in the prosecution such persons who are not intended to be prosecuted or dealt with by criminal court as that is violative of Article 21 of the Constitution - *J.K. (Bombay) Ltd.* v. *Bharti Mata Mishra* (*supra*).

Employee's right to retain company accommodation - After closure of the mill the company served notices on the employees claiming back possession of the accommodation given to them. On refusal to give back the possession, the matter went to court and the court held that in the absence of a contract to the effect that so long as one remains as employee of the company, he will enjoy the facility of the company accommodation allotted to him, mere continuation of the employment does not give right to employee to retain possession when notice was served on him by the company after closure to give back the possession. Also the contention of the employees that possession of accommodation can be claimed back only on the contingency of allotting the same to another employee is not tenable under section 630 [now Section 452] - *Gangubai Poonja Angre* v. *Mukesh Textile Mills* [2003] 41 SCL 27 (Bom.).

The Jharkhand High Court in *Ganesh Roy* v. *State of Jharkhand* has held that a proceeding in labour court against termination of employment does not entitle the employee concerned to retain the company's property [2004] 55 SCL 662. In a more complex case, it was held that raising of debit note by the company against its former director, who has retained certain assets of the company is not a good enough reason for quashing a section 630 [now Section 452] proceeding initiated by the company - *Satwant Singh* v. *Bharati Mobinet Ltd.* [2004] 55 SCL 667 (Mad.). If however, the board resolution on the basis of which a complaint for wrongful withholding of property under section 452 was filed against petitioner was itself under dispute, no further proceeding are permitted till final conclusion was arrived out between parties about validity of board resolution - *Shivraj Gupta* v. *Hansraj Gupta & Co. (P.) Ltd.* [2015] 59 taxmann.com 31 (Delhi).

In *Pravinbhai Ganeshbhai Choudhary* v. *Neutral Glass & Allied Industries (P.) Ltd.* [2001] 33 SCL 176, the Gujarat High Court held that - (*i*) "employee" is a wider generic term and includes "workman", (*ii*) there is no conflict between powers of the labour court and the powers of the criminal court under section 630 [now Section 452], and (*iii*) pendency of reference before labour court does not bar the Criminal Court in exercise of its powers under section 630 [now Section 452]. Also *see Indian Rayon & Industries Ltd.* v. *State of Gujarat* [2007] 76 SCL 83 (Guj.). The Rajasthan High Court in *B.N. Singh* v. *DCM Shriram Indus. Ltd.* [2007] 76 SCL 1 has held that pendency of a civil suit cannot debar criminal court from entertaining criminal complaint. Workmen were convicted for not vacating company premises given as accommodation, on termination of their services. The conviction was upheld as section 630 [now Section 452] is applicable to the workmen as well who were provided with accommodation under same set of rules as were applicable to officers/employees.

However, if factors are also present that need consideration, a simple employer-employee relationship may not suffice to invoke section 630 [now Section 452] *e.g.* when MOU was signed by two joint managing directors of two companies of the same group to allocate properties to the respective companies, the relationship of employer-employee *vis-a-vis* the joint managing director and the companies gets over shadowed by the terms of MOU and the case becomes fit for being decided by a civil court as relationship of employer-employee simpliciter does not exist - *C. Rangaswamy* v. *Coimbatore Pioneer Mills* [2002] 37 SCL 817 (Mad.).

A premise given by a company under an agreement but not as a part of service condition, for a specified period need to be restored back to the company when the employment of the allottee is terminated - *Tariq Azmi* v. *Tata Hydro Co. Ltd.* [2002] 39 SCL.

It appears that successive decisions of the Apex Court, specially the decisions in *Smt. Abhilash Vinod Kumar Jain* v. *Cox & Kings* and *J.K. (Bombay) Ltd.* v. *Mrs. Bharti Matha Mishra* are not consistent with each other. In the former case the expression 'officer or employee' used in section 630 [now Section 452] was given a broad coverage so as not to defeat the beneficent provision of section 630 [now Section 452] and not to ignore the factual realities that the legal heirs or family members of an officer/employee obtained the right of occupancy of the company property only through the 'officer' or 'employee' concerned and by no other basis. As such they are not to be excluded from the scope of the decision. As against this, subsequently in *J.K. (Bombay) Ltd.'s* case, the court ruled that the provision cannot be liberally construed so as to rope in family members other than legal heirs/representative of the former officer/employee.

A three-member bench of the Supreme Court has resolved the controversy on whether the terms 'officer' and 'employee' appearing in section 630(1) [now Section 452(1)] need to be given restricted meanings or wider (liberal) meanings. It held, in case where employee himself is not in occupation of premises either due to death or living elsewhere, all those who have come in possession of premises with express or implied consent of the employee and have non-vacated premises, would be withholding delivery of property to company and, therefore, be liable to be prosecuted under section 630 [now Section 452]. The scope of this judgment seems to cover 'officer' also. Further the ratio of this judgment would be applicable where the service of an employee or officer has been terminated and the premises continue to be in possession of persons who have come in such possession through him, even though the employee or officer concerned does not himself occupy the premises - *Lalita Jalan* v. *Bombay Gas Co. Ltd.* [2003] 44 SCL 130[4]. In *Shubh Shanti Services Ltd.* v. *Mrs. Manjula S. Agerwalla* [2005] 60 SCL 439 (Bom.) it has been explained that the proceedings under section 630 [now Section 452] being a criminal proceeding, the accused need only to make out a probable defence, while the complainant must make out a case beyond reasonable doubt. As facts stood, the family members of the former managing director were allowed by the company to stay in the flat allotted to the managing director. Hence, it was held as not a wrongful occupation under section 630 [now Section 452].

