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23 C, EKDALIA PLACE
KOLKATA – 700019
M: 98301 65501
Web: www.pksal.com

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ICWAI Group III (Final) New Syllabus

Corporate Laws

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Topic: Compromises, Arrangements and Amalgamation of Companies

1. Meaning of 'compromise' & 'arrangement'

Ans. The expression 'compromise' has not been defined by the Companies Act. It implies the existence of a dispute. There can be no compromise unless there is a dispute. The settlement of the dispute results in a compromise. In other words, 'compromise' denotes an agreement between two or more persons for the ascertainment of their rights when there is some question in controversy between them or some difficulty in the enforcement of their rights.

Meaning of 'arrangement'

Arrangement involves a readjustment of the rights and liabilities of the members or creditors or any class of them. There need not be any dispute for an 'arrangement'. The term is wider in scope than the word 'compromise'. It includes any form of internal reorganisation of the company or its affairs, as well as scheme for amalgamation of two or more companies. A few examples of arrangement are as follows:

a. Issue of fully paid up shares to pay off debentures.
b. Creditors agreeing to waive a part of their dues.
c. Preference shareholders surrendering their right of arrears of dividend.
d. Exchange of company's assets for shares in a newly formed company.

Arrangement includes reorganisation of the share capital of the company. It includes the following methods:

a. the consolidation of shares of different classes; or
b. the division of shares into shares of different classes; or
c. both these methods.

The words 'compromise' and 'arrangement' imply that both the parties make concessions and give up something. A total surrender of the rights by one party would not amount to a compromise or arrangement As such, where it was proposed that members should abandon all their rights without any compensating advantage, it was held not to be a compromise or arrangement and hence the Court had no jurisdiction to sanction it.

2. Meaning of 'reconstruction' and 'amalgamation'

Ans. Generally, the expressions 'reconstruction' and 'reorganisation' are used where one company is involved and the rights of its shareholders or creditors are varied. The term 'amalgamation' is used where two or more companies are fused into one by merger or by one taking over the other.

Meaning of 'reconstruction'

'Reconstruction' implies that substantially the same business shall be carried on by substantially the same persons. As such, the same company comes in a new form with the same members and creditors.

'Reconstruction' can be resorted to for the following purposes:

i To reorganise capital.
ii To compound with creditors.
iii To extend the objects of the company.
iv To alter the rights attached to different classes of the company's shares or debentures.
v To compel the members of a company to contribute further capital by taking new shares.
vi To revive a sick unit,

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Modes of effecting reconstruction

Reconstruction may be carried out by any of the following methods:

i Sale of the company under the powers contained in the memorandum of association.
ii Sale of undertaking of the company under a scheme of reconstruction - Section 394 read with section 391.
iii Acquisition of shares in another company (Takeover of a company) - Section 395.
iv Compulsory amalgamation of companies in public interest by an order of the Central Government - Section 396.
v Reconstruction of a company which is under members' voluntary wound up - Section 494.
vi Reconstruction of a company which is under creditors' voluntary wound up - Section 507.
vii Reconstruction by a scheme of arrangement with the creditors by a company in voluntary winding up - Section 517.

All these modes of reconstruction have been discussed in the succeeding paragraphs.

Meaning of 'amalgamation'

The term amalgamation has not been defined by the Act. In amalgamation, two companies are joined to form a third entity or one is absorbed into or blended with another. Under an amalgamation, assets of the two companies become vested in one company which has as its shareholders all or substantially all the shareholders of the two companies. Amalgamation involves a merger of two or more companies by any of the following methods:

i By consolidation of undertakings of two companies.
ii By acquisition of a controlling interest in the share capital of a company by another company.

iii By acquisition of a controlling interest in the share capital of both companies by a new company.

Amalgamation can be effected by -

i following the procedure as specified under sections 391 to 394.
ii a takeover bid as specified under section 395.
iii an order of the Central Government under section 396.

Amalgamation can be resorted to for the following purposes:

i To effect economies.
ii To avail tax concessions and benefits.
iii To revive a sick unit.
iv To diversify or expand business.
v To eliminate competition,
vi To make full use of the unutilised capacity,
vii To mobilise resources or improve cash flow.
viii To acquire assets at discount.

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3. Procedure for compromise or arrangement (Sections 391 to 393)

Ans. The procedure for making a compromise or arrangement with the intervention of Court is explained as follows:

Stage I. Application to the Court

To make a compromise or arrangement, an application shall be made to the Court. The application shall describe the scheme of the arrangement and the parties between whom it is proposed.

Parties to compromise. The compromise or arrangement may be proposed -

(i) between a company and its creditors or any class of them; or
(ii) between a company and its members or any class of them.

Application by whom? The application may be made by any of the following:

i The company
ii Any creditor of the company
iii Any member of the company
iv The liquidator of the company (in case of a company which is being wound up).

Where a company goes into liquidation, the right of the creditor or member to make an application is not lost [Rajendra Prasad Agarwal v Official Liquidator]. Thus, where a company is being wound up, not only the liquidator, but a creditor and a member may also make an application for compromise or arrangement.

Stage II. Directions for holding the meeting

On an application made by the company, the Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court. The Court will give the directions for holding the meeting only if it is satisfied that the scheme is reasonable and workable.

Stage III. Notice to the Central Government

The Court shall give notice of every application seeking a compromise or arrangement to the Central Government. The Central Government is empowered to make a representation and the Court shall take into account such representation while passing any order in respect of the scheme of compromise or arrangement (Section 394A). However, the Court is not bound to accept the opinion expressed by the Central Government.

Stage IV. Information about compromise or arrangement

Notice to contain specified particulars.

(a) Where a meeting of creditors or members is called, the notice given to them must contain
  i the terms of the compromise or arrangement;
  i an explanatory statement explaining the effect of the compromise or arrangement;
  ii a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how their interests are different from the like interests of other persons; and
  iii if the debenture holders are also affected by the scheme, the interest of the trustees should also be similarly disclosed.

(b) Every notice calling the meeting which is given by advertisement, shall contain the above particulars. Otherwise, such notice must mention that the explanations are available at the company's office and the explanations shall be furnished free of charge.

Disclosure by directors and trustees. It is the duty of every director, managing director, manager and trustee for debenture holders of the company to give notice to the company in respect of-
  i his interest in the scheme; and
  ii how his interest will be affected by the scheme.

Stage V. Approval of the scheme by creditors or members

The meeting shall be held and conducted in the manner as directed by the Court. At the meeting, the compromise or arrangement shall be approved by a majority of the creditors or members or any class of them, who are present and voting. Such majority of members or creditors must also be creditors or members representing three-fourths in the value of creditors or members present and voting at the meeting. In other words, a scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but remaining neutral are not to be counted. Members or creditors may vote in person or by proxy, where the proxies are allowed. Where the order of the Court so provides, the compromise or arrangement proposed may be passed with amendments or modifications at the meeting.

The scheme must be approved by both equity and preference shareholders. If separate meetings of preference shareholders and equity shareholders are ordered, then the scheme shall be approved by preference shareholders and equity shareholders in their separate meetings.

Stage VI. Court to be satisfied that the scheme is bona fide

The Court has the discretion to sanction the scheme placed before it. It is a well-accepted view that no scheme can be foolproof and it is possible to find faults in a particular scheme but that in itself is not sufficient to reject the scheme. The Supreme Court has discussed at length the procedure to be followed in determining whether the scheme is bona fide and capable of being sanctioned [Miheer H. Mafatlal v Mafatlal Industries Ltd.]. From the perusal of this decision of Supreme Court and other cases, it can be concluded that the Court will sanction the scheme if it is satisfied about all the following matters:

(a) Compliance with statutory provisions. The Court must be satisfied that -
- the meeting was duly held and conducted in accordance with the statutory provisions of the Act and the directions of the Court;
- the compromise or arrangement is a real compromise or arrangement;
- the compromise or arrangement was accepted by a competent majority;
- the provisions of the Companies Act have been complied with.

(b) Disclosure of material facts. The Court must be satisfied that the applicant has disclosed to the Court all the material facts relating to the company, such as -
- the latest financial position of the company;
- the latest auditor's report on the accounts of the company;
- the pendency of any investigation proceedings, and the like.

(c) Fair representation of affected classes at meeting. The Court must be satisfied that the members or creditors or any class of them are fairly represented by those who attended the meeting.

(d) Scheme should be fair and reasonable. The Court should be satisfied that -
- the majority is acting bona fide and not coercing the minority;
- the majority is acting reasonably, properly and prudently;
- the scheme is such, as an intelligent and prudent man taking decisions on commercial considerations might reasonably approve;
- the scheme is in the interest of the company as well as in the interest of shareholders or creditors;
- the scheme is workable, feasible, financially viable and practical and there is no reasonable objection to it;
- the scheme is not against public policy and public interest (if required, the Court would pierce the corporate veil for this purpose);
- the scheme has not been designed for some oblique or ulterior motive.

If the scheme is not bona fide but intends to cover the misdeeds of delinquent directors, then the Court shall not sanction the scheme [Pioneer Dyeing House Ltd. v Dr. Shanker Vishnu Marathe . It might be possible to find faults in a scheme, but that would not be sufficient ground to reject it, In order to reject a scheme, it must be shown that scheme is obviously unfair, patently unfair, unfair to the meanest intelligence. No scheme can be foolproof and it is possible to find faults in a particular scheme but that by itself is not enough to warrant a dismissal of the scheme.

Stage VII. Sanction of the scheme

Where the Court is satisfied that the scheme is bona fide, it may sanction the scheme. On the sanction of the scheme, it shall be binding on -

a. the creditors or members or any class of them; and
b. the company or the liquidator of the company, if the company is being wound up.

Stage VIII. Filing of order of the Court with the registrar

The scheme becomes effective only after a certified copy of the order is filed with the registrar. Until such filing, the sanctioned scheme remains dormant and no creditor or member can enforce any right under the scheme.

Effect of scheme coming into operation. After the sanctioned scheme is filed with the registrar, it becomes binding on all the creditors, shareholders, contributories and liquidators. Such scheme cannot be varied or amended by any agreement between the parties.

Stage IX. Copy of Court's order to be annexed to memorandum

After the certified copy of the scheme is filed with the registrar, the company shall annex to every copy of memorandum, a copy of such scheme. This is to ensure that any person who deals with the company will have the notice of the scheme.

Stage X. Supervision and modification of the scheme

The Court has the power to modify or vary the sanctioned scheme so that it becomes workable. If it becomes unworkable even after honest efforts, the Court may order the winding up of the company. Such an order may be made suo motu by the Court or on the application of the company or its creditors or any person interested in the affairs of the company. The Court may ask for a report on the working of the scheme and on consideration of such report, may give such directions as it thinks fit.

4. Powers of the High Court (Section 392) to enforce its orders relating to compromise and arrangement

Ans. Section 392 has conferred wide powers on the Court to remove the obstacles and difficulties for the proper working of the scheme. These powers are discussed as follows:

i **Power to give directions to the company:** Where a compromise or arrangement is proposed, the Court may order that a meeting of creditors or members or any class of them be called, held and conducted in the manner directed by the Court (Section 391). If the Court gives such directions, then the provisions of the

Companies Act will not apply to that extent. However, Court has no power to dispense with the holding of the meeting even though the shareholders unanimously approve the scheme.

ii **Power to stay any suit or proceedings:** The Court may stay the commencement or continuation of any suit or proceedings against the company until the application is finally disposed of (Section 391).

iii **Power to order winding up:** If, after sanctioning the scheme, the Court is satisfied that the sanctioned scheme has become unworkable even after an honest effort, the Court may wind up the company. The power can be exercised suo motu or on the application of the company or its creditors or any person interested in the affairs of the company (Section 392).

iv **Power to supervise and modify the scheme:** After sanctioning a scheme of compromise or arrangement, the Court may exercise the following powers:
  a. To supervise the carrying out of the scheme.
  b. To modify or vary the sanctioned scheme so that it becomes workable.
  c. To ask for a report on the working of the scheme. On consideration of such report, the Court may give such directions as it thinks fit (Section 392).

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KOLKATA – 700019
M: 98301 65501
Web: www.pksal.com

5. The provisions of the Companies Act, 1956 relating to amalgamation of companies.

Ans. The procedure for reconstruction or amalgamation of companies are explained as follows:

i. Application to the Court under section 391

For effecting the reconstruction of a company or amalgamation of two or more companies, an application shall be made to the Court under section 391 (under section 391, an application is made to the Court for entering into a compromise or arrangement).

Contents of application. The application shall state the following particulars:

a. Purpose of compromise or arrangement. The application shall state that the compromise or arrangement has been proposed for the purposes of reconstruction of the company or the amalgamation of two or more companies.
b. Transfer of undertaking etc. The application shall further state that, under the scheme the whole or any part of the undertaking, property or liabilities of any company concerned in the scheme is to be transferred to another company.

ii. Order of the Court

On an application made to the Court under section 391, the Court may make an order sanctioning the compromise or arrangement. The Court may also provide for one or more of the following matters:

a. The transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of any transferor company. The order of the Court shall be sufficient to vest all properties or liabilities in the transferee company without execution of any further document. If the order so directs, the properties shall be vested in the transferee company free from any charge. However, the order of the Court cannot provide for automatic transfer of contracts of person service. Therefore, the workers of the transferor company can lawfully refuse to join the service in the transferee company. In such a case, the workers shall be entitled to compensation for premature termination of services.
b. The allotment by the transferee company of any shares, debentures, policies, or other like interests as provided in the scheme.
c. The Court may order that any legal proceeding filed by the transferor company shall be continued in the name of the transferee company. Similarly, the Court may order that any legal proceeding filed against the transferor company shall be continued against the transferee company.
d. The dissolution, without winding up, of any transferor company. However, the Court will not make such an order unless it receives a report from the official liquidator to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or public interest.
e. The provision to be made for any person who dissents from the compromise or arrangement.
f. Such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

3. **Filing of order of the Court:** Within 30 days from the date of the order, a certified copy of the order shall be filed with the registrar by every company in relation to which the order is made.
4. **Duties of the Court before making order:** The principles adopted by the Court while approving amalgamation or reconstruction are same as those adopted at the time of approving a compromise or arrangement. The duties of the Court under section 394 are onerous and have to be carefully performed. The duties of the Court are as under:
   a. Compliance of statutory provisions. The reconstruction or amalgamation involves a compromise or arrangement. Thus, the Court shall sanction the reconstruction or amalgamation only when all provisions relating to compromise or arrangement (i.e., sections 391, 393 and 394A) and reconstruction or amalgamation (Section 394) are complied with.
   b. Meeting held properly. The Court must be satisfied that an extraordinary general meeting was convened under the directions of the Court. The holding of the extraordinary general meeting cannot be dispensed with on the ground that the shareholders have unanimously approved the merger at an ordinary meeting
   c. Notice to the Central Government. The Court shall give notice of every application made to it to the Central Government. It shall take into consideration the representation of the Central Government before making any order.
   d. Scheme 'should be bona fide. The Court shall not sanction any scheme merely because it is recommended by the Board of directors and is approved by a statutory majority. The Court will have

to be satisfy itself that the scheme is reasonable and fair to all the parties [Shankaranarayanan Hotels P. Ltd. v Official Liquidator]. Where the object of the scheme of amalgamation was to cover the misdeeds of directors and the implications of the proposed scheme was not clear to the creditors, the Court rejected to sanction the scheme [Pioneer Dying House Ltd. v Dr. Shanker Vishnu Marathe].Burden of proof on party opposing the scheme. Once statutory formalities are complied with, the onus lies on those opposing the scheme to satisfy the Court that the scheme is unfair or unreasonable or fraudulent

e. Amalgamation must be in public interest. The Court must be satisfied that the scheme is not contrary to public interest. The scheme should not result in impeding the promotion of the industry or obstructing the growth of the economy.
f. Valuation of shares. The material on the basis of which share valuation has been worked out should be placed on the records of the Court. The Court has to be satisfied that the price arrived at is reasonable and fair.
g. Satisfaction report of the registrar. No scheme of amalgamation of a company which is being wound up, with any other company, shall be sanctioned by the Court, unless the Court has received a report from the registrar that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest. It has been held that the report of the registrar must indicate in categorical terms that the affairs of the company have not been conducted in a manner which is prejudicial to interests of its members or to public interest or otherwise. This obligation cannot be dispensed with by the registrar. So long as such report is not submitted by the registrar, the Court cannot pass final order either by accepting the scheme of amalgamation or rejecting it [Shriniwas Fertilisers Ltd. v Khaitan Chemicals & Fertilisers Ltd.].

In Shriniwas Fertilisers Ltd. v Khaitan Chemicals & Fertilisers Ltd, the Court sanctioned a proposed scheme of merger, by taking into consideration the following factors:

- There was no kind of infirmity or objectionable feature or any kind of illegality or lacking bona fides in the proposed scheme.
- Almost all the persons directly or indirectly associated with these companies had given their no objection certificate for approval of the scheme.
- The only objections raised against the acceptance of the scheme was by three shareholders.
- The scheme was not prepared to defeat the creditors, shareholders or the Government dues.
- The proposed merger would enable the companies to run more effectively and economically than what they are presently functioning.
- None of the liabilities of the companies would be adversely affected.
- The rights of shareholders of the companies will remain intact.

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6. Reconstruction by sale of shares/Takeover of a company (Section 395)

An amalgamation of two companies may be carried out by following the procedure as prescribed under sections 391 to 394. However, the prescribed procedure is very cumbersome and time consuming. Instead of following the Court procedure, section 395 enables a company (i.e., the transferee company) to acquire the shares of another company (i.e., the transferor company). The acquisition of shares in the transferor company enables the transferee company to exercise control over the former. This process is commonly called as a 'take-over'. It does not involve the intervention of the Court unless the dissenting shareholders approach the Court. The company taken over remains in existence. The takeover may be effected by agreement with the directors, by purchase in the open market or by a 'take-over bid'.

Takeover bid

A 'take-over bid' means an offer to acquire the shares of a company where the shares are not closely held. Such offer to purchase the shares may be against cash or shares of the transferee company or partly by one and partly by another. The transferee company has the power to acquire the shares of shareholders who do not consent to the transfer (i.e., the dissenting shareholders) after complying with the provisions of section 395.

Procedure for takeover

Stage I: The offer to acquire shares

The transferee company makes an offer to the shareholders of the transferor company to acquire their shares at a stated price. The offer will mention the date by which the offer is to be accepted. The offer can be kept open for a maximum period of 4 months. There may be separate offers for the different classes of shares.

Duty of directors to give certain information to shareholders. The directors of the transferor company have a duty towards their own shareholders. Such duty includes a duty to be honest and a duty not to mislead. A shareholder of a transferor company may be prejudiced if his co-shareholders are misled to accept the offer because as soon as 90% of the shareholders have been misled and have accepted the offer, the minority become subjected under section 395 of the Companies Act to statutory powers of compulsory purchase. The minority can therefore, complain that they are wrongfully subjected to that power of compulsory purchase as a result of a breach of duty on the part of the Board of directors of the offerree company.

- Every offer or every recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information as may be prescribed.
- It shall 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.
- Every such offer or recommendation shall be registered with the registrar.
- The registrar may refuse to register it, if it does not contain the required information or if contains information which is likely to give a false impression.

- An appeal shall lie to the Court against the order of the registrar refusing registration of any such circular. Until the dispute is settled no such circular shall be issued.
- A director should not receive any payment by way of compensation from the transferor company. He may receive such payment from the transferee company or any other person but he must take all reasonable steps to secure that particulars with respect to the proposed payment are included in the notice of the offer given to the shareholders (Section 320).

Stage II. The acceptance of the offer

The shareholders of the transferor company may accept the offer. The transferee company must get acceptances of 90% of the shareholders before the expiry of the offer.

The transferee company's holdings are ignored in calculating the 90%. For example, where a company has 30 shareholders holding 3,000 shares of which the transferee company holds 100 shares, the acceptances must be 90% of 2,900 shares.

The offer may be made separately for each class of shares or jointly for all classes of shares. Where separate offers have been made, this section can be invoked only in respect of that class for which 90% acceptances have been received.

Stage III Transferee company's right to acquire the shares of dissenting shareholders

Where 90% acceptances have been received, the transferee company may give notice to one or more dissenting shareholders that it desires to acquire their shares. Such notice is to be given within 2 months of the expiry of the offer.

It is entirely a matter for the transferee company to decide whether or not to exercise its powers of compulsory acquisition of shares of dissenting shareholders. Such notice may be given only to some of the dissenting shareholders.

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Meaning of dissenting shareholders. A dissenting shareholder means a shareholder -

i who has refused to transfer his shares to the transferee company; or

ii who has not given his assent to the scheme (i.e., inaction also amounts to dissent).

Stage IV. Dissenting shareholders' application to Court

When the transferee company gives a notice to the dissenting shareholders, they may make an application to the Court praying that acquisition of their shares should not be permitted, in spite of the fact that the scheme has been approved by 90% in value of the shareholders. Only those persons who have been served with such notice by the transferee company are competent to apply to the Court. The application is to be made within 1 month from the date of such notice. On hearing the parties concerned, the Court may make such order as it thinks fit.

Test of fairness. The burden of proof lies on the dissenting shareholders to establish that the scheme is unfair. Considerable weight is given to the fact that a large body of shareholders have accepted the offer. The Court will see whether the transaction is fair to the shareholders as a whole, and not to the individual shareholders; whether the offer is obviously and convincingly unfair, fraudulent or improper and not merely one which is open to criticism or capable of improvement. The application must allege unfairness, it is not sufficient merely to say that insufficient information was given. The dissenting shareholders must prove that, in spite of the approval of a large majority of the shareholders, the scheme is affirmatively, patently, obviously and convincingly unfair, or the price offered for the shares is inadequate.

Approval by financial institutions - Presumption of fairness. Financial institutions are generally well informed, they examine the scheme with the eye of an expert, and they act in a bona fide manner. As such, approval by the shareholders and financial institutions (holding as much as 41% shares) creates a presumption of fairness

Intervention by Court only if scheme is unfair. The Court will not ordinarily interfere with the valuation made by the experts. Where the scheme is obviously unfair, patently unfair and unfair to the meanest intelligence, only then the Court will interfere. The Court will interfere if it is demonstrated beyond all reasonable arguments that the amount offered for exchange of shares is inadequate. The mere fact that balance sheet value of the share of transferor company is higher than the cash offered, is not sufficient in itself to render the scheme to be held as unfair

Stage V. Acquisition of shares of dissenting shareholders

Case (A). If application is allowed. Where the Court allows the application of dissenting shareholders, the transferee company shall not be entitled to acquire the shares of the dissenting shareholders. However, the Court has no power to vary the terms of acquisition of shares of dissenting shareholders

Case (B). If application is rejected or not made. The transferee company becomes entitled as well as bound to acquire the shares of the dissenting shareholders, if-

- the application of the dissenting shareholders is dismissed by the Court; or
- the dissenting shareholders do not make an application to the Court within 1 month of the notice by the transferee company.

Following provisions shall apply where the transferee company acquires the shares of the dissenting shareholders:

a. **Terms of acquisition to be the same.** The transferee company shall acquire the shares on the same terms as originally offered to all the shareholders of the transferor company. This is provided so as to ensure that a dissenting shareholder should not be penalised as a result of his dissent. He should receive no less favourable treatment than an approving shareholder.

b. **Nominee of Transferee Company executes transfer documents.** If the dissenting shareholders do not voluntarily transfer the shares, the transferee company may appoint a person to execute a transfer on their behalf. The transferee company then sends the transfer documents to the transferor company together with a copy of the notice which was sent to the shareholders and also the consideration. The transferor company is then bound to register the transferee company in respect of such shares.

c. **Money received by Transferor Company** - Held in trust. The transferor company pays into a separate bank account any consideration money received by it. It holds such money and any other consideration received from the transferee company in trust for the dissenting shareholders.

Situation where transferee company already holds more than 10% shares

Where the transferee company holds more than 10% of the shares to which the offer relates, the advantage of section 395 cannot be availed unless all the following three conditions are fulfilled:

a. The offer is made to the remaining holders of shares.
b. The offer is accepted by the shareholders holding at least 90% of value of shares.
c. The shareholders accepting the offer are not less than three-fourths in number of the holders of such shares.

Situation where holding of transferee Company exceeds 90%

Where the dissenting shareholders find themselves a helpless minority and wish that they ought to have accepted the offer, this provision allows them to change their mind, and they are given the opportunity to transfer their shares to the transferee company.

Notice to dissenting shareholders. The transferee company shall within 1 month of its acquiring 90% of the shares, give a notice to the dissenting shareholders.

Dissenting shareholders' rights. Within 3 months of receipt of notice from the transferee company, the dissenting shareholders may require the transferee company to acquire their shares and the transferee company shall be bound to acquire such shares. The terms of such acquisition shall be as follows:

a. The same terms as contained in the original offer made to the shareholders of the company; or
b. The terms as agreed between the transferee company and the dissenting shareholders; or
c. Such terms as may be directed by the Court.

7. Amalgamation of two or more companies in public interest (Section 396) by Central Government

Ans. Usually, the procedure prescribed in the Act for amalgamation of companies leads to prolonged delays. Therefore, the power has been conferred on the Central Government to order amalgamation of two or more companies in public interest. This results in speeding up the procedure for amalgamation of companies. Following procedure shall be adopted for effecting amalgamation of companies under section 396:

i. **Preparation of draft order of the scheme:** The Central Government shall prepare a draft order of the scheme of amalgamation of two or more companies. It shall provide that every member, debenture holder and creditor of each of the companies involved in the amalgamation shall have practically the same rights and interests in the new company as he possessed before amalgamation.

ii. **Determination of compensation:** Where the rights and interests of a member in the new company are less than those he possessed before amalgamation, he shall be entitled to compensation. The compensation shall be assessed by such authority as may be prescribed by the Central Government. Such compensation shall be paid by the new company. The amount of compensation and the parties entitled to compensation (viz. the members, debenture holders and creditors) shall be published in the Official Gazette.

iii. **Appeal against award of compensation:** Any person aggrieved by the assessment of compensation made by the prescribed authority may appeal to the Company Law Board. Such appeal is to be made within 30 days from the date of publication of assessment of compensation in the Official Gazette. On determination of compensation by the Company Law Board, the draft order of amalgamation, as modified by the order of Company Law Board giving the revised compensation, and objections and suggestions received from the companies, shall become the final order.

iv. **Preconditions for making an order of amalgamation:** The Central Government may make a final order of amalgamation under section 396, if following conditions are satisfied:
   (a) **Amalgamation in Public interest:** The Central Government must be satisfied that it is essential in the public interest to make the order for amalgamation of two or more companies.
   (b) **Consideration of objections and modification in scheme.** The Central Government shall send a copy of the draft order of the proposed amalgamation to each of the companies. The Central Government shall fix the time within which the objections and suggestions may be made, which shall not be less than 2 months. It shall consider any objections and suggestions of the companies concerned or any class of shareholders or creditors thereof. It may make modifications in the draft scheme in the light of suggestions and modifications so made.
   (c) **No pending appeal against compensation.** The draft order made by the Central Government specifies the compensation, if any, payable to the members or debentureholders or creditors of the company. The Central Government shall ensure that an appeal against the determination of compensation has not been filed or where it has been filed, the same has been finally disposed of.

v. **Order of amalgamation:** Where all the conditions for making the final order are satisfied, the Central Government may order the amalgamation of those companies. The order shall contain the following particulars:
   (a) **Constitution etc. of new company.** The order shall state the company's constitution, its property, powers, rights, interests, authorities and privileges together with its liabilities, duties and obligations.
   (b) **Legal proceedings.** The order may provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company.
   (c) **Other measures.** The order shall contain any other consequential, incidental and supplemental provisions which the Central Government may think necessary to give effect to the amalgamation.

vi. **Parliamentary control**

The order of the Central Government directing the amalgamation shall be placed in both the Houses of the Parliament.

8. Provisions regarding preservation of accounts and records of amalgamating company (Section 396A)

Ans. The object of section 396A is to prevent the practice of destroying incriminating accounts and records of the company which has been amalgamated with another company.

The books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company shall not be disposed of without the prior permission of the Central Government. Before granting such permission, the Central Government 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, formation or management of the affairs of the company or its amalgamation or the acquisition of its shares.

9. Reconstruction of a company which is being wound up (Section 494)

Ans. Section 494 confers powers on a company (transferor company) for reconstruction if the company is in members' voluntary winding up. The liquidator of the transferor company has the power to transfer the assets to another company (transferee company) in exchange for shares or other securities of the transferee company. The liquidator distributes such shares and securities among the shareholders of the transferor company.

i. Applicability of section 494

(a) Company in liquidation. The transferor company must be in liquidation. However, if the company is a going concern, it must pass the necessary resolution for members' voluntary winding up, if it wants to take the advantage of the section.

(b) Voluntary winding up. The winding up must be members' voluntary winding up. If the company is being wound up by the Court, then advantage of this section cannot be availed of.

(c) No specific power in memorandum is required. In view of specific provisions of section 494, the transferor company need not have any power in its memorandum to exercise the powers conferred by this section.

ii. Procedure under section 494

(a) The liquidator of the transferor company shall enter into a tentative agreement with the management of the transferee company.

(b) The agreement shall provide that whole or any part of the business or property shall be transferred or sold to the transferee company and the transferee company shall pay compensation to the transferor company. The compensation may be in the form of shares, cash or other consideration.

(c) The liquidator of the transferor company is authorised to carry out the agreement by passing a special resolution.

(d) The liquidator shall receive the compensation from the transferee company which shall be distributed among the members of the transferor company.

(e) Any member who did not vote in favour of the special resolution may express his dissent from the agreement. Such dissent shall be in writing and shall be left at the registered office of the company within 7 days of passing the special resolution.

(f) The dissenting member may require the liquidator either -
  (i) to abstain from carrying the resolution into effect; or
  (ii) to purchase his interest.

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(g) The price to be paid for shares will be agreed upon between the liquidator and the dissenting member. If they cannot arrive at an agreement, they will appoint an arbitrator with mutual consent.

(h) If the liquidator elects to purchase the member's interest, the purchase money shall be paid before the company is dissolved. The mode of raising the purchase money will be determined by a special resolution.

(i) If an order is made within 1 year for winding up the company by the Court, the special resolution shall not remain valid unless it is sanctioned by the Court.

iii. Application of section 494 to creditors' voluntary winding up (Section 507)

The benefit of section 494 is available when the company is into members' voluntary winding up. But, if the company is into creditors' voluntary winding up, then all the provisions contained in section 494 shall apply subject to the following modifications:

(a) The powers of the liquidator specified under section 494 shall be exercised only with the sanction of committee of inspection or the Court.

(b) The sanction to carry out the agreement shall be given by the Court or committee of inspection instead of the special resolution. Such power may be conferred generally or specifically for a particular agreement.

10. Arrangement with the creditors by a company in voluntary liquidation (Section 517)

Ans. Section 517 provides the opportunity to a company to enter into an arrangement with its creditors even though it is about to be, or is in the course of being, wound up. However, a company can claim the benefit of section 517 only in case of voluntarily winding up (whether members' voluntary winding up or creditors' voluntary winding up).

i. **Requirements of section 517.** The provisions of section 517 are explained as under:

(a) The scheme of arrangement must be sanctioned by a special resolution of the company.

(b) The scheme must also be agreed to by three-fourths in number and value of the creditors.

(c) Any creditor or contributory may, within 3 weeks from the completion of the arrangement, appeal to the Court against the scheme of arrangement.

(d) On an appeal made to the Court, the Court shall have the power to amend, vary, confirm or set aside the arrangement.

ii. Procedure under section 517

A company may enter into a scheme of arrangement with the creditors by following the procedure as given hereunder:

(a) The draft scheme of arrangement shall be considered and approved by the Board of directors.
(b) The company shall apply to the Court for directions to convene the meetings of the members and creditors.
(c) A general meeting of the company shall be held and the special resolution approving the scheme of arrangement shall be passed.
(d) A meeting of creditors shall be held whereat the scheme shall be agreed to by three-fourths in number and value of the creditors.
(e) The company shall approach the Court for approval of the scheme.
(f) On receipt of the Court's order, the company shall file a certified copy of the Court's order with the registrar.

Problems & Solutions

1. A meeting of members of a company was convened under the orders of the Court to consider a scheme of compromise and arrangement. The meeting was attended by 200 members holding 5,00,000 shares in aggregate. 70 members holding 4,00,000 shares voted for the scheme. The remaining members voted against the scheme. Examine with reference to the relevant provision of the Companies Act, 1955 whether the scheme is approved by the required majority.

Ans. The given problem relates to section 391 of the Companies Act, 1956. The legal position

Where the scheme of compromise of arrangement is required to be approved by the members, it must be approved by a majority of the members who are present and voting. Such majority of members must also be the members representing three-fourths in the value of members present and voting at the meeting. In other words, a scheme of arrangement between the company and members must be approved by more than 50% of the members who hold at least 75% of the value of shares. It is to be noted that members or creditors not present in the meeting or present in the meeting but remaining neutral are not to be counted.

Members or creditors may vote in person or by proxy, where the proxies are allowed. The given case

Members who attended the meeting	200 members
Shares held by the members who attended the meeting	5,00,000 shares
Members who voted in favour of the scheme	70 members
Shares held by the members who voted in favour of the scheme	4,00,000
Members who voted against the scheme	130 members
Shares held by the members who voted against the scheme	1,00,000

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M: 98301 65501
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Conclusion

The scheme has not been approved by the majority of members, present and voting, though it has been approved by the members holding three-fourth of the shares. It is evident that the requirements of approval by members in terms of 'majority in number of members' and 'three-fourths in value of shares' are cumulative, i.e., these are two separate compliances. Accordingly, the scheme has not been approved by the requisite majority, and therefore this scheme shall not be sanctioned by the Court.

Whether amalgamation is possible with a foreign company; what majority is required; when is dissolution ordered?

2. Answer the following with reference to a scheme of amalgamation of companies explaining the relevant provisions of the Companies Act, 1956.

(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 Court? Is the scheme to be approved by preference shareholders?
(iii) When will the Court order dissolution of the transferor company?

Ans.

(i) For effecting the reconstruction of a company or amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). The benefit of section 394 is available only if the transferee company (i.e., new company) is a company within the meaning of Companies Act, 1956. However, the transferor company may be any body corporate, whether a company within the meaning of the Companies Act, 1956 or not. As such, a foreign company can be a 'transferor company' but not a 'transferee company'. Therefore, a scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

(ii) The scheme shall be approved by a majority of the members, who are present and voting. Such majority of members must also be members representing three-fourths in the value of members present and voting at the meeting. It is to be noted that members not present in the meeting or present in the meeting but remaining neutral are not to be counted [Section 391(2)].