5. Also see *Gopika Chandrabhushan Saran* v. *XLO India Ltd.* Criminal Appeal No. 295 of 13-02-2009 (SC); 2009 90 SCL 281 (SC).

25.9-5 Penalty for improper use of the words "Limited" and "Private Limited" (section 453)

Any improper or unauthorised use of these words at the end of the name of the entity will attract a penalty not less than of rupees five hundred for every day during which the improper or unauthorised use has been made but may extend to rupees two thousand per day of improper use.

25.9-6 Power of Central Government to make Rules

Section 469 empowers the Central Government to make rules in respect of matters specified in the Act as also to generally carry on the purposes of the Act. Rules so made may prescribe punishment with fine (only) not exceeding rupees five thousand, with a further fine not exceeding rupees five hundred for contravention of the rule and for continuing the same.

25.10 Dormant Company

Under section 455 a company may make an application to the Registrar to be declared as a dormant company. Such an application may be made in the following circumstances:

(*i*) The company was formed for a future project or for holding an asset or intellectual property and has no significant accounting transaction; or

(*ii*) The company is inactive for the last two years *i.e.* has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

For the purpose of this section significant accounting transaction means transaction other than payment of fees to the Registrar or other payments made to fulfil the requirements of this Act or any other law or payments for maintenance of its office and records or allotment of shares to fulfil the requirements of this Act.

As per rule 3 of the Companies (Miscellaneous) Rules, 2014, for making an application as such the company needs to pass a special resolution in the general meeting of the company after issuing a notice to all the shareholders of the company for this purpose and obtaining consent of at least 3/4th shareholders in value. An application can be made only if the following conditions are met -

(*i*) no inspection, inquiry or investigation has been ordered or taken up or carried out against the company.

(*ii*) no prosecution has been initiated and pending against the company under any law.

(*iii*) the company is neither having any public deposits which are outstanding nor the company is in default in payment thereof or interest thereon.

(*iv*) the company is not having any outstanding loan, whether secured or unsecured. However if there is any outstanding unsecured loan, the company may apply under this rule after obtaining concurrence of the lender. The concurrence shall be enclosed with the application.

(*v*) there is no dispute in the management or ownership of the company. A certificate in this regard shall be enclosed with the application.

(*vi*) the company does not have any outstanding statutory taxes, dues, duties etc. payable to the Central Government or any State Government or local authorities etc.

(*vii*) the company has not defaulted in the payment of workmen's dues.

(*viii*) the securities of the company are not listed on any stock exchange within or outside India.

On such an application being made, the Registrar shall allow the status of a dormant company to the applicant and issue a certificate in such form as may be prescribed to that effect and enter the name of the company in a register of dormant companies. The Registrar on its own may enter the name of such company in the register if a company has not filed financial statements or annual returns for two financial years consecutively after issuing a notice to that company.

Such companies shall be governed by separate rules regarding minimum number of directors, filing of documents and annual fee to retain its dormant status in the register. A dormant company shall have a minimum of three, two or one director(s) in case of a public company, private company and one person company respectively. The provisions relating to rotation of auditors shall not apply to such a company. A return of dormant company is required to be filed annually duly audited by a chartered accountant within thirty days at the end of the financial year [Rules 6 and 7].

A dormant company may become an active company again by making an application with supporting documents and fee. If a dormant company fails to meet the conditions specified under Rule 3, the directors are under an obligation to file an application for obtaining the status of an active company within seven days.

The Registrar shall strike off the name of a dormant company from the register of dormant companies due to non-compliance with the requirements of this section. Under Section 248(1)(*c*) the Registrar may remove the name of company from the register of companies if it is not carrying on any business or operation for a period of two immediately preceding financial years and has not made any application within such period for obtaining the status of a dormant company under section 455.

25.11 Service of documents

25.11-1 Service of documents on a company

Section 20 contains the law relating to service of documents on company. The section provides that a document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by registered post or by speed post or by courier service or by leaving it at its registered office or by means of electronic mode as may be prescribed. As per Rule 35(5) of the Companies (Incorporation) Rules, 2014, courier means a document sent through a courier which provides proof of delivery.

However that where the securities are held in a depository, the records of the beneficial ownership may be served by such depository on the company by means of electronic or other mode.

Notice published in newspapers - Where before winding up order was passed, company was served notice on three occasions, one by creditor publishing demand notice and twice by court in two widely circulated newspapers, it was held that company was served and had full knowledge of proceedings of winding-up - *Om Prakash Jaiswal* v. *Shekharaj Hotel (P.) Ltd.* [2003] CLB 929 (All.).

25.11-2 Service of documents on R.O.C. [Section 20]

A document may be served to the R.O.C. by sending it to him by post or registered post or by speed post or by courier or by delivering it to his office or address or by such electronic or other mode as may be prescribed.

25.11-3 Service of documents on members by company [Section 20]

A document may be served to any member by sending it to him by post or registered post or by speed post or by courier or by delivering it to his office or address. In case a member has requested for delivery of any document through a particular mode, he shall pay fees for the same as determined by the company in the annual general meeting.

Rule 35(6) of the Companies (Incorporation) Rules, 2014 states that in case of delivery by post service shall be deemed to have been effected -

i. in the case of a notice of a meeting, at the expiration of forty-eight hours after the letter containing the same is posted, and

ii. in any other case, at the time at which the letter would be delivered in the ordinary course of post.

25.11-4 Electronic Communication

As per Rule 35 of the Companies (Incorporation) Rules, 2014, a document may be served on a company or an officer thereof through electronic transmission. For this purpose electronic communication means a communication delivered by:

(*a*) facsimile telecommunication or electronic mail when directed to the facsimile number or electronic mail address, respectively, which the company or the officer has provided from time to time for sending communications to the company or the officer respectively;

(*b*) posting of an electronic message board or network that the company or the officer has designated for such communications, and which transmission shall be validly delivered upon the posting;

(*c*) other means of electronic communication.