Section 391(2) uses the expression 'member', which includes a preference shareholder also. As such, both equity and preference shares shall be taken into account. However, if a separate meeting of preference shareholders and equity shareholders is ordered, then the scheme shall be approved by preference shareholders and equity shareholders in their separate meetings.

(iii) The order of the Court may provide for the dissolution, without winding up, of any transferor company [Section 394(1)]. However, the Court will not make such an order unless it receives a report from the official

liquidator to the effect that the affairs of the company have not been conducted in a manner prejudicial to the interests of its members or to public interest [Second Proviso to Section 394 (2)].
Requirements of notice; whether power to amalgamate is required in object clause, etc.

3. Examine with reference to the provisions of the Companies Act, 1956 the validity of the following:
(i) A scheme provides for amalgamation of a 'foreign company' with a company registered under the Companies Act, 1956.
(ii) The statement forwarded with the notice convening a meeting of its members pursuant to Court's direction under Section 391 contains only 'exchange ratio' without details of its calculation,
(iii) At the time of filing of the petition for amalgamation, the object clause of both the transferor and transferee Companies does not contain power to amalgamate.

Ans.

(i) For effecting amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). The benefit of section 394 is available only if the transferee company (i.e., new company) is a company within the meaning of Companies Act, 1956. However, the transferor company may be any body corporate, whether a company within the meaning of the Companies Act, 1956 or not. As such, a foreign company can be a 'transferor company' but not a 'transferee company', Therefore, a scheme of amalgamation may provide for transfer of foreign companies to Indian companies.

(ii) For effecting amalgamation of two or more companies, an application shall be made to the Court under section 391 (Section 394). On receipt of such an application, the Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court. Where a meeting of creditors or members is called, the notice given to them must contain
- the terms of the compromise or arrangement;
- an explanatory statement explaining the effect of the compromise or arrangement;
- a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how their interests are different from the like interests of other persons; and
- if the debenture holders are also affected by the scheme, the interest of the trustees should also be similarly disclosed.

In the present case, the notice convening a meeting of members contains only 'exchange ratio' without details of its calculation. As is evident, the terms of the compromise or arrangement have not been disclosed. Therefore, the notice given to members is not valid.

(iii) The memorandum of association explains the scope of operations of a company beyond which the company cannot go. Anything done by a company outside the objects clause of memorandum is ultra vires the company.

However, to amalgamate with another company is a power of the company, and not an object of the company. Therefore, no power to amalgamate is required in the memorandum of a company before making an application to the Court for effecting amalgamation. Also, the power to amalgamate has been given by the statute under section 394. Since there is a statutory provision dealing with amalgamation of companies (which does not require that such a provision must be present in the memorandum or articles of the company), no special power in the objects clause of the memorandum is necessary for its amalgamation with another company. Section
394 is a complete code which gives full jurisdiction to the Court to sanction amalgamation of companies, even though there may be no power in the objects clause of memorandum

4. ABC Co. Ltd. was amalgamated with, and merged in XYZ Co. Ltd. Some workers of ABC Co. Ltd. refuse to join as workers of XYZ Co. Ltd. and claim compensation for premature termination of services. 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 Co. Ltd. or the XYZ Co. Ltd.? Give reasons.

Ans. As per section 394, the order of the Court sanctioning the reconstruction or amalgamation shall be sufficient to vest all the properties or liabilities in the transferee company without execution of any further document. However, the order shall not automatically transfer contracts of personal service, e.g., the services of workers cannot be transferred to the transferee company without their consent; no contract of service is created between the workers and the transferee company [Nokes v Doncaster Amalgamated Collieries Ltd.]. Therefore in the given case, workers of ABC Co. Ltd. will succeed against XYZ Co. Ltd. They cannot be compelled to join XYZ Company Limited and therefore they shall be entitled to receive compensation.

5. HPC Ltd. for a number of years was in various types of business. In order to exit from its non-core business, its management decided to hive off the business of Food Processing by demerging the said business with an associate company, namely, BCD Ltd. You are required to advise briefly, with reference to the provisions of the Companies Act, 1956, the steps the management should take to give effect to the proposed demerger.OR
M/s Over-ambitious Consultants Ltd. had, in the course of its operations over the years acquired various other ventures like plantations and tourism businesses. With a view to consolidate its core business activities, the management decided to hive off its non-core activities by demerging them with an associate company. Advise briefly the steps the management should take to achieve the purpose of demerger.

Ans. For effecting the reconstruction of a company, the provisions of section 394 need to be complied with. Section 394 requires that an application shall be made to the Court under section 391 (under section 391, an application is made to the Court for entering into a compromise or arrangement). Since, demerger is also a kind of reconstruction, M/s Over Ambitious Consultants Ltd. or HPC Ltd. may demerge its plantation and tourism business or Food Processing business by complying with the provisions of section 394, which are as under:

i. Ambitious Consultants Ltd. or HPC Ltd. (known as 'transferor company') shall prepare a draft scheme under which the assets and liabilities of Ambitious Consultants Ltd. or HPC Ltd. as comprised in the plantation and tourism business or Food Processing business shall be transferred to the associate company (known as 'transferee company'). The scheme shall specify the necessary details like –
   a. agreed values for transfer of assets and liabilities;
   b. the consideration for the transfer;
   c. where the associate company issues shares to the shareholders of M/s Over Ambitious Consultants Ltd. or HPC Ltd., the exchange ratio of the shares;
   d. other terms and conditions.
ii. An application shall be made to the Court by Ambitious Consultants Ltd. or HPC Ltd. jointly with the Associate company.
iii. The Court may order that a meeting of the creditors or members or any class of them be called, held and conducted in the manner directed by the Court.
iv. The Court shall give notice of every application seeking a compromise or arrangement to the Central Government. The Central Government is empowered to make a representation and the Court shall take into account such representation while passing any order in respect of the scheme of compromise or arrangement (Section 394A).
v. Where a meeting of creditors or members is called, the notice given to them must contain -
   a. the terms of the compromise or arrangement;
   b. an explanatory statement explaining the effect of compromise or arrangement;
   c. a statement explaining any material interests of the directors, managing director, or manager of the company. The effect of those interests on the scheme should be explained stating if and how they are different from the like interests of other persons.
vi. The meeting shall be held and conducted in the manner as directed by the Court. The scheme must be approved by more than 50% of the members who hold at least 75% of the value of shares.
vii. The Court has the discretion to sanction the scheme placed before it. Where the Court is satisfied that the scheme is bona fide, it may sanction the scheme.
viii. The scheme becomes effective only after a certified copy of the order is filed with the registrar. Until such filing the sanctioned scheme remains dormant and no creditor or member can enforce any right under the scheme.
ix. After the certified copy of the scheme is filed with the registrar, the company shall annex to every copy of memorandum, a copy of such scheme.
x. Necessary steps shall be taken to give effect to the scheme as approved by the Court.

6. The scheme of amalgamation was approved by overwhelming majority of the members of the merging companies, namely, ABC Ltd. and XYZ Ltd. at meetings called as per directions of the court. When the scheme of amalgamation was awaiting sanction of the court, the exchange ratio was questioned by a small group of dissenting shareholders of ABC Ltd. The exchange ratio was fixed by a firm of reputed Chartered Accountants. Examine with reference to the Court rulings, whether the dissenting shareholders will succeed.
Would your answer be different, if the exchange ratio was objected to by the Central Government and not by the members of the merging companies?

Ans. On an application made to the Court for sanctioning a scheme of amalgamation or reconstruction, the Court may make an order sanctioning it. Once statutory formalities are complied with, the onus lies on those opposing the scheme to satisfy the Court that the scheme is unfair or unreasonable or fraudulent.
Where, the valuation is confirmed to be fair by eminent firm of Chartered Accountants and is also approved by overwhelming majority, the Court will not find fault with the exchange ratio
Where the exchange ration was fixed by two reputed firms of chartered accountants who had examined the accounts, annual reports, working results and financial positions of the two companies and certified on that basis that the share exchange ratio of 5:2 was fair and reasonable, and the scheme was widely advertised, unanimously approved and no objection was raised by any of the affected quarters, and the Central Government had not affirmatively established that the valuation of assets was unfair or inequitable, the Court refused to interfere (M.G.Investment & Industrial Co. Ltd. v New Shorrock Spg. & Mfg. Co. Ltd.).
Thus, if, on overall consideration the Court is satisfied as to feasibility of the scheme, it should not hesitate to grant sanction
Applying the above Court rulings, the given problems are answered as under:
a. The dissenting shareholders shall not succeed unless they satisfy the Court that the valuation is grossly unfair
b. Even if exchange ratio is objected by the Central Government, the Court may sanction the scheme, since the representation or opinion made by the Central Government to the Court under section 394A is not binding on the Court.

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KOLKATA – 700019
M: 98301 65501
Web: www.pksal.com

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ICWAI Group III (Final) New Syllabus

1

Corporate Laws

Topic: Corporate Governance

Introduction

Literally speaking, "Corporate Governance" means set of best practices to do a particular act. However, our discussion will be confined to set of best practices for managing a company.

In this regard, SEBI had constituted a committee on Corporate Governance under the chairmanship of Mr. Kumarmangalam Birla, on the lines of Cadbury Committee of UK. The Birla Committee submitted its recommendations on Corporate Governance to SEBI. Then in order to implement the said recommendations, SEBI directed the Stock Exchanges to amend their Listing Agreements. On such direction from SEBI, all the Stock Exchanges have accordingly inserted clause 49 in their Listing Agreement, which contains the recommendations on Corporate Governance.

It may be noted a Committee, under the Chairmanship of Mr. N. R. Narayanmurthy, recommended number of amendments in Clause 49 of the Listing Agreement. Presently, Clause 49 of the Listing Agreement contains the provisions of Corporate Governance, based on Narayanmurthy Committee Report.

Provisions of Clause 49 of Listing Agreement

Mandatory Requirements

Board of Directors: There should be an optimum combination of executive and non-executive directors, with not less than 50% of the Board comprising of non-executive directors.

Further, in case company has a non-executive chairman, at least one-third (1/3rd) of the Board should comprise of independent directors; and in case company has an executive chairman, at least half (1/2) of the Board should comprise of independent directors. If the Non Executive Chairman is a promoter or is related to promoters or persons occupying management positions at the Board Level or at one level below the Board, at least half of the Board should consist of Independent Directors.

The gap between resignation/removal of an Independent Director and appointment of another Independent Director shall not exceed 180 days. However this position would not apply in case the Company fulfills the minimum requirement of Independent Directors in its Board i.e. 1/3rd or 1/2 as the case may be, even without filing the casual vacancy created by such resignation / removal.

The minimum age for Independent Directors shall be 21 years.

Here, 'independent directors' means a non-executive director who:

(a) Apart from receiving directors' remuneration, does not have any other material pecuniary relationship or transaction with the company, its promoters its senior management or its holding company, its subsidiaries and associates which may affect the independence of the director.
(b) is not related to the promoters or persons occupying management positions at the Board level or at one level below the Board.
(c) has not been an executive of the company in the immediate preceding 3 Financial years.
(d) is not a partner or an executive or was not a partner or an executive during preceding 3 Financial years of the statutory audit firm, internal audit firm, legal firm or consulting firm that have material association with the company. (The term 'material association' has been used for legal or consulting firm).
(e) is not a material supplier, service provider or customer or a lessor or lessee of the company, which may affect independence of the director.
(f) is not owning 2% or more of the voting shares (i.e. equity shares) of the company.

It may be noted that an institutional director (i.e. nominee director), whether of investing institution or lending institution, shall be deemed to be an independent director.

Board Procedure: There shall be at least four Board Meetings a year. The time between two successive Board Meetings can be a maximum of four months.

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Following information must be placed before the Board of Directors:

(i) Annual operating plans and budget,
(ii) Quarterly results for the company,
(iii) Minutes of the meetings of Committee of Directors,
(iv) The information on recruitment and remuneration of senior officers,
(v) Show Cause, demand, prosecution and penalty notices,
(vi) Any material default in financial obligations to and by the company,
(vii) Details of any joint venture or collaboration agreement,
(viii) Significant labour problems and their proposed solutions,
(ix) Sale of material nature, of investments, subsidiaries, assets, which is not in normal course of business,
(x) Non compliance of any regulatory, statutory or listing requirements.

A director of a Company shall not be a Member in more than ten committees of directors across all companies in which he is a director. Further, a director of a company shall not be a Chairman of more than five committees of directors (i.e. in the committees in which he is a member) across all companies in which he is a director. It may be noted that membership/ chairmanship of committee of directors of private, foreign and Section 25 companies shall be excluded for the above purpose. Further, membership/ chairmanship only of Audit Committee and Shareholders' Grievance Committee shall be considered for the above purpose.

Audit Committee of Directors: All listed companies shall constitute a Committee of Directors to be known as 'Audit Committee of Directors' to look into accounting, financial and audit aspects of a company.

Audit Committee of Directors shall consist of at least three directors, out of which at least 2/3rd shall be independent directors. All members of Audit Committee shall be financially literate and at least one member shall have accounting or related financial management expertise. The Chairman of the Audit Committee shall be an independent director and he shall present himself at the AGM to answer the shareholders' queries.

Audit Committee shall meet at least 4 times in a year and not more than 4 months shall elapse between 2 consecutive meetings.

The quorum of the meetings of the Audit Committee of Directors shall be either two members or 1/3rd of the members, whichever is higher and minimum of two independent directors.

The Company Secretary of the Company shall act as the Secretary to the Audit Committee.

The Audit Committee shall review information relating to financial statements, management discussion and analysis of financial condition and results of operations, risk management report, internal control weaknesses report issued by statutory auditors.

A Statement of all transactions with related parties shall be placed before Audit Committee for its approval.

Remuneration of Directors: The remuneration of non-executive directors shall be decided by the Board of Directors and shall require previous approval of shareholders in General Meeting. However such approval of shareholders is not required for payment of sitting fees.

Further, the Company shall make certain specified disclosures on the remuneration of directors in the Corporate Governance Section of the Annual Report of the Company.

Management Discussion and Analysis Report: A report to be known as 'Management Discussion and Analysis Report' shall form part of the Directors' Report. This report shall contain the discussion on the following matters:

(i) Industry structure and developments;
(ii) Opportunities and Threats;
(iii) Segment-wise or product-wise performance;
(iv) Outlook;
(v) Risk and concerns;
(vi) Internal control systems and their adequacy;
(vii) Financial performance with respect to operational performance;
(viii) Developments in Human Resources/Industrial Relations.

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Shareholders: The shareholders shall be provided with the following information about a person who is proposed to be appointed as the new director or re-appointed as the director of the company:

(i) A brief resume of the director;
(ii) Nature of his expertise in specific functional areas; and
(iii) Names of the companies where he is already a director.

Further, a Committee of Directors to be known as 'Shareholders/Investors Grievance Committee of Directors' shall be formed to look into the various complaints of the investors like transfer of shares, non-receipt of annual accounts, non-receipt of declared dividend, etc. The Committee shall be headed by (i.e. the Chairman should be) a non-executive director.

Report on Corporate Governance: There shall be a separate section on Corporate Governance in the Annual Report (Directors' Report) of a Company with detailed compliance report on Corporate Governance. Non-compliance of any mandatory requirements with reasons thereof and the extent to which the non-mandatory requirements have been adopted should be specifically highlighted.

Compliance: The Company shall arrange to obtain a certificate, from the Statutory Auditors of the Company / practicing CS, regarding compliance of conditions of corporate governance as stipulated in Clause 49 of Listing Agreement and annex the certificate with the Directors' Report, which is sent annually to all the shareholders of the company. A copy of the said certificate shall also be sent to all the Stock Exchanges, where securities of the Company are listed, along with the Annual Report filed by the Company.

Quarterly Compliance Report: The Company shall submit a quarterly compliance report, in the prescribed format, to the Stock Exchanges within 15 days from the close of each quarter. The report shall be signed either by the compliance officer or Chief Executive Officer (CEO) of the company.

Code of Conduct: A code of conduct for all Board members and senior management of the company shall be laid down by the Board and the same should be posted on the website of the company. The Board members and senior management personnel shall annually affirm compliance with the Code. A declaration to this effect signed by the CEO shall form part of the Annual Report.

Certification: The CEO and Chief Financial Officer (CFO) shall certify the review of the Balance Sheet and Profit and Loss Account of the company.

Holding and Subsidiary Company: At least one Independent Director on the Board of Directors of the Holding Company shall be a director on the Board of Directors of a Material Unlisted Indian Subsidiary Company. The term 'Material Unlisted Indian Subsidiary Company' means a subsidiary incorporated in India, whose turnover or net worth exceeds 20% of the consolidated turnover and net worth respectively, of the Listed Holding Company and its subsidiaries in the immediately preceding accounting year.

The Audit Committee of the Listed Holding Company shall also review the financial statements, in particular, the investments made by the Unlisted Subsidiary Company.

The Minutes of the Board Meetings of the Unlisted Subsidiary Company shall be placed at the Board Meeting of the Listed Holding Company.

The management of Material Unlisted Subsidiary Company shall periodically bring to the attention of the Board of Directors of the Listed Holding Company, a statement of all significant transactions and arrangements entered into by it. Here the term 'significant transactions' means any single transaction which exceeds 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the Material Unlisted Subsidiary for the immediately preceding accounting year.

Non-Mandatory Requirements

Remuneration Committee of Directors: The Board of Directors of a listed company may constitute a 'Remuneration Committee of Directors' to determine the company's policy on remuneration package of the executive directors of the company.

The Remuneration Committee of Directors shall comprise of at least three directors, all of whom shall be non-executive directors. The Chairman of the Remuneration Committee of Directors shall be an independent director, who shall present himself at the AGM to answer the shareholders' queries.

The quorum of the meetings of the Remuneration Committee of Directors shall be all the members of the Committee.

Whistle Blower Policy: The Company may establish a mechanism for employees, to report to the management, concerns about unethical behaviour, actual or suspected fraud or violation of the company's Code of Conduct or ethics policy. This mechanism could also provide for adequate safeguards against victimisation of employees who avail of the mechanism and also provide for direct access to the Chairman of the Audit Committee in exceptional cases. Once established, the existence of the mechanism may be appropriately communicated within the organisation.

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23 C, EKDALIA PLACE
KOLKATA – 700019
M: 98301 65501
Web: www.pksal.com

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3

Corporate Laws

Topic: Competition Act, 2002

ICWAI - Group III (New Syllabus)

Q. 1. Define the following :

(*a*) Agreement
(*b*) Cartel
(*c*) Consumer
(*d*) Enterprise
(*e*) Person
(*f*) Statutory authority

Ans. (*a*) Agreement [Sec. 2(b)]

'Agreement' includes any arrangement or understanding or action in concert,

(*i*) whether or not such arrangement, understanding or action is formal or in writing; or

(*ii*) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings.

The element of mutuality is, however, inherent in the word agreement. Thus, a ere direction or recommendation by one party in circumstances which do not arrant the acceptance of any obligation (whether legal or moral) by the other party nnot constitute an arrangement.

(*b*) **Cartel [Section 2(c)]**

It includes an association of producers, sellers, distributors, traders or service-oviders who, by agreement amongst themselves, limit, control or attempt to ntrol the production, distribution, sale or price of, or, trade in goods or provision of rvices.

(*c*) **Consumer [Section 2(f)]**

'Consumer' means any person who :

(*i*) buys any goods for a consideration which has been paid or promised or partly paid and partly promised of under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use;

(*ii*) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such services other than the person who hires or avails of the services for consideration paid or promised or partly paid or partly promised or under any system of deferred payment, when such services are availed of with the approval of first mentioned person, whether such hiring or availing of services is for any commercial purpose or for personal use.

(*d*) **Enterprise [Section 2(h)]**

'Enterprise' means a person or a department of the Government who or which is, or has been engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities of any other body corporate, either direct or through one or more of its units or divisions or subsidiaries, whether such unit or division of subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

Explanation : For the purposes of this clause,

(*a*) "activity" includes profession or occupation.

(*b*) "article" includes a new article and "service" includes a new service.

(*c*) "unit" or "division", in relation to an enterprise includes.

(*i*) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;

(*ii*) any branch of office established for the provision of any service.

(*e*) **Person [Section 2(l)]**

As per clause (1) of Section 2, the expression 'person' includes :

(*i*) an individual;
(*ii*) a Hindu undivided family;
(*iii*) a company;
(*iv*) a firm;
(*v*) an association of persons or a body of individuals whether incorporated or not in India or outside India;
(*vi*) any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Section 67 of the Companies Act, 1956;
(*vii*) any body corporate incorporated by or under the laws of a country outside India;
(*viii*) a co-operative society registered under any law relating to co-operative societies;
(*ix*) a local authority;
(*x*) every artificial juridical person not filling within any of the preceding sub-clauses;

(f) Statutory Authority [Section 2 (w)]

'Statutory Authority' means any authority, board, corporation, council, institute, university or any other body corporate, established by or under any Central, State or Provincial Act for the purposes of regulating production or supply of goods or provision of any services or markets therefor or any matter connected therewith or incidental thereto.

Q.2. What do you mean by anti-competition agreements?

Ans. Anti-competitive Agreements (Section 3)

Section 3 provides that no enterprise or person shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition within India. This rule applies to association of enterprises and association of persons while entering into any such agreement [Section 3 (1)].

Agreement void. Any agreement entered into in contravention of the provisions contained in Section 3(1) shall be void [Section 3(2)].

Adverse effect on competition. Any agreement entered into between competitors, which—

(a) directly or indirectly determines, purchase or sale prices;

(b) limits or controls production, supply, markets, technical development, investment or provision of services;

(c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way;

(d) directly or indirectly results in bid rigging or collusive bidding, shall be presumed to have an appreciable adverse effect on competition.

'Bid rigging' means any agreement, between enterprises or persons referred to above engaged in identical or similar production or trading of goods or provision of services, which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding.

An agreement which causes or is likely to cause an appreciable adverse effect on competition, includes the following agreements also:

(a) tie-in arrangement;

(b) exclusive supply agreement;

(c) exclusive distribution agreement;

(d) refusal to deal;

(e) resale price maintenance.

Tie-in arrangements include any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods. *For example,* requiring a purchaser of scooter to purchase helmet also. Likewise, refusing to give a gas connection unless the buyer purchases gas stove also.

Exclusive supply agreement includes any agreement restricting in any manner the purchaser in the course of his trade from acquiring or otherwise dealing in any goods other than those the seller or any other person. *For example* insisting that a dealer of BPL products will not deal in Samsung or LG products.

Exclusive distribution agreement includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods. *In other words,* dealer is not allowed to distribute his products in an area other than the one allotted to him.

Refusal to deal includes any agreement which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought.

Resale price maintenance includes any agreement to sell goods on condition that the prices to be charged on the resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged [Section 3(4)].

Factors which cause adverse effect on competition

The Commission shall, while determining whether an agreement has an appreciable adverse effect on competition under Section 3, have due regard to all or any of the following factors, namely:

(a) creation of barriers to new entrants in the market;

(b) driving existing competitors out of the market;

(c) foreclosure of competition by hindering entry into the market;

(d) accrual of benefits to consumers;

(e) improvements in production or distribution of goods or provision of services;

(f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services [Section 19(3)].

Exemption for Copyrights, Patents, Exports, etc.

The provisions relating to anti-competitive agreements, as contained in Section 3 and discussed in the aforesaid paragraphs, do not apply to :

(i) the right of any person to restrain any infringement of, or to impose reasonable conditions, as may be necessary for protecting any of his rights which have been or may be conferred upon him under—

- (a) 'copyright' under the Copyright Act, 1957;
- (b) 'patent' or 'exclusive right' granted under the Patents Act, 1970;
- (c) 'design' registered under the Designs Act, 2000;
- (d) 'layout-design' registered under the Semi-conductor Integrated Circuits Layout Design Act, 2000;

(ii) the right of any person to export goods from India to the extent to which the agreement relates exclusively to the production, supply, distribution or control of goods or provision of services for such export [Section 3(5)].

Q. 3. What do you mean by 'Dominant Position' ?

Ans. Prohibition of abuse of dominant position (Section 4)

Section 4 prohibits abuse of dominant position by any enterprise [Section 4(1)]

Meaning of Dominant Position

Dominant position means a position of strength, enjoyed by an enterprise, in the relevant market, whether in India or outside India, which enables it to:

(*i*) operate independently of competitive forces prevailing in the relevant market; or

(*ii*) affect its competitors or consumers or the relevant market in its favour.

According to Section 4, there shall be an abuse of dominant position, if an enterprise,—

(*a*) directly or indirectly, imposes unfair or discriminatory—

(*i*) condition in purchase or sale of goods or services; or

(*ii*) 'price in purchase or sale (including predatory price) of goods or service; or

(*b*) limits or restricts—

(*i*) production of goods or provision of services or market therefor; or

(*ii*) technical or scientific development relating to goods or services to the prejudice of consumers; or

(*c*) indulges in practice or practices resulting in denial of market access; or

(*d*) makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts; or

(*e*) uses its dominant position in one relevant market to enter into, or protect, other relevant market.

Q. 4. What do you mean by Combination ? What are the procedures for its investigation?

Ans. Combinations

Meaning of Combination (Section 5)

The acquisition of one or more enterprises by one or more persons or merger or amalgamation of enterprises shall be treated as 'combination' of such enterprises and persons or enterprises in following cases:

Acquisition By Large Enterprises—Any acquisition where the parties to the acquisition, being the acquirer and the enterprise, whose control, shares, voting rights or assets have been acquired or are being acquired jointly have, (*a*) either, in India, the *assets* of the value of more than *rupees one thousand crores* or *turnover* more than *rupees three thousand crores*; or (*b*) in India or outside India, in aggregate, the *assets* of the value of more than *five hundred million US dollars* or *turnover* more than *fifteen hundred million US dollars*; will be 'combination'. [Section 5 (*a*) (*i*)]. Thus, if after acquisition, the joint assets turnover reach or cross the aforesaid limits, it will be 'combination'. Of course, if acquirer already had those assets or turnover, any further acquisition will be 'combination'.

Acquisition By Group—Any acquisition where the group, to which the enterprise whose control, shares, assets or voting rights have been acquired or are being acquired, would be belong referred to as CCI of India (or just CCI or Commission) and the fee which may be determined, by regulations, disclosing the details of the proposed combination, within 7 days of —

(*a*) approval of the proposal relating to merger or amalgamation referred to in Section 5(*c*), by the Board of Directors of the enterprises concerned with such merger or amalgamation, as the case may be;

(*b*) execution of any agreement or other document for acquisition referred to in Section 5(*a*) or acquiring of control referred to in Section 5(*b*) [Section 6(2)].

The Commission shall, after receipt of notice, deal with such notice in accordance with the provisions contained in Sections 29, 30 and 31 [Section 6(3)]. These Sections deal with (*i*) Procedure for investigation of combinations (Section 29), inquiry into disclosures (Section 30), and orders of the Commission on certain combinations (Section 31).

The provisions of Section 6 shall not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement [Section 6(4)].

The public financial institution, foreign institutional investor bank or venture capital fund, shall, within seven days from the date of the acquisition, file, in form as may be specified by regulations, with the Commission the details of the acquisition including the details of control, the circumstances for exercise of such control and the consequences of default arising out of such loan agreement or investment agreement, as the case may be [Section 6(5)].

Procedure for investigation of combinations (Section 29)

Issue of notice. Where the Commission is of the opinion that a combination is likely to cause, or has caused, an appreciable adverse effect on competition within the relevant market in India, it shall issue a notice to show cause to the parties to combination. The notice shall call upon the parties to respond within 30 days of the receipt of the notice, as to why investigation in respect of such combination should not be conducted [Section 29(1)].

The Commission, if it is *prima facie* of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall, within 7 working days from the date of receipt of the response of the parties to the combination, direct parties to the said combination to publish details of the combination within 10 working days of such direction [Section 29 (2)].

Written objections. The Commission may invite any person or member of the public, affected or likely to be affected by the said combination, to file his written objections, if any, before the Commission within 15 working days from the date on which the details of the combination were published [Section 29(3)].

Additional information. The Commission may, within 15 working days from the expiry of the period of 15 days, call for such additional or other information as it may deem fit from the parties to the combination [Section 29(4)]. The information called for by the Commission shall be furnished by the parties within 15 days from the expiry of the period specified in Section 29(4) [Section 29(5)].

After receipt of all information and within a period of 45 working days from the expiry of the period specified in Section 29(5), the Commission shall proceed to deal with the case in accordance with the provisions contained in Section 31 [Section 29(6)].

Q. 5. What is the composition of Competition Commission ?

Competition Commission of India

Ans. Establishment of Commission (Section 7)

With effect from such data as the Central Government may appoint, there shall be established for the purposes of this Act, a Commission to be called the "Competition Commission of India' (hereinafter called 'Commission' or CCI) [Section 7(1)].

The Central Government has, in exercise of the aforesaid powers established w.e.f. 14th October 2003, the Competition Commission of India having its head office at New Delhi [*Vide Notification No. SO1198(E) dtd. 14.10.2003]*.

Corporate Body. The Commission shall be a body corporate by the name 'Competition Commission of India' having perpetual succession and a common seal. It shall have power to acquire, hold and dispose of property, both movable and immovable, and to contract and shall, by its name, sue or be sued [Section 7(2)].

Offices. The head office of the Commission shall be at such place as the Central Government may decide from time to time [Section 7(3)].

The Commission may establish offices at other places in India [Section 7(4)].

Composition of Commission (Section 8)

The Commission shall consist of a Chairperson and not less than 2 and not more than 10 other Members to be appointed by the Central Government. However, during the fist year of the establishment of the Commission, the Central Government shall appoint the Chairperson and only one Member [Section 8(1)].

Qualifications : The Chairperson and every other Member shall be the persons of ability, integrity and standing, who:

(*a*) are, or have been, or are qualified to be, a judge of a High Court; or

(*b*) have special knowledge of, and professional experience of not less than 15 years in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public fairs, administration or in any other matter which, in the opinion of the Central Government, may be useful to the Commission [Section 8(2)].

The Chairperson and other Members shall be whole-time Members [Section 8(3)].

Q. 6. What are the Powers and Functions of the Competition Commission ?

Ans. Powers and Functions of Commission

With a view to perform the duties enumerated under Section 18, the Commission has been charged with certain obligations and conferred with certain powers. These obligations and powers are as follows:

1. *Inquiry into certain agreements* (*Section 19*)

The Commission may inquire into any alleged contravention of the provisions contained in Section 3(1) or 4(1) either on its own motion or on:

(*a*) receipt of a complaint from any person, consumer or their association or trade association; or

(*b*) a reference made to it by the Central Government or a State Government or a statutory authority [Section 19(1)].

2. *Inquiry whether an enterprise enjoys dominant position*

The Commission shall, while inquiring whether an enterprise enjoys a dominant position or not under Section 4, have due regard to all or any of the following factors, namely:

(*a*) market share of the enterprise;

(*b*) size and resources of the enterprise;

(*c*) size and importance of the competitors;

(*d*) economic power of the enterprise including commercial advantages over competitors;

(*e*) vertical integration of the enterprises or sale or service network of such enterprises;

(*f*) dependence of consumers on the enterprise;

(*g*) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;

(*h*) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;

(*i*) countervailing buying power;

(*j*) market structure and size of market;

(*k*) social obligations and social costs;

(*l*) relative advantage by way of contribution to the economic development, by the enterprise enjoying a dominant position having or Likely to have appreciable adverse effect on competition;

(*m*) any other factor which the Commission may consider relevant for the inquiry [Section 19(4)].

3. *Inquiry into combination by Commission (Section 20)*

Inquiry into acquisition, control and combination. The Commission may, upon its own knowledge or information relating to acquisition referred to in Section 5(*a*) or acquiring of control or merger or amalgamation referred to in Section 5(*c*), inquire into whether such a combination has caused or is likely to cause an appreciable adverse effect on competition in India.

The Commission shall not initiate any inquiry under this sub-section after the expiry of one year from the date on which such combination has taken effect [Section 20(1)].

4. *Power to grant interim relief (Section 33)*

Section 33 empowers the Commission to grant interim relief by way of temporary injunctions.

Where during an inquiry before the Commission, it is proved to the satisfaction of the Commission, by affidavit or otherwise that an act in contravention of Section 3(1), or Section 4(1) or Section 5 has been committed and continues to be committed or that such act is about to be committed, the Commission may grant a temporary injunction restraining any party from carrying on such act until the conclusion of such inquiry or until further orders, without giving notice to the opposite party, where it seems necessary [Section 33(1)].

5. Power to award compensation (Section 34)

Without prejudice to any other provisions contained in this Act any person may make an application to the Commission for an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered by such person as a result of any contravention of the provisions of Chapter II (Sections 3 to 6), having been committed by such enterprise [Section 34(1)].

The Commission may, after an inquiry, made into the allegations mentioned in the application made under sub-section (1) pass an order directing the enterprise to make payment to the applicant, of the amount determined by has realisable from the enterprise as compensation for the loss or damage caused to the applicant as a result of any contravention of the provisions of Chapter II having been committed by such enterprise Section 34(2)].

Where any loss or damage referred to in sub-section 1) is caused to numerous persons having the same interest, one or more of such persons with the permission of the Commission, make an application for and on behalf of offer for the benefit of the persons so interested. Thereupon, the provisions of Rule 5 of Order 1 of the First Schedule to the Code of Civil Procedure, 1908, shall apply subject to the modification that every reference therein to a suit or decree shall be construed as a reference to the application before the Commission and the order of the Commission thereon [Section 34(3)].

The Commission shall, on receipt of a notice or upon receipt of a reference under Section 6(2), inquire whether a combination referred to in that notice or reference has caused or is likely to cause an appreciable adverse effect on competition in India [Section 20(2)].

Factors having effect on combination. For the purposes of determining whether a combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, the Commission shall have due regard to all or any of the following factors, namely:

(*a*) actual and potential level of competition through imports in the market;
(*b*) extent of barriers to entry to the market;
(*c*) level of combination in the market;
(*d*) degree of countervailing power in the market;
(*e*) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
(*f*) extent of effective competition likely to sustain in a market;
(*g*) extent to which substitutes are available or are likely to be available in the market;
(*h*) market share, in the relevant market of the persons or enterprise in a combination, individually and as a combination;
(*i*) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in market;
(*j*) nature and extent of vertical integration in the market;
(*k*) possibility of a failing business;
(*l*) nature and extent of innovation;
(*m*) relative advantage by way of contribution in the economic development by way of combination having or likely to have appreciable adverse effect on competition;
(*n*) whether the benefits of the combination outweigh the adverse impact of the combination, if any [Section 20(4)].