It must be ensured that the company or the officer has put in place reasonable systems to verify that the sender is the person purporting to send the transmission. The system shall also create a record that is capable of retention, retrieval and review, and which may thereafter be rendered into clearly legible tangible form.

Likewise, a document may be served on the Registrar or any member through electronic transmission. For this purpose electronic communication means a communication delivered by:

(*d*) facsimile telecommunication or electronic mail when directed to the facsimile number or electronic mail address, respectively, which the Registrar or the member has provided from time to time for sending communications to the Registrar or the member respectively;

(*e*) posting of an electronic message board or network that the Registrar or the member has designated for such communications, and which transmission shall be validly delivered upon the posting;

(*f*) other means of electronic communication.

It must be ensured that the Registrar or the member has put in place reasonable systems to verify that the sender is the person purporting to send the transmission. The system shall also create a record that is capable of retention, retrieval and review, and which may thereafter be rendered into clearly legible tangible form.

25.12 Company law in a computerised environment - E-filing - Introduction

25.12-1 Filing of applications, documents, inspection etc. in electronic form

Section 398 of the Act empowers the Central Government to make rules for filing various applications, forms etc. through the electronic mode. The section states that notwithstanding anything contained in this Act, and without prejudice to the provisions contained in section 6 of the Information Technology Act, 2000, the Central Government may, by notification in the Official Gazette, make rules regarding :

(*a*) Filing or delivery of specified applications, balance-sheet, prospectus, return, declaration, memorandum of association, articles of association, particulars of charge, or any other particulars or documents to be done through the electronic form and authenticated in manner as may be specified;

(*b*) Service or delivery of specified document, notice, any communication or intimation, required to be done through the electronic form and authenticated in manner as specified;

(*c*) Maintenance of such applications, balance-sheet, prospectus, return, register, memorandum of association, articles of association, particulars of charge, or any other particulars or document and return filed by the Registrar in the electronic form and registered or authenticated in the manner as may be specified;

(*d*) Inspection of the memorandum of association, articles of association, register, index, balance-sheet, return or any other document maintained in the electronic form, may be made by any person through the electronic form as may be specified;

(*e*) Prescribed fees, charges or other sums to be paid through the electronic form and in the manner as may be specified;

(*f*) Registration of change of registered office, alteration of memorandum of association or articles of association, prospectus, issue certificate of incorporation or certificate of commencement of business, register such document, issue such certificate, record notice, receive such communication by the Registrar or performance of other duties or discharge of functions or exercise of powers by the Registrar, by the electronic form, in the manner as may be specified.

(2) The Central Government may, by notification in the Official Gazette, frame a scheme to carry out the provisions specified under sub-section (1) through the electronic form.

25.12-2 Electronic form to be exclusive, alternative or additional

Section 400 clarifies that the electronic form shall be exclusive or in alternative or in addition to the physical form. The Central Government is empowered to make rule in this respect.

25.12-3 Providing of 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 prescribed.

25-12-4 Application of provision of Information Technology Act, 2000

Section 402 states 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.

25.12-5 What is e-Governance

Electronic Governance is the application of information technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. E-Governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

Traditionally, the interaction between citizens or business and Government agency takes place in a Government office. In e-Governance, the interaction takes place virtually using Internet based technology, thus reducing time and cost involved. Even better, E-Governance enhances the citizens and business access to Government information and services and provides new ways to increase citizen participation in the democratic process.

Advantages of e-Filing

- 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 of breed services.

Launch of MCA-21 Programme

Ministry of Company Affairs (MCA) has launched a major E-Governance initiative (MCA-21). It envisages e-filing of all documents relating to company matters on the MCA portal.

MCA has moved from the traditional paper-based operation to a near paperless environment. Consequently, the conventional forms prescribed for various transactions have been adapted for use through electronic medium. The processes and forms of MCA have been simplified and standardized for electronic filing (e-Filing) through e-Forms.

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, Company Law Board/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

- Allotment, change in particulars and surrender of director identification number
- Refund of fees paid

For the purpose of standardization and better understanding, the proposed 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 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 ROCs approval*—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.

(*h*) *DIN Services* - Allotment of director identification number, surrender of DIN and change in particulars of directors to be given to the Central Government.

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, charge documents, annual returns and balance sheets, change in directors and other documents.

Five Step e-Filing Process

For e-filing, computer with window 2000 or later will be required. The other hardware/software requirements include Java Runtime Environment (Java version 8), internet connection to access MCA website with internet explorer 10 or above or Chrome 49 or above or Firefox 45 or above. Adobe acrobat 11 or above for e-form upload, scanner for scanning paper attachment and printer for printing bank challan or service fee payment receipt would also be needed. Pop-ups from MCA 21 portal must be enabled in the browser.

Step 1 : Register Yourself

- Only registered users will be allowed to do e-filing.
- Registration is a simple one-time process, where guidance will be available on MCA-21 portal to create your personalized login ID - this is to ensure security and also serves as a channel for providing you personalized information as the functionality evolves.
- If you possess a Digital Signature Certificate (DSC) and if you intend to sign the e-Forms as an authorised signatory, you will need to also register your DSC. You will need to Register your DSC every time you procure a new DSC or renew/revalidate your DSC.

Step 2 : Download e-Form

- e-Forms are freely downloadable and are in the 'PDF' format. You will need Adobe Reader v11 which is downloadable through link available on MCA-21 portal.
- There are new set of e-Forms available on MCA-21 portal and you may need to familiarize yourself with the new set of e-Forms.
- Instruction kits for each e-Form is also available alongside the e-Forms.

Step 3 : Complete e-Form

- e-Forms are essentially PDF documents, specifically tailored by MCA to meet e-filing needs as required by the Companies Act.
- You may choose to fill in an e-Form offline at your convenience without staying connected to internet.
- These e-Forms can be filled-in and signed digitally.
- As a part of the simplification of form filing, certain fields can be filled-up automatically by the system (to the extent such data is available in the database of MCA) by selecting the "pre-fill" option that is available in the form.
- You will also be able to do "automated pre-scrutiny", a step that will ensure that your e-Form is complete in all respects and is good for e-filing.
- You may also attach supporting documents, where applicable, but please make sure that these are also in PDF format - support for conversion of popular formats such as Microsoft Office into PDF is made available in the MCA-21 portal.

- Make sure that you keep the size of your attachments minimal, wherever possible.
- Sign the e-Form using the Digital Signature Certificate.
- If more than one signatory is involved, you can send the e-Form either on suitable media or as an e-mail attachment (or transfer a file over the network) to other individuals who can also sign digitally.
- Multiple signatures can be applied on a given e-Form, but just make sure that contents of the e-Form are not altered after it has been signed, in which case the document will become invalid and will be rejected during the e-filing process.
- After all individuals have digitally signed the form, it is ready for submission.

Step 4 : Submit e-Form

- You will need to connect to the Internet if you want to carry out e-Filing.
- Submission will need to be made at the MCA-21 portal using specialized functionality that is provided.
- Sending the e-Form by email does not constitute e-Filing and should be avoided.
- Submission of e-Form will generally take a couple of minutes and will depend on the size of e-Form/attachments and the speed/quality of your Internet connection - better the connection, faster the process.
- If the e-Form is defective as may be identified by the MCA-21 system during submission, it will be rejected and returned to the user with clear details of the nature of the defect - such defect could be a result of incorrect data that may have been entered in the e-Form or due to missing or invalid digital signatures.
- If your e-Form is correct in all respects, you can proceed to the next step.
- It is advisable to save a copy of the document before submission (using submit button) as a part of your records.

Step 5 : Make Payment

- Fee calculation will be done automatically by the system as applicable under law and the fee for the service will be displayed to the user.
- MCA-21 system supports following methods of payment :
  - (*i*) Credit card/prepaid card
  - (*ii*) Internet banking
  - (*iii*) NEFT
  - (*iv*) Offline Challan
  - (*v*) Pay Later

The concerned bank branch will send data in e-form to MCA to acknowledge the payment that is made by you.

Completion of e-Filing

Filing will be completed once the necessary payment is remitted either through electronic payment means or through the challan based method.

List of e-forms

The list of e-forms to be used for various purposes is given below:

Description	e-form
Intimation of Director Identification Number by the company to the Registrar DIN services	DIR-3C
Information to the Registrar by company regarding the number of layers of subsidiaries.	CRL-1
Approval Services (Headquarters)	
Form of intimation of appointment of cost auditor by the company to Central Government.	CRA-2
Form for filing application or documents with Central Government	CG-1
Approval Services (Regional Director)	
Application for removal of auditor(s) from his/their office before expiry of term	ADT-2
Application to Regional director for conversion of section 8 company into company of any other kind	INC-18
Application to Regional Director for approval to shift the Registered Office from one state to another state or from jurisdiction of one Registrar to another Registrar within the same State	INC-23
Memorandum of Appeal	ADJ
Applications made to Regional Director	RD-1
Application to Central Government for extension of time for filing particulars of registration of creation/modification/satisfaction of charge OR for rectification of omission or misstatement of any particular in respect of creation/modification/satisfaction of charge	CHG-8
Approval Services (Registrar of Companies)	
Application for Condonation of delay Scheme -2018.	CODS
Application by company to ROC for removing its name from register of Companies	STK-2
One Person Company- Application for Conversion	INC-6
Application for approval of Central Government for change of name	INC-24
Application to Registrar for obtaining the status of dormant company	MSC-1
Application for seeking status of active company	MSC-4
Applications made to Registrar of Companies	GNL-1

Description	e-form
Application for grant of License under section 8	INC-12
Application for striking off the name of company under the Fast Track Exit(FTE) Mode	FTE
Change Services	
One Person Company- Nominee consent form	INC-3
One Person Company- Change in Member/Nominee	INC-4
Notice of situation or change of situation of registered office	INC-22
Conversion of public company into private company or private company into public company	INC-27
Notice to Registrar of any alteration of share capital	SH-7
Particulars of appointment of Directors and the key managerial personnel and the changes among them	DIR-12
Return of alteration in the documents filed for registration by foreign company	FC-2
Annual accounts along with the list of all principal places of business in India established by foreign company	FC-3
Charge Management	
Application for registration of creation, modification of charge (other than those related to debentures)	CHG-1
Particulars for satisfaction of charge thereof	CHG-4
Notice of appointment or cessation of receiver or manager	CHG-6
Application for registration of creation or modification of charge for debentures or rectification of particulars filed in respect of creation or modification of charge for debentures	CHG-9
Details of persons/directors/charged/specified	GNL-3
DIN Forms	
Application for allotment of Director Identification Number before appointment in an existing company	DIR-3
Application for surrender of Director Identification Number	DIR-5
Intimation of change in particulars of Director to be given to the Central Government	DIR-6
A Report by a company to ROC for intimating the disqualification of the director	DIR-9
Application for KYC of Directors	DIR-3 KYC
Incorporation services	
Active Company Tagging Identities & Verification (ACTIVE)	INC-22A
Simplified Proforma for Incorporating Company Electronically (SPICe) - with mandatory PAN & TAN application included.	SPICe
eMemorandum of Association (SPICe MoA)	SPICe MoA