Q. 7. What orders can be passed by Competition Commission after inquiry ? (Sec. 27).

Ans. Orders by Commission after inquiry into agreements or abuse of dominant position (Section 27)

Orders by Commission. Where after inquiry the Commission finds that any agreement or action of an enterprise in a dominant position, is in contravention of Section 3 or Section 4, it may pass all or any of the following orders, namely:

(*a*) direct any enterprise or association of enterprises or person or association of persons, involved in such agreement, or abuse of dominant position, to discontinue and not to re-enter such agreement or discontinue such abuse of dominant position;
(*b*) impose such penalty, as it may deem fit which shall be not more than 10 per cent of the average of the turnover for the three preceding financial years upon each of such person or enterprises which are parties to such agreements or abuse. However, where any agreement referred to in Section 3 (*i.e.*, any anti-competitive agreement) has been entered into by any cartel, the Commission shall impose upon each producer, seller, distributor, trader or service provider included in that cartel, a penalty equivalent to three times of the amount of profits made out of such agreement by the cartel or ten per cent of the average of the turnover of the cartel for the last preceding three financial years, whichever is higher;
(*c*) award compensation to parties in accordance with the provisions contained in Section 34;
(*d*) direct that the agreements shall stand modified to the extent and in the manner as may be specified in the order by the Commission;
(*e*) direct the enterprises concerned to abide by such other orders as the Commission may pass and comply with the directions, including payment of costs, if any;
(*f*) recommend to the Central Government for the division of an enterprise enjoying dominant position;
(*g*) pass such other order as it may deem fit.

Q. 8. What do you mean by Competition Advocacy?

Ans. Competition Advocacy (Section 49)

In formulating a policy on competition including review of laws related to competition, the Central Government may make a reference to the Commission for *its opinion on possible effect of such policy on competition and on receipt of such a* reference, the Commission, shall, within sixty days of making such reference, give its opinion to the Central Government, which may thereafter formulate the policy as it deems fit. The opinion given by the Commission shall not be binding upon the Central Government in formulating such policy. The Commission shall take suitable measures, as may be prescribed, for the promotion of competition advocacy, creating awareness and imparting training about competition issues (Section 49).

Q. 9. What are the powers of the Central Government under the Competition Act?

Ans. Powers of the Central Government

1. Power to Exempt (Section 54)

The Central Government is empowered to exempt from the application of this Act, or any provision thereof, and for such period as it may specify in such notification—

(*a*) any class of enterprises if such exemption is necessary in the interest of security of the state or public interest;

(*b*) any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries;

(*c*) any enterprise which performs a sovereign function on behalf of the Central Government or a State Government.

However, in case an enterprise is engaged in any activity including the activity relatable to the sovereign functions of the Government, the Central Government may grant exemption only in respect of activity relatable to the sovereign functions.

2. Powers to Issue Directions (Section 55)

The Central Government is empowered under Section 55, after giving opportunity of being heard, to issue directions to the Competition Commission with respect to policy matters. It cannot, however, issue directions on technical and administrative matters. As to whether a question is one of policy or not, the decision of the Central Government shall be final.

3. Power to Supersede Commission (Section 56)

If at any time the Central Government is of the opinion :

(*a*) that on account of circumstances beyond the control of the Commission, it is unable to discharge the functions or perform the duties imposed on it by or under the provisions of this Act; or

(*b*) that the Commission has presently made default in complying with any direction given by the Central Government under this Act or in the discharge of the functions or performance of the duties imposed on it by or under the provisions of this Act and as a result if such default the financial position of the Commission or the administration of the Commission has suffered; or

(*c*) that circumstances exist which render it necessary in the public interest so to do;

the Central Government may, by notification and for reasons to be specified therein, supersede the Commission for such period, not exceeding six months, as may be specified in the notification.

However, before issuing such notification, the Central Government shall give a reasonable opportunity to the Commission to make representations against the proposed supersession and shall consider representations, if any, of the Commission.

Consequences of Supersession

Upon the publication of a notification of supersession, Commission:

(*a*) the Chairperson and other Members shall, as from the date of supersession, vacate their offices as such;

(*b*) all the powers, functions and duties which may, by or under the provisions of this Act, be exercised or discharged by or on behalf of provisions of the Commission shall, until the Commission is reconstituted under sub-section (3), be exercised or discharged by the Central Government or such authority as the Central Government may specify in this behalf;

(*c*) all properties owned or controlled by the Commission shall, until the Commission is reconstituted under sub-section (3), vest in the Central Government.

On or before the expiration of the period of supersession specified in the notification issued under sub-section (1), the Central Government shall reconstitute the Commission by a fresh appointment of its Chairperson and other Members and in such case any person who had vacated his office under clause (*a*) of sub-section (2) shall not be deemed to be disqualified for reappointment.

The Central Government shall cause a notification issued under sub-section (1) and a full report of any action taken under this section and the circumstances leading to such action to be laid before each House of Parliament at the earliest.

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ICWAI Group - III Final (New Syllabus)

Subject: Corporate Laws

Topic: Articles of Association

Meaning, contents and different forms of Articles of Association

Articles means the Articles of Association of a company as

(*i*) originally framed; or

(*ii*) altered from time to time,

as per the Companies Act, 1956 or any of the previous companies law.

They are the rules and regulations for the *internal management* of the affairs of a company. They are prepared with the object of carrying out the aims and objects of the Memorandum of Association. Though Articles are subordinate to the Memorandum, yet if there is any ambiguity in the Memorandum, the Articles may be used to explain it.

The scope of the Articles has been summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage* and *Iron Co. Ltd. v. Riche,*

The Articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the Memorandum and the Companies Act.

Companies to have their own Articles (Sec. 26)

The following companies *must* have their own Articles, namely,

(*i*) unlimited companies;

(*ii*) companies limited by guarantee;

(*iii*) private companies limited by shares.

A public company *need not have its own Articles*.

Contents of Articles

Articles normally *contain* provisions relating to the following important matters:

(*i*) calls on shares;

(*ii*) lien on shares;

(*iii*) forfeiture of shares;

(*iv*) transfer of shares;

(*v*) transmission of shares;

(*vi*) conversion of shares into stock;

(*vii*) alteration of share capital;

(*viii*) payment of underwriting commission;

(*ix*) general meetings and proceedings thereat;

(*x*) quorum, voting, poll and proxies;

(*xi*) directors, their appointment, remuneration, share qualification, powers and proceedings of Board of directors;

(*xii*) issue of bonus shares;

(*xiii*) audit committee.

Articles to be printed, signed, witnessed (Sec. 30)

The Articles shall

(*i*) be *printed;*

(*ii*) be *divided* into paragraphs; and

(*iii*) be *signed* by each subscriber of the Memorandum who shall add his address, description and occupation, if any;

(*iv*) include the name of each such witness, his address, description and occupation, *if any*.

Adoption of Articles (Sec. 28)

There are *three* alternative forms in which a public company may adopt Articles:

(*i*) it may *adopt* Table A in full;

(*ii*) it may wholly *exclude* Table A and frame its own Articles in full;

(*iii*) it may *partly* have its own Articles and adopt *part of Table A*.

Articles of Association v. Memorandum of Association

1. The Memorandum of Association lays down the constitution of the company. It is the fundamental document containing the terms and conditions on which the company is incorporated. It prescribes the area beyond which the actions of the company cannot go. It lays down the limit of the scope of the company. The Articles, on the other hand, are merely bye-laws for the internal regulation of the company. They play a subsidiary role to the Memorandum. If, therefore, they conflict with the Articles, the Memorandum will have the *upper say*.

2. The articles may be referred to for explaining ambiguities but they cannot be used for extending the scope of the Memorandum [Dr. Lakshmanaswami Mudaliar v. LIC]. If the Articles deal -with a point about which the Memorandum is silent, it shall have to be seen that it does not go beyond the scope of the Memorandum. Within the scope of the Memorandum, the members may frame any regulations. If, therefore, what is given in the Articles is beyond the scope of the company, it shall not be binding on the company as the Articles can in no case supersede the Memorandum.

Alteration of Articles

1. Companies have been given *statutory rights* to alter their Articles of Association. Any provision in the Articles making the Articles unalterable is regarded as bad in law.
2. A company may, by passing a *special resolution*, alter its Articles any time. A copy of every special resolution altering the Articles shall be filed with the Registrar within 30 days of its passing. Any alteration so made in the Articles shall be as valid *as if originally contained in the Articles* (Sec. 31).

   Note: A company may alter its Articles in any of the following ways:
   (*a*) it may adopt new Articles;
   (*b*) it may add a new Article;
   (*c*) it may delete an Article;
   (*d*) it may amend an Article.

Restrictions or limitations on alteration of Articles

1. The alteration must not be *inconsistent* or *go beyond* the provisions of the *Companies Act*. For example, Articles of a public company cannot be changed so as to reduce quorum of less than 5 members personally present. If Articles are contrary to the provisions of any law, they will be invalid *Kinetic Engineering Ltd.* v. *Sadhana Gadia*
2. Articles must not conflict with the provisions of *Memorandum*. If they do, they will be '*ultra vires*' and wholly *void* and *inoperative*.
3. The alteration can be made only by a *special resolution*. The spelling and grammatical errors in the Articles should also be rectified by passing a *special resolution*.
4. No alteration in the Articles can be made to convert a public company into a private company *without the approval of Central Government* (Sec. 31).
5. A company is not *prevented* from *altering its Articles* even if such an alteration would result in *breach of some contract*. The affected party may, however, file a suit for damages for the breach of contract *Southern Foundaries Ltd.* v. *Shirlaw*

   Chidambaram Chettiar v. Krishna Iynger, I.L.R. 33 Mad. 36.

   The company secretary was *appointed* on a salary of Rs. 2,500 per month under the terms of Articles of the company. He *accepted* the post on this salary. Subsequently, the company *altered* its Articles reducing the salary to Rs. 2,000 per month. Held, the company secretary did *not* succeed in an action against the company as any one dealing with the company *must* take the risk of the Articles being altered.

   Where compensation would *not* be an *adequate remedy*, the Court may *restrain* the company from altering its Articles.
6. The alteration cannot be made with *retrospective effect*. The Articles can only operate from the date of alteration *Pyare Lal Sharma* v. *Managing Director, J.K. Industries Ltd.*
7. The alteration must be made *bona fide* for the interest of the company as a whole. If an alteration is *bona fide* and is made for the benefit of the company as a whole, it is *immaterial* that it puts hardship on a minority. It is for the company to decide whether the alteration is for the benefit of the company as a whole. The alteration should be left to the discretion of the shareholders to adopt or drop the motion *K.G. Khosla* v. *Rahul G. Kirloskar*

   Allen v. Gold Reefs of West Africa Ltd.

   The Articles of a company gave lien to the company on all shares '*not fully paid up*' for call money due to the company. Z was the only holder of *fully paid shares*. He owed money to the company for *calls* due on *other* shares. After his death, the company *altered* the Articles so as to *extend* the lien over his *fully* paid shares. *Held*, as the lien was for the benefit of the company as a *whole*, the *alteration* was *valid*, inspite of the fact that it was with retrospective effect and to Z's disadvantage.
8. The alteration must not contain anything which is *illegal* or against *public policy*.
9. An alteration cannot increase a member's liability in any way *except with his written consent*. But where the company is a club or association, the Articles may be altered to *provide* for subscription or charges at a *higher rate* (Sec. 38).
10. The Articles *cannot* be *altered* so as to confer on the Board of Directors the power to *expel* a member. Such a move is opposed to the basic principles of company jurisprudence and is ultra vires the company.
11. The alteration must not constitute a '*fraud on the minority*'.

Legal and binding effects of Articles

The Memorandum and Articles, when registered, bind a company and the members thereof to the same extent as if they:

(*i*) had been signed by the company and each member; and
(*ii*) contained covenants by the company and each member to observe all the provisions of the Memorandum and of the Articles (Sec. 36).

The effect of these provisions is to constitute, through the Memorandum and the Articles of a company, a contract between each member and the company. The legal implications of these documents may be discussed as to how far these documents bind:

(1) members to the company;
(2) company to the members;
(3) members *inter se*;
(4) company to the outsiders.

1. **Members bound to the company**
   The Articles constitute a contract between each member and the company.

Borland's Trustee v. Steel Bros & Co. Ltd.

The Articles of a company *provided* that on the bankruptcy of a member his shares would be sold to another person and at a price fixed by the directors. *B*, a shareholder became *bankrupt*. His trustee in *bankruptcy* claimed that he was *not* bound by these provisions. *Held*, the Articles were a *personal contract* between *B* and the company and his trustee were bound.

But an alteration of the Memorandum or the Articles which requires a member to take or subscribe for more shares or increase his liability to contribute to the share capital of the company shall *not* be binding on him *unless* he agrees in writing *before* or *after* the alteration (Sec. 38).

2. **Company bound to the members**

   A company is *bound* to the members in the same way as members are *bound* to the company while *observing* and *following* the Articles.

   (*i*) A member has a right to
   - (*a*) receive notice of general meetings;
   - (*b*) receive dividend.

   (ii) A member can enforce Articles against the company. In Wood v. Odessa Waterworks Co. the Board of directors recommended payment of dividend in kind by issuing debentures. The Articles contained provision for payment of dividend. Held, payment means payment in cash and the company was compelled to pay dividend in cash.

3. **Members bound to each other**

   The Articles constitute a contract between each member and the company. There is no contract between the individual members of the company. The Articles do not, any the less, regulate their rights *inter se* (among themselves). Such rights can only be enforced through the company. No member has, between himself and other members, any right beyond that which the contract of the company goes. The leading case on the point is:

   Rayfield v. Hands

   The company's Articles required a shareholder to inform the directors of his intention *to transfer his shares in the company*. The company's Articles also provided that the directors would take the said shares equally between them at a *fair value*. The directors *refused* to take the shares and argued that the Articles did not impose any liability upon them. *Held*, the directors were *compelled* to take the shares. The Articles imposed an obligation on them not as *directors* but as *members* of the company.

4. **Company not bound to the outsiders**

   The Articles bind the members to the company and the company to the members. But neither of them is bound to an outsider to give effect to the Articles. No Article can constitute a contract between the company and a third person. The term *an outsider* implies a person who is not a member. But a member may be an outsider. The leading case on the point is:

   Eley v. Positive Govt. Security Life Ass. Co.,

   The Articles of a company contained a clause that Eley should be the solicitor of the company for *life*. He could be *removed* from office only for *misconduct*. Eley accepted the assignment. In lieu of his professional services rendered to the company, he was paid in cash and was also allotted shares. By this way, he became a shareholder. After some time the company dismissed him without alleging misconduct. Eley sued the company for *damages for breach of contract*. *Held*, the company was not liable as the Articles did not *constitute* any contract between the company and outsider.

Doctrine of constructive notice

The Memorandum and the Articles of Association of every company are registered with the **Registrar of Companies**. The office of the Registrar is a *public office* and consequently the Memorandum and the Articles become *public documents*. They are open to inspection by anyone on payment of nominal fee. This is known as *constructive notice* of Memorandum and Articles. It is the duty of every person dealing with the company to inspect these documents and ensure that it is in the powers of the company to enter into the proposed contract. But whether he *actually* reads them or not, it will be *presumed* that he has *read* them.

The doctrine of constructive notice of the Memorandum and the Articles is not a *positive doctrine* but a *negative one*. It cannot *operate* against the company. It *operates* only against an outsider dealing with the company. It *prevents* him from alleging that he did not know the contents of the Memorandum and the Articles.

Kotla Venkataswamy v. C. Rammurthi

The Articles of Association of a company *included* a clause that all documents and deeds of the company shall be signed by the managing director, the secretary and a working director on behalf of the company. A mortgage deed was signed by the secretary and a working director only. *Held*, the mortgage was *invalid* in spite of the fact that the plaintiff acted in *good faith* and the money was utilised for the company. The mortgagee should have consulted the Articles before executing the mortgage deed.

Doctrine of indoor management

The *rule in Royal British Bank* implies that the outsiders dealing with the company are entitled to assume that *as far as the internal proceedings of the company are concerned, everything has been regularly done*. They are presumed to have read these documents and to ensure that the proposed dealing is not inconsistent therewith. They are not bound to do more. They need not inquire into the regularity of the internal proceedings. They can presume that all is being done regularly. This limitation of the doctrine of constructive notice is known as:

(*a*) the doctrine of indoor management, or
(*b*) the rule in *Royal British Bank* v. *Turquand*, or
(*c*) just *Turquand* rule.

Royal British Bank v. Turquand,

The directors of a banking company borrowed a sum of money from Turquand. The company's Articles provided that the directors could borrow money on bonds provided they were authorised by a *resolution passed by the shareholders at a general meeting of the company*. No such required resolution authorising the loan was passed by the company. *Held*, Turquand could recover the amount of the bond from the company on the ground *that he could presume that the necessary resolution must have been passed*.

The rule is based on convenience in business relations:

Firstly, the Memorandum and the Articles are public documents. They are open to public inspection but the details of internal procedure are not thus open to public inspection. Hence an outsider "is presumed to know the constitution of a company but not what may or may not have taken place within the doors that are closed to him."

Secondly, the lot of creditors of a limited company is not a particularly happy one. It would be unhappier still if the company could escape liability by denying the authority of the officials to act on its behalf.