Description	e-form
eArticles of Association (SPICe AoA)	SPICe AoA
Application for Goods and Services Tax Identification Number, employees state Insurance corporation registration plus Employees provident fund organisation registration (AGILE)	AGILE
One Person Company- Nominee consent form	INC-3
Application by a company for registration under section 366	URC-1
Information to be filed by foreign company	FC-1
Compliance Related Filing	
Form for furnishing half yearly return with the registrar in respect of outstanding payments to Micro or Small Enterprise.	MSME
Form for filing Cost Audit Report with the Central Government.	CRA-4
Return of deposits	DPT-3
Information to the Registrar by Company for appointment of Auditor	ADT-1
Notice of Resignation by the Auditor	ADT-3
Statement regarding deposits existing on the commencement of the Act	DPT-4
One Person Company- Intimation of exceeding threshold	INC-5
Return of allotment	PAS-3
Letter of offer	SH-8
Declaration of Solvency	SH-9
Return in respect of buy-back of securities	SH-11
Filing of Resolutions and agreements to the Registrar	MGT-14
Notice of resignation of a director to the Registrar	DIR-11
Form for submission of documents with the Registrar	GNL-2
Annual Return of a Foreign company	FC-4
Return of dormant companies	MSC-3
Persons not holding beneficial interest in shares	MGT-6
Informational Services	
Notice of situation or change of situation or discontinuation of situation, of place where foreign register shall be kept	MGT-3
Form for filing Report on Annual General Meeting	MGT-15
Notice of address at which books of account are maintained	AOC-5
Changes in shareholding position of promoters and top ten share-holders	MGT-10
Declaration for commencement of business	INC-20A

Description	e-form
Intimation to Registrar of revocation/surrender of license issued under section 8	INC-20
Notice of Order of the Court or any other competent authority	INC-28
Reply To Call for Information on CSR	CFI(CSR)
Investor Services	
INVESTOR COMPLAINT FORM	ICP
SERIOUS COMPLAINT FORM	SCP
Provisions related to Managerial personnel	
Form of application to the Central Government for approval of appointment or reappointment and remuneration or increase in remuneration or waiver for excess or over payment to managing director or whole time director or manager and commission or remuneration to directors	MR-2
Return of appointment of MD/WTD/Manager	MR-1
Annual filing eForms	
Form for filing XBRL document in respect of financial statement and other documents with the Registrar	AOC-4 (XBRL)
Form for filing annual return by a company	MGT-7
Form for filing financial statement and other documents with the Registrar	AOC-4
Form for filing consolidated financial statements and other documents with the Registrar	AOC-4 (CFS)
Addendum Form	
Addendum for rectification of defects or incompleteness	GNL-4
Refund Form	
Application for requesting refund of fees paid.	Refund

25.13 The Depositories Act, 1996 : An Analysis

25.13-1 Objectives

Depositories Act, 1996, aims at providing for:

(*a*) a legal basis for establishment of depositories to conduct the task of maintenance of ownership records of securities and effect changes in ownership records throughout by book entry;

(*b*) dematerialisation of securities in the depositories mode as well as giving option to an investor to choose between holding securities as at present or holding securities in a dematerialised form in a depository;

(*c*) making the securities fungible;

(*d*) making the shares, debentures and any interest thereon of a public limited company freely transferable; and

(*e*) exempting all transfers of shares within a depository from stamp duty.

Benefits of depository system

The benefits from the depository system are following:

(*a*) It reduces the cost of issue and transfer of securities by the issuer.

(*b*) It reduces the scope for theft, forgery damage to security certificates.

(*c*) It entitles the transferee to all the rights associated with the securities immediately on settlement of purchase transaction.

(*d*) It enhances the velocity of the securities in circulation and hence liquidity in the market. The investors can trade in securities immediately on allotment without waiting for receipt of security certificates.

Services to be rendered by a Depository

The Depository service for securities usually refers to making a computerized book entry record of securities to effect transfer of ownership. In the context of the Depositories Act, 1996, (*a*) allotment of securities, (*b*) transfer of ownership of securities are reflected through book entry system only and do not require existence of security certificates etc.

Who can render Depository services?

Anybody to be eligible to provide depository services must—

(*a*) be formed and registered as a company under the Companies Act

(*b*) be registered with SEBI as a depository under the SEBI Act, 1992,

(*c*) have framed bye-laws with the previous approval of SEBI,

(*d*) have obtained a certificate of commencement of business from SEBI,

(*e*) have one or more participants to render depository services on its behalf,

(*f*) have adequate systems and safeguards to prevent manipulation of records and transactions to the satisfaction of SEBI, and

(*g*) have been established by one or more of the following (*i*) public financial institution (*ii*) a bank (*iii*) a foreign bank (*iv*) recognized stock exchange (*v*) a body corporate engaged in providing financial services (*vi*) a body corporate constituted or recognized in foreign country for providing custodial, clearing or settlement services in securities market and approved by the Central Government (*vii*) an institution engaged in providing financial services established outside India and approved by the Central Government.

Securities eligible for depository services

The Depository services are available in respect of securities as may be specified by SEBI. The eligibility criteria for admission of securities into depository have been determined by SEBI Regulations. This provides flexibility to SEBI, for example, to admit certain instruments like units of mutual funds in the depository mode. An instrument to be under the depository mode need not be a security as defined in the Securities Contracts (Regulation) Act, 1956.

Are all eligible securities required to be in the depository mode?