Exceptions to indoor management (*i.e.*, cases when an outsider shall not be protected in his dealings with the company).

The doctrine of indoor management does not apply in the following cases:

1. **Knowledge of irregularity**

   The person contracting may in some cases be himself a part of the internal procedure, so he cannot claim the benefit under the rule of indoor management.

   Devi Ditta Mal v. Standard Bank of India, A.I.R.

   A transfer of shares was approved by two directors, one of whom within the knowledge of the transferor was disqualified by reason of being the transferee himself. The other was never validly appointed. *Held*, the transfer was ineffective.

   Howard v. *Patent Ivory Co.*

   The directors of a company could borrow upto £ 1,000 without the sanction of members in general meeting. The directors themselves gave funds to the company an amount in excess of the borrowing powers. *Held*, the directors had the notice of the internal irregularity and the company was liable to them only for £ 1,000.

2. **Negligence**

   A person dealing with a company cannot be protected under 'the *Turquand* rule' if he behaves negligently. Suspicion *should* arise:

   (*a*) where an officer *apparently acts outside the scope of his authority;*
   (*b*) where the plaintiff accepted a *transfer of a company's property from its accountant*.

   Anand Bihari Lal v. Dinshaw & Co. A.I.R.

   The plaintiff, Anand Bihari Lal, accepted a transfer of company's property from its accountant. *Held*, the transfer was void as such a transaction was apparently beyond the scope of the accountant's authority. The plaintiff should have seen the power of attorney executed in favour of the accountant by the company.

3. **Forgery**

   The *Turquand* rule has never been extended to cover a complete forgery. It is quite true that persons dealing with limited liability companies are not bound to inquire into their indoor management. This doctrine which is well-established, applies to irregularities which otherwise might affect a genuine transaction. *It cannot apply to a forgery*. The leading case on the point is:

   Ruben v. Great Fingall Consolidated Co.

   The Secretary of a company *issued* a share certificate under the company's seal with his own signature and the signature of a director which was forged by him. *Held*, the share certificate was *not* binding on the company.

   However, If an officer of a company acts fraudulently under his *ostensible* authority on behalf of the company, the company is liable for his fraudulent act.

   Official Liquidator v. Commissioner of Police (1969)

   A company borrowed money on a document executed by the Managing Director. To comply with the requirements of the Articles, the Managing Director *forged* the signatures of other directors. *Held*, the company was *liable* to pay.

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ICWAI Group - III Final (New Syllabus)

Subject: Corporate Laws

Topic: Meetings and Resolutions

Meetings may, broadly, be classified as:

1. Shareholders' meeting or general meeting
   - (a) Statutory meeting (Sec. 165)
   - (b) Annual general meeting (Sec. 166)
   - (c) Extraordinary general meeting (Sec. 169)
2. Class meetings, *viz.*, meeting of debentureholders, preference shareholders
3. Board Meetings (Sec. 285)

Statutory meeting (Sec. 165)

1. **Companies required to hold meeting**
   - (a) A company limited by shares; and
   - (b) a company limited by guarantee and having a share capital:

   shall hold its first general meeting of the members which is known as the 'statutory meeting.' Such a meeting may be called within a period of:
   - (i) *not less* than 1 month,
   - (ii) *not more* than 6 months,

   from the date the company is *entitled to commence business*.
2. **Contents of the statutory report**
   The Board of Directors *shall* forward a report, called the '*statutory report*', to every member of the company at least 21 *days* before the date of the meeting. The statutory report *contains* the following matters:
   - **(a) Total shares allotted**
     The total number of *shares allotted* distinguishing:
     - (i) shares allotted as fully or partly paid-up otherwise than in cash, and;
     - (ii) in case of partly paid-up shares, the extent to which they are so paid up; and
     - (iii) in either case, the consideration for which they have been allotted;
   - **(b) Cash received**
     The total amount of *cash received* by the company in respect of all shares allotted;
   - **(c) Summary of receipts and payments**
     A summary of the *receipts* and of the *payments* made upto a date *within 7 days* of the report;
   - **(d) Directors and auditors**
     The names, addresses and occupations of the *directors, auditors* and *manager* and *secretary*, and the changes which have taken place in such names, *etc.*, since the date of the incorporation of the company;
   - **(e) Contracts**
     The particulars of any *contract* which is *to be submitted* to the meeting for its approval or modification;
   - **(f) Underwriting contract**
     the extent to which any underwriting contract *has not been carried out* and the reasons therefor;
   - **(g) Arrears of calls**
     the call money due from every director and from the manager;
   - **(h) Commission and brokerage**
     the particulars of any commission or brokerage relating to the *issue of shares and debentures* paid to any *director* or to the *manager*.
3. **Certification of the report**
   The statutory report *shall* be certified as correct by *at least* 2 directors of the company. One of these directors shall be a managing director, *if* there is one. The auditors of the company are also required to certify as *correct* the following contents:
   - (a) *total shares* allotted by the company;
   - (b) *cash received* by the company in respect of all shares allotted;
   - (c) summary of *receipts* and *payments*.

   The Board of directors shall have a list showing the names, addresses and occupations of the members of the company, and the number of shares held by them respectively, to be produced at the commencement of the statutory meeting. The list is to remain open and accessible to any members of the company during the continuance of the meeting.
   The members of the company present at the meeting shall be at liberty to discuss any matter relating to the formation of the company or arising out of the statutory report.

   Notes: 1. No resolution may be passed of which notice has not been given in accordance with the provisions of this Act.
   2. The meeting may adjourn from time to time, and at any adjourned meeting, any resolution of which notice has been duly given may be passed. Such an adjourned meeting *shall* have the same powers as an original meeting.
4. **Default**
   If default is made in complying with the provisions of Sec. 165, every director or any other officer of the company *who is in default shall* be punishable with fine which may extend to Rs. 5,000. If default is made
   - (a) in delivering the statutory report to the Registrar; or
   - (b) in holding the statutory meeting,

   the company *may be wound up* by the Court.

5. Exemption

(*a*) A private company; and

(*b*) a company limited by guarantee and *not* having a share capital, are *not required* to hold a statutory meeting.

nnual general meeting (Secs. 166 and 167)

1. Duration

(*a*) Every company *shall in each year* hold in addition to any other meetings a general meeting as its annual general meeting and *shall specify* the meeting as such in the notice calling it.

The term 'year' has *not* been defined in the Companies Act. It means 'calendar year' as defined in the General Clauses Act.

There should be at least one annual general meeting per year and as many meetings as there are years *Sree Meenakshi Mills Co. Ltd.* v. *Assistant Registrar of Companies,*

(*b*) There *shall not* be a gap of *more than 15 months* between one annual general meeting and the next.

(*c*) A company *may* hold its first annual general meeting within a period of *18 months* from the date of its *incorporation*. In such a case it *shall not* be necessary for the company to hold any annual general meeting—

– in the year of its incorporation; or

– in the following year.

(*d*) The Registrar may, for *any special reason*, extend the time within which any annual general meeting (*not being the first annual general meeting*) *shall be* held by a period *not exceeding three months*.

While fixing the date of any annual general meeting, provisions of Sec. 210 should be kept in mind and complied with.

Note: The adjourned annual general meeting must be held within the maximum time-limit allowed by Sec. 166.

2. Time and place

(*a*) Every annual general meeting *shall be* called during *business hours*. The meeting need not conclude during *business hours*. The starting point should be during *business hours*.

(*b*) It *shall be* called on a day which is not a '*public holiday*'. The term "public holiday" means a public holiday within the meaning of the Negotiable Instruments Act, 1881.

– The term 'public holiday' *includes Sundays* and *any other day* declared by the Central Government to be a public holiday.

– If a day on which AGM is called is declared by the Central Government or State Government as a public holiday *after* the issue of the notice of Annual General Meeting, the company can go ahead in holding such a meeting.

– 30th June and 31st December are *not* public holidays. So, meeting can be held on these days.

Note: If two different dates are declared holidays for the same festival by the Central Government and the State Government under the negotiable Instruments Act, it may be noted that both the days will be public holidays for the companies in that particular state.

(*c*) It *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.

Companies having their registered offices in the State of Punjab and having foreign nationals as their members were granted *exemption* by the Central Government.

(*d*) The Central Government may *exempt* any class of companies from the requirements of time and place of holding such a meeting.

A public company or a subsidiary of a public company, may by its Articles fix the time for its annual general meetings. It may also by a resolution passed in one annual general meeting fix the time for its subsequent annual general meetings. A private company which is not a subsidiary of a public company may in like manner and also by a resolution agreed to by all the members thereof, fix the time as well as the place for its annual general meeting.

3. Business to be transacted

In the case of an annual general meeting, the following business is *deemed* as ordinary business, *viz.*, business relating to:

(*a*) Consideration and adoption of *annual accounts* and the reports of the Board of directors and auditors;

(*b*) Declaration of a *dividend;*

(*c*) Appointment of *directors* in place of those retiring;

(*d*) Appointment of *auditors* and the fixing of their remuneration.

Special business. In the case of an annual general meeting, *any business other than the ordinary business*, and in the case of any other meeting *all business* is deemed *special*.

Some of the examples of special business are:

(*i*) *Removal* of a *director;*

(*ii*) Issue of *rights shares;*

(*iii*) Issue of *bonus shares;*

(*iv*) *Election* of a person (other than a retiring director) *as director*.

There is no provision in the Act which prohibits the holding of two annual general meetings on the same day. *Unless the Articles have any provision to the contrary*, annual general meeting for the current year as also for the previous year can be held on the same day. *The meetings should be called by giving separate notices and to be held at different timings.*

4. Length of notice

(a) An annual general meeting may be called by giving *not less* than 21 days' notice in writing. The period of 21 days is calculated from the date of *receipt of the notice by the members*. It excludes:
(i) the day of service of the notice;
(ii) the day on which the meeting is to be held.
Notice is deemed to have been received by the members at the *expiration of 48 hours after the letter containing it is posted.*

(b) A meeting may be called at a *shorter notice* if it is agreed to by *all the members entitled to vote thereon*. The consent for a *shorter notice* may be obtained either *before* or *after* the meeting.

5. Incomplete books of account

Annual general meeting *has* to be called even where the company did not function during the year. Even where the *accounts are not ready* for being placed before the annual general meeting, non-holding of the meeting is an offence. The excuse that the accounts are not complete is not legally acceptable *P.S. Chettiar & Co. v. The Registrar.*

The offence is, however not punishable where the account books of the company were *seized* during the raid by the police party [*Asia Udyog (Pvt.) Ltd.*, Re (1961) 31 Comp. Cas. 261].

As per Sec. 210, the date of the first annual general meeting *must* be within 9 months from the date of the financial year for which a Profit and Loss Account has been prepared.

6. Default

If a company *fails* to hold an annual general meeting:
(a) any member can apply to the Central Government* for calling the meeting;
(b) the company and every officer who is in *default* shall be punishable with fine.

While mere default is *enough* to punish the company, in the case of an officer it must be shown that he was *knowingly a party to the default Registrar of Companies* v. *Krishnan Nambiar*

Thus a managing director will not be an 'officer in default' where he has been pressing the directors to call the annual general meeting but in vain [*S.S. Jhunjhunwala* v. *The State*

By the direction of the Company Law Board*, even *one member* of the company present in person or by proxy shall be *deemed to constitute a meeting*.

The term "*officer in default*" may include:
(i) the managing director;
(ii) the whole time director;
(iii) the manager;
(iv) the secretary;
(v) any person under whose *directions* or *instructions*, the Board of directors of the company is accustomed to act.

7. Penalty

If default is made by a company in *either* holding an annual general meeting or in *complying* with any direction of the Central Government* in calling such a meeting, the company and every officer of the company who is in *default* shall be punishable with:
(a) fine upto Rs. 50,000;
(b) a further fine of Rs. 2,500 per day, in the case of a continuing *default*.

The Companies (Amendment) Act, 2000 has raised the maximum amount of penalty from Rs. 5,000 to Rs. 50,000 and a further daily fine from Rs. 250 to Rs. 2,500.

Extraordinary general meeting (Sec. 169)

An extraordinary general meeting is called for transacting some *urgent or special business* which needs to be transacted before the next annual general meeting.

Who may call the meeting?

1. The meeting *may be* called by:
(a) the Board of directors on its *own;*
(b) the Board of directors on the *requisition of the members;*
(c) the requisitionists themselves on the *failure of the Board of directors to call the meeting;*
(d) the Company Law Board*.

Notes: 1. The requisiton *shall* be deposited at the registered office of the company.

2. A member's right to requisition a meeting *remains* even where a receiver has been appointed in respect of his shares *Balkrishan Gupta* v. *Swadeshi Polytex Ltd.*

2. Meeting by the Board of Directors

An extraordinary general meeting *may be* called by the Board of directors to transact business *like:*
(a) issue of rights shares,
(b) increase in the remuneration of managing director, whole-time director, etc.

3. Meeting on the requisition of members

(a) The Board of directors of a company *shall*, on the requisition of a specified number of members, forthwith proceed duly to call extra-ordinary general meeting.
(b) The requisite number of members *shall be:*
(i) in the case of a company having a share capital, holders of *at least* 10% of the paid-up capital of the company, and
(ii) in the case of a company *not* having a share capital, members having *at least* 10% of the total voting power.
(c) The requisition shall *disclose* the matters for the consideration of which the meeting is to be called.

(*d*) The requisition shall be *deposited* at the registered office of the company.
(*e*) The Board of directors shall *proceed to call* a meeting within 21 days from the date of the deposit of a valid requisition.
(*f*) The meeting shall be *held* within 45 days from the date of the deposit of the requisition.

4. **Meeting called by the requisitionists**
   (*a*) If the Board of Directors *fails* to call a meeting as required by the requisitionists, the meeting may be called:
   (*i*) by the requisitionists themselves;
   (*ii*) in the case of a company having a share capital by such of the requisitionists as represent either,
   – a majority in value of the share capital held by them, or
   – *at least* 10% of the paid-up share capital of the company having the right of voting,
   whichever is *less*.
   (*iii*) in the case of a company *not* having a share capital, by the requisitionists having *at least* 10% of the total voting power of all the members of the company.

   Notes: 1. As alternative remedy of calling the meeting *lies* with the requisitionists, no action can be taken against the defaulting directors of the company for not holding the meeting.
   2. Where two or more person hold any shares in a company jointly, a requisition or notice calling a meeting, *signed by one shall have the same effect as if it had been signed by all of them*.

   (*b*) The meeting *shall be* called in the *same manner* as nearly as possible as that in which meetings are called by the Board of directors.
   (*c*) The meeting *shall not* be held *after the expiration of three months* from the date of deposit of requisition. However a meeting commenced before the expiry of three months may be adjourned to some day after the expiry of that period.
   (*d*) A requisitioned meeting *cannot* transact any business *other than* that for which it has been *especially* convened.
   (*e*) Where any of the requisitionists of an extraordinary general meeting have *not* paid the call money, the meeting held on the basis of their requisition is *not* a valid meeting *Kuldip Singh Dhillon* v. *Paragon Utility Financiers (Pvt.) Ltd.*
   (*f*) Any reasonable expenses incurred by the requisitionists by reason of the failure of the Board of Directors to duly call a meeting *shall be* repaid to the requisitionists by the company. Any sum so paid *shall be* retained by the company out of the remuneration or any sum due to *defaulting directors*. The company may also exercise its right to recover by other lawful means such as recovery by suit or exercise of a power of lieu over the shares of the defaulting directors, if it is so provided in the Articles.

5. **Meeting called by the Company Law Board***
   If for any reason it is *impracticable* for a company to call, hold or conduct an extraordinary general meeting, the Company Law Board* may either:
   (*a*) of its own motion;
   (*b*) on the application of any director, or
   (*c*) on the application of any member, entitled to vote,
   may call an extraordinary general meeting.
   The Company Law Board* may give such ancillary or consequential directions as it thinks fit. Such a direction may state that one member of the company present in person or by proxy *shall be deemed to constitute a meeting*.
   The term "*impracticable*" means impracticable from a *reasonable point of view*. The holding of a meeting is impracticable where, for example, the registered office of a company is not made available. [*Ruttonji & Co. Ltd.* . The Company Law Board's* order may prescribe the business to be transacted at the extraordinary general meeting. *Baptist Church Trust Assn.* v. *Member Company Law Board*

Adjournment of meetings

1. A duly convened meeting *may be adjourned* by the chairman only with the consent of the members and *shall* adjourn a meeting if so decided by the members.
2. If a meeting is adjourned *sine-die* or for a period of 30 days or more, a notice for the same *shall* be given in the same way as notice for original meeting is given.
3. If a meeting is adjourned for a period of less than 30 days, in the case of listed companies with more than 5,000 members, Notice thereof specifying the day, date, time and venue of the meeting should be published immediately in a newspaper having a wide circulation within such states of India where more than 1,000 members reside.
4. Only the *unfinished business* of the original meeting can be taken up at the adjourned meeting.

Requisites of a valid meeting

A meeting of a company can validly transact any business if the following requirements are met:

1. **Proper authority**

   The meeting must be *duly convened* by a proper authority. The proper authority to convene a general meeting is the Board of directors. The Board of its own accord or on the requisition of members should, either at a meeting of the Board or by passing a resolution by circulation, convenes or authorise the convening of a general meeting.

   If, on a requisition having been made in this behalf, the Board fails to call a meeting, the requisitionists may themselves call the meeting in the same manner, as nearly as possible, as that in which meetings are to be called by the Board. The Board should pass a resolution to call a general meeting.