It is not necessary that all eligible securities must be in the depository mode. In the scheme of the depository legislation, the investor has been given supremacy. If he wishes to avail of the depository services in respect of any eligible security, whether existing or to be issued, the issuer who has entered into an agreement with one or more depositories has to give him the facility. The investor has the choice of holding physical securities or opting for a depository based ownership record. At the time of fresh issue, the issuer who has entered into an agreement with the depository is under obligation to give the option to the investors either to receive the security certificates under the paper based system (non-depository mode) or opt to hold securities with a depository (depository mode). The decision on whether or not to hold securities within the depository mode and if in the depository mode with which depository or participant, would be entirely with the investor. Such freedom can be exercised either at the time of the initial offer of the security by indicating his choice in the application form or at any subsequent time. He will also have the freedom to switch from depository mode to non-depository mode and *vice versa*. Under Section 29, companies making public offer of any security shall issue the same only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and regulations made thereunder.

Who is a participant?

Participant is an agent of depository and is registered as such under the SEBI Act, 1992 to render depository services. The participants shall have such rights and obligations as may be specified by the regulations *viz.* SEBI (Depositories and Participants) Regulations, 1996. The eligibility criteria for admission of any person as a participant has been determined by SEBI by Regulations, Banks, custodians, public financial institutions, foreign bank, state financial corporation, an institution engaged in providing financial services, clearing corporation, stock broker, non-banking finance companies and Registrar to an issue or share transfer agent are eligible for registration as participant.

Responsibilities of a depository vis-a-vis participant

The depository does not render services directly but only through an agent who is registered as a participant with SEBI. The relationship between a depository and the participant is that of a principal and agent and is governed by the bye-laws of the depository and the agreement between them. The depository shall maintain ownership records in the name of each participant and each such participant shall act as the agent of the depository, further maintain ownership records in respect of individual investors. The depository shall, however, indemnify the investor for any loss caused to him due to negligence of depository and/or participant. The depository in turn shall raise consequential claims on the concerned participant.

Status of the depository in the records of the issuer

By fiction of law, the depository is deemed to be a registered owner of the securities. In respect of the securities held in a depository, the name of the depository shall appear in the records of the issuer as registered owner of the securities and such registered owner shall have the right to effect the transfer of securities on behalf of the beneficial owner but shall not have voting and other rights associated with the securities.

Status of an investor who avails of depository services

If an investor avails of depository services, the name is replaced by the name of the depository in the records of the issuer, as the depository becomes the registered owner of the securities held by the investor. The status of the investor changes from that of a registered owner, again by fiction of law, to beneficial owner. The name of the investor appears on the records of the depository as beneficial owner in respect of the securities held by him. The beneficial owner shall continue to have the rights and benefits and be subject to all the liabilities associated with the securities held by the depository on his behalf.

Dematerialisation of securities

The Depositories Act, 1996, envisages dematerialisation in the depository mode. In such a case the securities held in a depository shall be dematerialised and the ownership of the securities shall be reflected through book entry only. The securities outside the depository shall be represented by physical scripts.

Fungibility

The Depositories Act, 1996, specifies that all securities held in a depository are fungible. That is all certificates of the same security are inter-changeable in the sense that investors lose the right to obtain the exact certificate they surrender at the time of entry into depository. It is like withdrawing money from the bank without bothering about the distinctive number of the currencies (Section 9).

How does an investor avail services of a depository?

(*a*) *In the case of existing securities:* An investor, before availing the services of a depository, shall enter into an agreement with the depository through a participant and then shall surrender security certificate to the issuer. The issuer, on receipt of security certificate shall cancel them and substitute in its records the name of the depository as the registered owner in respect of that security and inform the depository accordingly. The depository shall thereafter enter the name of the investor in its records as beneficial owner.

(*b*) *In the case of fresh issue :* At the time of initial offer, the investor would indicate the choice in the application form. If the investor opts to hold a security in the depository mode, the issuer shall intimate the concerned depository about the details of allotment of a security made in favour of investors and records the depository as registered owner of the securities. On receipt of such information, the depository shall enter in its records the name of allottees as the beneficial owners. In such case a prior agreement by the investor with the depository as well as an agreement between the issuer company and depository may be necessary.

(*c*) *In the case of exit from the depository :* If a beneficial owner or a transferee of a security desires to take away a security from depository, he shall inform the depository of his intention. The depository in turn shall make appropriate entries in its records and inform the issuer. The issuer shall make arrangements for the issue of certificate of securities to the investor.

(*d*) *In the case of transfer within the depository :* The depository shall record all transfers of securities made among the beneficial owners on receipt of

suitable intimation to the effect that a genuine purchase transaction has been settled.

(*e*) *In the case of pledge :* Before creation of any pledge or hypothecation in respect of a security, the beneficial owner is required to obtain prior approval of the depository and on creation of pledge or hypothecation, the beneficial owner shall give intimation of such pledge or hypothecation to the depository. The depository shall make appropriate entries in its records which will be admissible as evidence.

What is free transferability of services?

It refers to a situation where on receipt of intimation regarding settlement of purchase transaction, the transfer of a security is effected immediately and the transferee enjoys all the rights and obligations associated with the securities. Once a genuine purchase transaction is settled, nobody including the issuer, depository, participant, any intermediary or regulatory authority can withhold the transfer of security.

Types of securities freely transferable

Only the shares, debentures and any interest therein of a public limited company (listed as well as unlisted companies) have been made freely transferable. The Board of directors of such a company or the concerned depository shall not have any discretion to refuse or withhold a transfer of such security. Any other security, for example, shares or debentures of a private company or any unit of a mutual fund, or any security issued by any issuer other than a public limited company are not freely transferable and would be subject to the restrictions contained in the articles of association or the bye-laws of the concerned issuer and terms of issue.

Is it required to have a transfer deed for transfer of securities within the depository mode?