2. **Notice of meeting** (Sec. 172)

   Notice of every meeting of a company shall be given to:

   (*a*) every member of the company entitled to vote;
   (*b*) the persons on whom the shares of any deceased or insolvent persons may have devolved;
   (*c*) the auditors of the company.

   Notes: 1. In the case of joint-shareholders, the notice should be given to the person whose name appears first in the register of members or in the records of the depository, as the case may be.

   2. In case of insolvency of a member, the notice should be sent to the assignees of the insolvent or the person entitled to a share in consequence of the insolvency of a member.

   3. The '*accidental omission*' to give notice to, or the non-receipt of notice by, any member or other person to whom it should be given shall *not* invalidate the proceedings at the meeting.

   The term '*accidental omission*' means that the omission should *not* be deliberate. The company has to *prove* that the notice has been despatched to the address given by members. The non-receipt of the notice by members shall not invalidate the proceedings at the meeting.

   A general meeting may be called by giving *not less than* 21 days' notice in writing to the members. A general meeting may be called by less than 21 days' notice if it is so agreed:

   (*a*) In the case of an annual general meeting, by all the members *entitled to vote* thereat;
   (*b*) In the case of any other meeting of:
      (*i*) a company having a share capital, by members holding *at least* 95 per cent of the paid-up share capital as gives them a right to vote;
      (*ii*) in a company not having share capital, by members having *at least* 95 per cent of the voting power exercisable at the meeting.

   Note: Consent for shorter notice may be given *before or at* the meeting.

3. **Quorum** (Sec. 174)

   If the Articles of a company do *not* provide for a *larger quorum*,

   (*a*) five members *personally* present in the case of a public company; and
   (*b*) two in the case of any other company constitute the quorum.

4. **Chairman of the meeting** (Sec. 175)

   A chairman is necessary to conduct the proceedings at a meeting. He is the *presiding officer* of the company. He is *responsible* for keeping order and conducting the meeting. He is the *proper person* to put motions to the meeting, count the votes, *declare* the result and *authenticate* the minutes by his signature.

5. **Minutes of the meeting** (Sec. 193)

   Every company *shall* keep a record of all proceedings of every general meeting. This is done by making within 30 days of the conclusion of every such meeting concerned, entries of the proceedings in the books, known as *minutes books* kept for that purpose.

   The pages of every minutes book shall be *consecutively* numbered. Each page of the minutes book shall be *initialled or signed* by the chairman of the same meeting or the next succeeding meeting. The last page of the record of the proceedings of each meeting in minutes book shall be *dated* and *signed*.

   The minutes book containing the minutes of the proceedings of any general meeting of a company shall be:

   (*a*) kept at the registered office of the company; and
   (*b*) open during *business hours* for the inspection of any member.

   Any member shall be entitled to be furnished, within 7 days after he has made a request in that behalf to the company, with a copy of any minutes on payment of prescribed fee.

   If any such inspection is *refused*, or if any such copy is not furnished within the time specified therein,

   - the company; and
   - every officer of the company who is in default

   shall be punishable with fine upto Rs. 5,000 for each such offence.

   In the case of any such refusal or default, the Company Law Board* may, by order, compel an immediate inspection of the minute books or direct that the copy required shall forthwith be sent to the person requiring it.

   Note: A shareholder has no right of inspection or of obtaining copies of the minutes of its Board meetings.

Evidentiary value of the minutes

According to Sec. 194, minutes of meetings kept in accordance with the provisions of Sec. 193 shall be *evidence* of the proceedings recorded therein and shall be *conclusive* of the facts stated therein.

Kerr v. Jon Mottram, Ltd.

An extraordinary general meeting of a company was summoned in order to offer for sale to the members shares over which the company had a lien. The plaintiff claimed that he was the highest bidder for a block of shares and, therefore, there was a contract for the sale of such shares. The minutes of the meeting did not show that any such contract was entered into. *Held*, the minutes were conclusive evidence of the facts stated.

Presumptions to be drawn where minutes duly drawn and signed (Sec. 195). Where minutes of the proceedings of any general meeting of a company or of any meeting of its Board of directors or of a committee of the Board have been kept in accordance with the provisions of Sec. 193, the meeting *shall be* deemed to have been duly called and held, until the contrary is proved. The proceedings at the meeting *shall* also be deemed to have duly taken place, and in particular, all appointments of directors or liquidators made at the meeting *shall be deemed to be valid*.

Quorum (Sec. 174)

1. 'Quorum' means the *minimum number* of members who must be present in order to constitute a valid meeting and transact business thereat.
2. *If the Articles of a company do not provide for a larger quorum*, the following rules apply:
   (*a*) *Five members personally present* in the case of a public company and *two* in the case of any other company, shall constitute the quorum.
   For the purposes of quorum a person may be *counted* as two or more members if he *holds* shares in different capacities, *e.g.*, as a trustee and also in his own right.
   The authorised representative of:
   (*i*) a body corporate,
   (*ii*) the President of India,
   (*iii*) the Governor of a State,
   is a *member personally present* for the purpose of a quorum. The quorum requirement of *five* members in the case of a public company will be fulfilled where a person acting as an authorised representative of *five* bodies corporate is present in the meeting along with another member *personally present*.
   (*b*) If within *half an hour* from the time appointed for holding a meeting of a company, a quorum is not present, the meeting, if called upon the requisition of members, shall stand *dissolved*.
   If the chairman came half an hour later then the time fixed for the meeting and he called the meeting to order and the quorum was complete on his arrival, the Court held that there was no infirmity in the meeting *Janaki Printers P. Ltd. v. Nadar Press Ltd.*

   (*c*) In any other case, the meeting shall stand *adjourned* to same day in the next week, at the same time and place, or to such other day and at such other time and place as the Board may determine.
   (*d*) If at the *adjourned meeting* also, a quorum is not present *within half an hour* from the time appointed for holding the meeting, the members present shall be the *quorum*.

Notes:
1. The word '*personally*' implies that a proxy will *not* be counted for the purposes of quorum.
2. A quorum is always presumed to be there *unless* it is *questioned* at the meeting.
3. The *presence* of a director who is *not a* member *cannot* be counted for the purpose of quorum.
4. Joint shareholders are collectively regarded as one shareholder for the purposes of the quorum.
5. Where two or more corporate members are represented by a single individual, each of the corporate member will be treated as member *personally persent*.
6. Preference shareholders, as a rule, are not to be counted as *members* for determining quorum except for which they have right to vote under the Act.
7. Under the General Clauses Act, singular *includes* plural and *vice versa*.

One person quorum

The word 'meeting' *prima facie* means a coming together of more than one person. Strictly speaking, therefore, *one shareholder cannot constitute a meeting*. This is known as Rule in *Sharp v. Dawes*.

Sharp v. Dawes

A general meeting of a company was called for the purpose of making a call. Only one shareholder attended the meeting. The business of the company was carried through including a call on the shareholders. *D* was sued for the call he had failed to pay. In his defence, *D* argued that the call had not been *validly made* at a general meeting. *Held, one person could not constitute a meeting*.

Exceptions. In the following cases, one person *may* constitute a meeting:

(*a*) Where there is a *class* meeting of the shareholders of a company and all the shares of that class (*e.g.*, preference shares) are held by one person. If the rights of preference shareholders are directly effected, their presence *should* be taken into account for the purposes of the quorum.

(*b*) Where the Company Law Board* *calls or directs the calling* of an annual general meeting under Sec. 167, it has the *power to direct* that one member:
  (*i*) present in person, or
  (*ii*) by proxy
  shall *constitute* the meeting.

(*c*) Where the Company Law Board* *orders a meeting* of a company (other than the annual general meeting) under Sec. 186 to be held, it *may* direct that even one member of the company:
  (*i*) present in person, or
  (*ii*) by proxy,
  shall *constitute* the meeting.

(*d*) Where the Board of directors delegates, subject to the provisions of the Act, any of its powers to a committee, the committee may consist of one person. In such a case, that person shall constitute the quorum.

(*e*) Where a quorum is not present at a general meeting within half an hour of the meeting, the *meeting* shall stand *adjourned* to the same day in the next week at the same time and place.
  If at the *adjourned meeting* also a quorum is not present within half an hour of the time of the meeting, the members present are the quorum. In such a case, even one member may constitute the meeting.

Proxy (Sec. 176)

1. A proxy is an authority to *represent* and *vote* for another person at a meeting. It is also an instrument appointing a person as proxy. The person so appointed is also called a proxy.
   If a company has adopted its own proxy form and requires its members to use only that form, it was held that even then the members use the form prescribed by Schedule IX of the Act. [*General Commerce* v. *Apparel Export Council*
2. The proxy *may or may not* be a member of the company but he shall not have any *right to speak* at the meeting.
3. The proxy shall:
   (*a*) be in *writing*; and
   (*b*) be *signed* by the appointer or his duly authorised attorney.
   Notes: 1. A proxy form should be either in the form specified in the Articles or in any of the forms prescribed in the Act.
   2. A proxy form is *valid* only if it is properly *stamped*.
4. A proxy *shall be deposited* with the company *forty-eight hours* before the meeting. Any provision in the Articles of a public company or of a private company which is a subsidiary of a public company which requires a *longer* period than *forty-eight hours* before a meeting of the company for depositing a proxy, shall have effect as if a period of *forty-eight hours* had been specified for such deposit.
5. *Unless the Articles otherwise provide:*
   (*a*) a proxy can *vote* only on a poll.
   (*b*) a member of a private company *cannot appoint* more than one proxy to attend on the same occasion.
   (*c*) a member of a company *not* having a share capital cannot appoint a proxy.
6. Proxy is *revocable*. The right of *revocation* can, however, be exercised *before the proxy has voted*. Where a shareholder who having appointed a proxy personally attends and votes at the meeting, the proxy is revoked thereby, and he can vote in person.
   If a proxy has been appointed for the *original meeting* and such meeting is *adjourned*, any proxy given for the adjourned meeting *revokes* the proxy given for the original meeting.
7. The *death or insanity* of a shareholder after he has appointed a proxy *shall not* revoke the authority of the proxy, until the company has notice of the death or insanity.
8. Every notice calling a meeting of a company shall mention with reasonable prominence that a member *can appoint a proxy* and that a *proxy need not be a member*.
   If default is made in complying with this provision, *every officer of the company who is in default* shall be punishable with fine which may extend to Rs. 5,000. [The Companies (Amendment) Act, 2000 has raised the maximum amount of penalty from Rs. 500 to Rs. 5,000].
9. A member is entitled to inspect the proxies lodged at any time during the *business hours* of the company. This can be done any time during the period beginning *twenty-four hours* before the meeting and till the conclusion of the meeting. A *three days'* notice for the inspection of the proxies is required to be given to the company.
   The Delhi High Court has given landmark ruling in *Swadeshi Polytex Ltd.*, Re (1988) 63 Comp. Cas. 709, in which it has said that there is nothing wrong with the practice of blank proxy forms.
10. *Blank and Incomplete Proxies:* A proxy form which does not state the name of the proxy should not be considered valid. If a company recieves multiple proxies for the same holdings of a member, which either not dated or bear the same date without specific mention of time, all such multiple proxies should be treated as invalid.

Methods of voting

(1) The voting on a motion proposed in a general meeting of a company may be:

I. by a show of hands, or

II. by taking a poll.

I. Voting by a show of hands (Secs. 177 and 178). Every resolution should, in the first instance, be put to vote on a show of hands. A member present in person or by proxy has only *one* vote *irrespective* of the number of shares held. In taking a vote by show of hands, the duty of the chairman is to count the hands raised and to declare the result accordingly, without regard to the number of votes that a member raising the hand possesses.

Note: Unless the Articles otherwise provide, a proxy cannot vote on a show of hands.

Chairman's declaration of result of voting by a show of hands conclusive (Sec. 178)]. A declaration by the chairman as evidenced by an entry in the minutes books shall be conclusive evidence of the fact that a resolution has, on a show of hands, been carried.

II. Poll (Sec. 179)

1. (*a*) If the members are *dissatisfied* with the result of voting by a *show of hands*, they may *demand* a poll. A member present in person or by proxy shall, on a poll, have votes in proportion to his share of the paid-up equity capital of the company.
   While a proxy cannot speak at the meeting, he has the right to demand or join in the demand for a poll.
   (*b*) Unless a poll is demanded, voting is to be done by a show of hands of persons present.
2. The chairman of the meeting is *bound* to order a poll when it is *demanded*:
   (*a*) In the case of a public company having a share capital, by members having:
   (*i*) *at least* one-tenth of the total voting power in respect of the resolution, or
   (*ii*) *at least* Rs. 50,000 of paid-up capital.
   (*b*) In the case of a private company having a share capital by:
   (*i*) one member present in person or by proxy if *not more than seven such members* are personally present, and
   (*ii*) two such members present in person or by proxy if *more than seven such members* are personally present.
   (*c*) In the case of *any* other company, by members having at least one-tenth of the total voting power in respect of the resolution.

   Note: If the Articles so provide, the chairman shall have a casting or second vote.
3. The demand for a poll may be *withdrawn* at any time by the person or persons who made the demand.
4. (*a*) A poll *demanded* on a question of
   (*i*) adjournment; or
   (*ii*) the appointment of the chairman;
   shall be taken forthwith.
   (*b*) A poll demanded on any other question (*other than* adjournment or the appointment of the chairman) shall be taken within *forty-eight* hours of the demand for poll.
5. In the case of a poll which is not taken forthwith, the chairman should announce at the meeting the date, venue and time of taking the poll to enable members to have adequate and convenient opportunity to exercise their vote.
6. The member who did *not* attend the meeting can participate and vote in the poll.
7. Each resolution on which a poll is demanded should be put to vote *separately*.
8. On a poll taken at meeting of a company, a member entitled to more than one vote, or his proxy or other person entitled to vote for him, as the case may be, need *not use all his votes in the same way*.

Resolutions

There are three kinds of resolutions which may be passed in a general meeting under the Companies Act, 1956. These are as follows:

1. Ordinary resolutions,
2. Special resolutions,
3. (Ordinary) resolutions requiring special notice.

1. Ordinary resolution [Sec. 189(1)]

An ordinary resolution is a resolution passed at a general meeting of a company by a *simple majority of votes*. The votes may be cast by members—

(*a*) in person, or

(*b*) by proxy, where proxies are allowed.

Unless

– the Companies Act; or

– the Memorandum of Association; or

– the Articles of Association;

expressly require a special resolution or resolution requiring special notice, an ordinary resolution is *sufficient* to *carry* out any matter.

Matters requiring ordinary resolution. Some of the important matters requiring ordinary resolutions are as follows:

(*i*) Issue of shares at a discount (Sec. 79).

(*ii*) Alteration of share capital (Sec. 94).

(*iii*) Adoption of statutory report (Sec. 165).

(*iv*) Adoption of profit and loss account, balance sheet along with report of Board of directors and auditors (Sec. 210).

(*v*) Appointment of auditors and fixation of their remuneration (Sec. 224).

(*vi*) Appointment of first directors who are liable to retire by rotation (Sec. 255).
(*vii*) Appointment of managing director (Sec. 269).
(*viii*) Removal of a director before the expiry of his term (Sec. 284).
(*ix*) Approval of appointment of sole selling agent (Sec. 294).
(*x*) Winding up a company voluntarily in certain cases [Sec. 484(1)].

2. **Special resolution** [Sec. 189(2)]
A resolution is a special resolution which is passed by a majority of three-fourths of the votes of the members present in a meeting. A special resolution must satisfy the following conditions:
(*a*) The *intention* to propose the resolution as a special resolution has been duly *specified* in the notice calling the general meeting.
(*b*) The *notice* has been *duly given* of the general meeting.
(*c*) The votes cast in favour of the resolution by members entitled to vote are *at least 3 times* the number of votes cast against the resolution by members.
(*d*) An *explanatory statement* setting out all material facts concerning the subject-matter of the special resolution, has been annexed to the notice of the meeting.
Matters requiring special resolution. The following matters shall require passing of a special resolution:
(*i*) Alteration of objects clause or registered office clause (Sec. 17).
(*ii*) Change of name of a company with the consent of the Central Government (Sec. 21).
(*iii*) Change of name of a charitable or other non-profit company by omitting the word or words 'Limited' or 'Private Limited' (Sec. 25).
(*iv*) Alteration of the Articles of a company (Sec. 31).
(*v*) Creation of reserve capital (Sec. 99).
(*vi*) Reduction of share capital (Sec. 100).
(*vii*) Payment of interest out of capital (Sec. 208).
(*viii*) Appointment of an inspector for investigating a company's affairs (Sec. 235).
(*ix*) Applying to the Court* to wind up a company [(Sec. 433 (*a*)].
(*x*) Winding up a company voluntarily [Sec. 484(1) (*b*)].

3. **Resolutions requiring a special notice** (Sec. 190)
A resolution requiring a special notice is only a different kind of an ordinary resolution of which notice to move a resolution has to be given to the company by the proposer. The notice shall be given *at least* 14 days before the meeting at which the resolution is to be moved exclusive:
(*i*) of the day on which the notice is served, and
(*ii*) the day of the meeting.
The company shall, immediately after the notice of the intention to move any such resolution has been received by it, give its members notice of the resolution in the same manner as it gives notice of the meeting.
If that is not practicable, it shall give members notice by advertisement in a newspaper having an appropriate circulation or in any other mode allowed by the Articles, at least 7 days before the meeting.
Matters requiring resolution with a special notice. The following matters shall require passing of a resolution with special notice:
(*i*) Appointment of an auditor *other than the retiring one* (Sec. 225).
(*ii*) Provision that a retiring auditor shall not be reappointed (Sec. 225).
(*iii*) Removal of a director before the expiry of his term (Sec. 284).
(*iv*) Appointment of a director in place of one who is removed (Sec. 284).
The Articles of a company may provide for *additional matters* in respect of which special notice is required.