The transfer deed and all other associated paraphernalia stipulated in section 56 of the Companies Act, 2013 shall not apply to the transfer effected within the depository mode. However, this formally needs to be complied with for transfer of securities outside the depository mode. In case of the securities in the depository mode, the depository would effect the transfer on the basis of intimation (contract note or some other suitable evidence to the effect that a purchase transaction has been settled) received through participants.

Powers of SEBI under the Depositories Act, 1996

(*a*) to register the depositories and the participants under the SEBI Act, 1992,

(*b*) to issue certificate of commencement of business to the depositories on being satisfied that the depository has adequate systems and safeguards to ensure against manipulation of records and transactions,

(*c*) to frame regulations under the SEBI Act as well as under the Depositories Act, 1996 to carry out the purposes of the Depositories Act,

(*d*) to suspend or cancel the certificate of registration after giving a reasonable opportunity of being heard,

(*e*) to regulate depositories, participants, issuers and their relationship with the investors,

(*f*) to monitor, inspect, call for information, summon and enforce attendance of witnesses and production of documents, conduct inquiries and audit of depositories, participants, investors of securities,

(*g*) to specify the securities and the eligibility criteria of the securities for admission into a depository,

(*h*) to give directions to any depository, participant or issuer in the interest of investors or the securities market,

(*i*) to approve the bye-laws of a depository and amend or a revoke any bye-laws of the depository.

Bye-laws of a depository

A depository has to frame bye-laws with the previous approval of SEBI consistent with the provisions of the Act and the regulations made by SEBI thereunder, SEBI has, however, the power to direct the depository to amend or revoke any bye-laws already made wherever it considers expedient so to do. If the depository fails or neglects to comply with the directions of SEBI, SEBI may make the bye-laws or amend or revoke the bye-laws on its own.

Contents of the bye-laws

The bye-laws of a depository would include:

(*a*) the eligibility criteria for admission and removal of securities into/from the depository,

(*b*) the conditions subject to which the securities shall be dealt with,

(*c*) the eligibility criteria for admission of any person as a participant,

(*d*) the manner and procedure for dematerialisation of securities,

(*e*) the procedure for transactions within the depository,

(*f*) the manner in which securities shall be dealt with or withdrawn from a depository,

(*g*) the procedure for ensuring safeguards to protect the interests of participants and beneficial owners,

(*h*) the conditions of admission into and withdrawal from a participant by a beneficial owner,

(*i*) the procedure for conveying information to the participants and beneficial owners on dividend declaration, shareholder meetings and other matters of interest to the beneficial owners,

(*j*) the manner of distribution of dividends, interest and monetary benefits received from the company among beneficial owners,

(*k*) the manner of creating pledge or hypothecation in respect of securities held with a depository,

(*l*) *inter se* rights and obligations among the depository, issuer, participants and beneficial owners,

(*m*) the manner and the periodicity of furnishing information to SEBI, issuer and other persons,

(*n*) the procedure for resolving disputes involving depository, issuer, company or a beneficial owner,

(*o*) the procedure for proceeding against the participants committing breach of the regulations and provisions for suspension and expulsion of participants from the depository and cancellation of agreements entered into the depository,

(*p*) the internal control standards including procedures for auditing, reviewing and monitoring.

Stamp duty on security certificates

At the time of fresh issue of securities (shares or otherwise) either issued in the form of physical certificate directly to investors or through records of a depository, the issuer shall pay the stamp duty on the total amount of the security issued by it, even though there may be no physical securities (instrument) which can be stamped (executed).

Payment of stamp duty at the time of entry into the depository

Entry by an investor into a depository by surrendering the security certificates involve change of registered ownership as the investor becomes the beneficial owner and the depository becomes the registered owner in respect of the security. Such change of registered ownership of shares from an investor to a depository has been exempted from stamp duty.

Stamp duty in the case of transfer of securities within the depositories

All transfers of securities involve change in registered ownership and/or beneficial ownership. If such change is in respect of shares within the depository mode, no stamp duty shall be payable.

Stamp duty payable while opting out of depository

If an investor opts to exit from a depository, the registered ownership changes from the depository to the investor. Such change of ownership in respect of shares shall not attract stamp duty. However, when the investor seeks the issue of physical certificate of securities from the issuer, the issue of such certificates shall attract stamp duty as is payable on the issue of duplicate certificates.

Stamp duty in respect of transactions outside the depository mode

The transactions outside the depository mode attract stamp duty as at present.

Distinctive number of shares

The mandatory requirement of distinguishing each security by an appropriate number is not required. However, it does not prohibit a company from having distinct number for its securities which are outside the depository mode.

Exercise of membership rights in respect of securities held by a Depository

The Depository as a registered owner, has not any voting rights or any other rights in respect of securities held by it on behalf of the beneficial owners. The beneficial owner shall be entitled to all the rights and benefits (including the right to vote) and be subject to all the liabilities in respect of securities held by a depository.

The evidential value of the records of the depository

The depository has been treated as a bank for the purposes of the Bankers' Book Evidence Act, 1891. The ownership records of securities maintained by deposito-

ries, whether maintained in the form of books or machine readable forms, shall be accepted as *prima facie* evidence in all legal proceedings.

Cognizance of offence by courts

No court shall take cognizance of any offence under the Depositories Act except on a complaint made by the Central Government or State Government or SEBI.

Penalty for offences under the Depositories Act

A maximum penalty of imprisonment for a term which may extend to ten years or fine up to rupees twenty five crores or both can be imposed.

Test your knowledge

[QUESTIONS HAVE BEEN SELECTED FROM PAST EXAMINATIONS OF C.A. (FINAL) & ICSI (FINAL & INTER)]

1. What are the essential requirements of Section 447 relating to fraud in relation to affairs of a company?
2. Write a short note on the role of the National Financial Reporting Authority.
3. InfoCom Ltd. receives a notice at its registered office through a local courier and the company refuses to accept the same objecting on the ground that the notice has not been sent in proper manner - Discuss.

   Hint : Refusal is not in order.
4. A notice issued and sent by the R.O.C. to a director of a company by registered post is returned with the remark 'refused'. What further action needs to be taken in respect of such a notice?

   Hint : Notice is deemed to have been served.
5. Prepare a comprehensive note on compounding of offences under section 441 with special reference to the issue on whether a company as such can be imprisoned.
6. Explain the provisions relating to wrongful withholding of property by officers or employees of the company. Does the liability extend to the family members as well?
7. State the benefits of the depository system.
8. What are the advantages of e-filing? What are the areas for which e-services are available?

PRACTICAL PROBLEMS

P. 1 XYZ Limited decided to terminate the services of Mr. X, who was employed as sales manager. It is apprehended by the company that the sales manager may not vacate the company's flat at Bombay. What action can be taken by the company under the Companies Act to regain possession of the flat? Is it necessary to take such action under the Companies Act before terminating the services of Mr. X? Will it make any difference if the flat is not owned by the company but taken on lease?

Hint : *Wrongful withholding of property* - The company can take action under section 452 of the Companies Act, 2013 if the ex-sales manager refuses to vacate the residential accommodation provided by the company.

According to section 452, it is an offence if any officer or employee of a company (*a*) wrongfully obtains possession of any property of a company or (*b*) having any such property in his possession wrongfully withholds it or knowingly applies it to purposes other than those expressed or directed in the articles and authorised by the Act and such an offence is punishable with fine [section 452(1)]. Further, the court trying the offence may also order such officer or employee to deliver to the company, any such property wrongfully obtained

or wrongfully withheld, within a time fixed by the court. Non-compliance of the court's order is an offence punishable with imprisonment for a term which may extend to two years [section 452(2)].

So, the company can file a complaint under section 452 as it provides speedy relief to the company.

Though the expression used in section 452 is not 'past or present officer or employee', it has been held by the Supreme Court that the term 'officer or employee' in section 452 applies not only to existing officers or employees of a company but also to past officers or employees if such officer or employee either (*a*) wrongfully obtains possession of any property of the company or (*b*) having obtained such property during the course of his employment withholds the same after the termination of his employment—*Baldev Krishna Sahi* v. *Shipping Corporation of India Ltd.* [1988]. In view of this Supreme Court's decision, it is possible to initiate action under section 452 even after terminating the services of Mr. X.

It is not necessary that the property in question should be actually owned by the company. Even if the company exercises only a leasehold right, the provisions of section 452 can be invoked— *P.V. George* v. *Jayens Engineering Co. (P.) Ltd.* [1990].

P. 2 Sandeep, General Manager of a unit of Aashirwad Ltd., occupied the guest house of the company for residential purposes. He was removed from the service by the company and he still continued to occupy the same. What action can be taken by the company to take possession of the guest house of the company?

Hint: *Refer Para 26.9-5* and *see Petlad Bulakhidas Mills Co.'s* case.

P. 3 Mr. X and Mr. Y were joint managing directors of B Ltd. and C Ltd. An MOU was entered into between Mr. X and Mr. Y to allocate the companies and the combined properties of the two companies among themselves to avoid future problem. Under the terms of MOU Mr. X will be the sole managing director of B Ltd. and Mr. Y of C Ltd. Besides certain movable properties of the two companies were also assigned to two companies in a distinct manner. A bungalow appearing in the name of C Ltd. was in the occupation of the family of Mr. X. Similarly another bungalow belonging to B Ltd. was in the occupation of the family of Mr. Y. Pending implementation of the terms of MOU, it was agreed that Mrs. X will be the tenant of the bungalow along with all the movable properties remaining there. Within two weeks thereof, after Mr. X submitted his resignation from C Ltd. as per the MOU, C Ltd. brought a case under Section 452 of the Act alleging that Mr. X is in wrongful occupation of its bungalow and the movable properties lying in it.

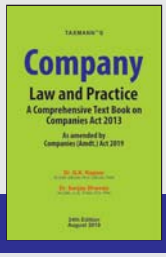
Decide, giving reasons whether the contention of C Ltd. will succeed.

Hint : Since occupation was given to Mrs. X under the MOU which was under implementation - the contention of 'C' Ltd. is not tenable. Besides, the bungalow was not given to Mr. X.

Subject Index*

*No. after entry denotes page Nos.

Registers and returns



About the Book

A Comprehensive Text Book on Companies Act, 2013, as amended by the Companies (Amendment) Act, 2019, especially conceived for the students of CA/CS/CMA/CFA/LL.B/LL.M/M.Com and other professional courses

- An authentic, comprehensive, up-to-date, simple and lucid analysis of the provisions of the Companies Act, 2013, **as amended by the Companies (Amendment) Act, 2019**/Rules made under the Companies Act, 2013/SEBI Regulations.
- An effort has been made to present the complicated provisions in a simple manner.
- Secretarial Practice/Check List, wherever relevant, has been given to make the book more relevant for professionals. Besides, specimen resolutions/notices have also been given.
- Important circulars, notifications, amendments and case laws (up to 31st July, 2019) have been incorporated.
- Law stated in this book is as amended by Companies (Amendment) Act, 2019
- **Revision Highlights of the present Edition :**
  - Provisions of the Companies (Amendment) Act, 2019
  - Important case law since 1st July, 2018 to 31st July, 2019
  - Amendments in Rules up to 31st July, 2019
  - Discussion on Private Placement enlarged
  - Discussion on Shares held in trust and disclosure of beneficial interest added
  - Discussion on rectification of register of members, independent directors, Committees of the Board of Directors, Interested director added and enlarged.

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