Passing of resolutions by postal ballot (Sec. 192-A)
Rationale of postal ballot. As the shareholders of any large public listed company are scattered throughout the length and breadth of the country, they are unable to physically attend the general meetings of the company to exercise the right to vote on matters of vital importance. The system of voting by proxy has not proved very effective.
With a view to strengthening shareholders democracy, it is felt that all the shareholders of a company should be given the right to vote on certain critical matters through a postal ballot system.
The concept of passing of resolutions in general meeting by postal ballot has for the first time been introduced by the Companies (Amendment) Act, 2000.
Its *salient features* are as follows:

1. A *listed* public company *shall* get a resolution (relating to such business as may be notified by the Central Government) passed by means of a postal ballot, *instead of transacting the business in general meeting of the company*. Some of the important matters requiring passing of resolution by postal ballot are listed below :
(*a*) Alteration in the objects clause;
(*b*) Alteration of Articles;
(*c*) Buy back of own shares;
(*d*) Issue of equity shares with differential voting rights;
(*e*) Change in place of registered office;
(*f*) Sale of undertaking;
(*g*) Election of director; *etc.*
2. Where a company *decides* to pass any resolution by resorting to *postal ballot*—
(*a*) it *shall send* a *notice* to all the shareholders, alongwith a draft resolution *explaining the reasons* therefor; and
(*b*) *requesting them* to send their *assent* or *dissent* in writing on a postal ballot within a period of 30 days from the date of posting of the letter.

Note: There is *no* option on the part of the company to decide not to pass resolutions by postal ballot.

3. The notice *shall be* sent by
   (*a*) *registered post* acknowledgement due; or
   (*b*) *under postal certificate.*
4. Such a notice *shall* include a *postage pre-paid envelope.*
5. If a resolution is *assented* to by a requisite majority of the shareholders by means of postal ballot, it shall be *deemed to have been duly passed* at a general meeting.
6. If a shareholder sends his *assent or dissent* in writing on a postal ballot and thereafter any person *fraudulently defaces or destroys the ballot paper* or declaration of identity of the shareholder, such person shall be *punishable* with
   (*a*) imprisonment for a term which may extend to 6 months; or
   (*b*) fine; or
   (*c*) both.
7. If a *default* is made in complying with provisions of Sec. 192-A,
   (*a*) the company, and
   (*b*) every officer of the company who is in default,
   shall be *punishable* with fine which may extend to Rs. 50,000 in respect of *each such default.*
   Explanation. For the purpose of this section, postal ballot *includes voting by electronic mode.*

Circulation of members' resolutions (Sec. 188)

1. The Board of directors of a company usually decides what resolutions are to be moved at the general meeting of the company. At times, members may desire to move a resolution at the general meeting.
2. The members *shall* serve a requisition on the company. The requisition *shall* be signed by —
   (*a*) members representing *at least* one-twentieth of the total voting power of all the members having the right to vote on the resolution;
   (*b*) 100 members having the right to vote and who hold shares of the value of *at least* Rs. 1,00,000.
3. After *receiving* the requisition, the company *shall* give to the members notice of any resolution which may properly be moved and is intended to be moved at the meeting.
4. It *shall* also *circulate* to the members any statement of *not more than* 1,000 words with respect to the *matter* referred to in any proposed resolution.
5. The company is *not* bound to give notice of any resolution or to circulate any statement *unless* —
   (*a*) a copy of such requisition is deposited at the registered office of the company —
      (*i*) in the case of a requisition requiring notice of a resolution, *at least* 6 weeks before the meeting; and
      (*ii*) in the case of any other requisition *at least* 2 weeks before the meeting; and
   (*b*) a sum reasonably *sufficient* to meet the company's expenses in giving effect there to is deposited with the requisition.
6. The company is *not* bound to circulate any statement if
   (*a*) The Company Law Board* is *satisfied* that the *right* of circulation of statement is being abused to secure *needless publicity* for a defamatory matter.
   (*b*) The Board of directors of a banking company *feels* that the circulation of the statement *shall* be *injurious* to the interest of the company.

Registration of resolutions and agreements (Sec. 192)

Following resolutions and agreements are *required* to be registered with the Registrar of Companies:

1. special resolution;
2. resolutions which have been *agreed* to by *all the members* of the company, but which, in the absence of such an agreement *would have* to be passed as *special resolutions;*
3. any *resolution* of the Board of directors of a company or agreement *executed* by a company relating to the *appointment* of a managing director or *variation* of its terms;
4. resolutions or agreements which have been *approved* by *all* the members of a class of shareholders, but which *would* have *otherwise required* to be passed by a majority vote and resolutions or agreements which *bind* all the *members* of a class of shareholders though *not* agreed to by all those members;
5. resolutions passed by a company giving powers to the Board of directors
   (*a*) to *sell, lease or otherwise dispose of the whole* or *substantially* the whole of the undertaking;
   (*b*) to borrow money *beyond* a certain limit; or
   (*c*) to contribute to charities *beyond*
      - Rs. 50,000; or
      - 5% of company's average net profits for the last three years,
      whichever is greater.
6. resolutions approving the appointment of a sole selling agent;
7. resolutions requiring a company to be wound up voluntarily; and
8. copies of the terms and conditions of appointment of a sole selling agent appointed under Sec. 294 or Sec. 294-AA.
   Such resolutions or agreements *shall* be filed with the Registrar within 30 days. The *copy* to be filed must be duly *certified* under the signature of an *officer* of the company.

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ICWAI - Group III (New Syllabus)
Corporate Laws
Topic: Board of Directors – Basics, Appointment & Removal

1. Who is a Director? Bring out the need for having Directors.

1. Definition:

(a) Meaning [Sec. 2(13)]: Director includes any person occupying the position of Director, by whatever name called. The definition is function-based, and hence any person who functions as a Director shall be included within this definition.

(b) Deemed Director (or Shadow Director):
- Sec 254: Subject to regulations in the AOA, and until Directors are appointed u/s 255, the individuals who are Subscribers to MOA will be deemed to be Directors.
- Sec 303 and 307: Any person in accordance with whose directions or instructions the Board of Directors of a Company is accustomed to act, is deemed to be a Director of the Company.

(c) Exception to Deemed Directors: When the Board acts on the advice given by a person in his professional capacity, such person shall not be deemed to be a Director. [Sec.7].

Example:
Professional Advisors like Chartered Accountant, Management Consultant, Solicitors, etc. are not deemed to be Directors, for that reason alone.

Criterion to determine whether a person is a Director or not, is based on the nature of his office, functions performed and the duties discharged by him and not the official title he carries.	Forest of Dean Coal Mining Co.

2. **Need for having Director:**

Basis	Need
Artificial Person – Incapable of acting by itself	(a) Company is a Legal Person, but an **artificial** person. A Company has a legal entity on its own, but is invisible, intangible and exists only as per Law. (b) It is not a natural person and cannot act by itself. It has to depend upon some human agency to act in its name, which may be its Members (Owners) and Directors (Management).
Separate Owner and Management	(a) Members do not posses any inherent right to participate in or any expertise to manage the affairs of the Company. (b) A large number of Members makes it impossible to assign the duty to manage the Company in their hands. Hence, there is a need for a specialized body of persons, as the Directors, who are appointed by the Members.
Statutory Requirement	Every Public Company should have a minimum of 3 Directors and every Private Company should have a minimum of 2 Directors. **[Sec.252]**

2. Write short notes on – (1) Executive Directors, and (2) Non–Executive Directors.

Executive Director	Non–Executive Director
These are Directors who are in the employment of the Company.	These Directors are not in employment of the Company.
They are also called as **Inside Directors**. They are very closely connected with the day–to–day affairs of the Company.	They are also called as **Part Time Directors** or Outside Directors. They are not appointed to work full time and are not intimately connected with the Company's day–to–day affairs.
Example: Whole Time Director (WTD), Managing Director (MD).	**Example:** Professional Directors, Nominee Directors.
They have a thorough knowledge about the business and are connected with the policy formulation.	They have a diverse experience and knowledge and provide independent thinking and perspective to the Company Management.

3. Explain the term "Board of Directors".

1. **Meaning [Sec. 252(3)]:** The Directors of a Company are collectively referred to as Board of Directors.
   (a) "Board of Directors" means a duly constituted body for controlling and supervising the activities of affairs of the Company. Board of Directors is the directing mind and will of the Company.
   (b) The terms "Board of Directors", "Directors" and "Board" are synonymous, and can be used interchangeably.

2. **Power:** The Board is entrusted with the power of management and control of the affairs of the Company. It is entitled to exercise all such powers as the Company is authorized to exercise.

3. **Functions:** The Board is in charge of direction, control, management and superintendence of the affairs of the Company. It formulates the general policy of the Company, establishes the organizational set up for implementing these policies, and directs its affairs to achieve the objectives laid down by it. The success of the Company depends on the efficient functioning of the Board.

4. Explain the legal position of Directors in a Company.

1. Agents:

Basis	• The Company can **act only through Directors**, and so the relationship between the Company and the Director is that of **principal and agent**. • Hence, **contract entered** into by a person as a Director of a Company, will be **binding on that Company**. • However, Directors are **not Agents of Members** of the Company.
Personal Liability of Directors	Directors are **personally liable** under the following circumstances – • Director acts in his **own name**, • Director contracts on behalf of the Company **without using the words Limited or Private Limited**, as a part of the name of the Company, • Director enters into an agreement / contract which **does not state clearly** as to whether the Director is signing in his personal capacity or in his representative capacity as an agent of the Company
Rights of Company	• Contract executed by the Director in **excess of his authority**, is **binding** on the Company. However, the Company may **claim damages** from the Director for breach of implied warranty of authority. • When Directors **act properly** on behalf of the Company, they **do not incur personal liability**, if they do not exceed their powers.

2. **Trustees:**

Basis	• Office of the Director is an office of Trust. The Director stands in a fiduciary relationship with the Company. • Directors are Trustees of the money and property of the Company, and also of the powers conferred on them. • They must perform their duties in the best interest of the Company.
Trustees of Money and Property	• Money and the property of the Company must be applied for genuine purposes and also in the best interest of the Company. • Misapplication of property or money constitutes breach of trust for which Directors are liable to make good the loss.
Trustees of Powers	• Directors are required to exercise their powers for bonafide purposes, and for the benefit of the Company as a whole. • Powers should not be put to use to promote their private interests. They are also required to ensure that they are not in a position where their duties and personal interests are in conflict. **[Piercy vs S Mills & Co Ltd]** • Directors are liable to make good the loss to the Company, caused as a result of their misuse of Company's assets, secret information, their fiduciary position, etc.

3. **Employee:** Directors are **employees,** if they are in the service or employment of the Company.

4. **Officers:**
   (a) Directors are also the Officers of the Company. **[Sec.2(30)]**
   (b) This is irrespective of whether or not the Director is in employment or not. i.e. Executive Directors and Non–Executive Directors, both are considered as Officers of the Company.
   (c) Whole Time Directors and Managing Directors are covered under the definition of Officer in default.

5. **Managing Partners:**
   (a) Directors may also be considered as Managing Partner(s), since their activities are oriented towards the benefit of themselves and also of the shareholders.
   (b) Their position as Managing Partner arises since they are **appointed** to their office **by an arrangement** between them and other Members.
   (c) However, they do not have all the powers and liabilities of Managing Partners, since generally an **Individual Director has no authority** to act on behalf of the Company. They can act only if such powers are specifically delegated to them.

6. **Shareholders / Members:** Directors are required to hold Qualification Shares in the manner stipulated in the AOA. There is no ban or restriction for Directors holding Shares in the Company.

5. Explain the law relating to minimum and maximum number of Directors in a Company.

1. **Minimum Number of Directors [Sec.252]:** Public Company should have a minimum of 3 Directors. Private Companies must have atleast 2 Directors.

A Company can, by its Articles of Association, provide a higher number to be the minimum strength of the Board. In such cases, a smaller number **cannot** act, and any acts done by them will be invalid.	**Re. Kirk Bell**
Where the AOA provides that remaining Directors can act, notwithstanding vacancies, the smaller number of Directors can validly transact business, even if it is smaller than the minimum as prescribed in AOA.	**Re. Scottish Petroleum Co.**
Business transacted after the number of Directors falls below the **statutory minimum** is **invalid**.	**Re. Sly, Spink & Co.**

2. **Maximum Number of Directors:** The Companies Act has not prescribed any maximum number. The AOA generally specify the maximum number of Directors, in which case the Company should not appoint beyond such number.

6. Outline the procedures and requirements for increase or decrease in the number of Directors. [Sec.258 & 259]

1. **Procedure for Increase:**

Increase in number of Directors

- Within limits fixed by AOA [Sec.258]
  - Initial AOA Limits ≤ 12 / Initial AOA limits > 12
    - Ordinary Resolution
    - No Central Government approval
- Beyond limits specified in AOA
  - Initial AOA limits ≤ 12
    - Special Resolution to amend AOA
    - No Central Govt approval upto 12 Directors
  - Initial AOA limits > 12
    - Special Resolution to amend AOA
    - Prior approval of Central Govt.

Note:
(a) If the appointment is not approved by the Central Government, it becomes **void.**
(b) Central Government approval is not required in the following cases –
- If the Company is in existence on 21.07.1951, and the number of Directors as increased does not exceed maximum number of Directors as per its AOA as on 21.07.1951.
- If the limit fixed by AOA is 12 or less, and proposed increase is upto 12 Directors.
- Increase in number of Directors due to appointment of Additional Directors. **[Sec.260]**
- Private Company.
- Government Company.
- Company formed u/s 25.

2. **Procedure for Decrease:**
   (a) A Company may, by an **Ordinary Resolution,** reduce the number of its Directors within the limits fixed by its AOA.
   (b) Powers u/s 258 cannot be used to remove a Director holding office. Removal of Director can be made only in accordance with provisions of Sec.284. **Example:** Maximum Number of Directors as per AOA = 11. Present No. of Directors holding position = 11. In such cases, a resolution u/s 258 cannot be passed to reduce the number of Directors to 10.

When increase is beyond the limits prescribed by the AOA, the Company should first amend its AOA by passing a Special Resolution.	**Ram Kissen Das Dhanuka vs Satya Charan Law 20 CC 133**
It will not be necessary for the Company to pass a separate resolution increasing the number of Directors before appointing Directors to fill additional sanctioned posts.	**Lalibhai C Kapadia vs Laiji B.Desai 43 CC 17 (Bom)**
A Company cannot be restrained from appointing new Directors because of an agreement between some groups of Shareholders. Shareholders cannot infringe the fiduciary rights and duties of Directors. They cannot dictate terms to the Directors except by amendment of AOA or by removal of Directors.	**Rolta India Ltd vs Venire Industries 1 CLJ 161 (Bom.)**

7. Explain the procedure for increase in number of Directors in the following situations –

Situation	Present no. of Directors on the Board	Max.limit fixed by Articles of Association	Proposed Board Strength
A	6	9	9
B	6	15	15
C	6	9	12
D	6	12	12
E	6	15	18

Situation	Sec.	Procedure
A	258	Ordinary Resolution only, No Central Government Approval.
B	258	Ordinary Resolution only, No Central Government Approval.
C	259 Proviso	Special Resolution to amend AOA. No Central Government Approval.
D	258	Ordinary Resolution only, No Central Government Approval.
E	259	Special Resolution to amend AOA. Prior Central Government Approval.

8. Explain the procedure for decrease in number of Directors in the following situations –

Situation	Present no. of Directors on the Board	Min.limit fixed by AOA	Proposed Board Strength
A	5	5	3
B	3	3	2
C	7 (Only 3 Directors are holding position)	3	5
D	7	5	3

Situation	Procedure
A	Decrease is not possible since this will lead to removal of existing Directors.
B	Decrease below statutory minimum of 3 Directors for Public Company is not permissible.
C	Ordinary Resolution u/s 258 is required.
D	Not permissible u/s 258 since th proposed Board strength is below the AOA Limit.

Note: For decrease in number of Directors, Central Government approval is **not required**.

9. The maximum number of Directors of each of the foll. Companies as per its AOA is 11.
(a) ABS Company Ltd.
(b) DSP Trading (P) Ltd.
(c) Traders Association (A Company registered u/s 25 of the Act).
(d) Hindustan Paper Ltd (A Government Company u/s 617 of the Act).
The Board of Directors of the Company wants to increase the number of Directors to 15. State whether the Directors can do so.

Company	Procedure to be adopted
ABS Company Ltd	For an increase in number of Directors beyond the limit specified in AOA, the Company should – (a) pass a special resolution amending the AOA, and (b) obtain prior approval of the Central Government.
DSP Trading (P) Ltd Traders Association Hindustan Paper Ltd	Sec.259 is **not** applicable. Hence, Central Government approval is not required. So, increase in number of Directors can be made only by passing suitable resolution by the Members of the Company, and complying with other procedural requirements.

10. State whether approval of the Central Government is required in the following case. AOA of a Company provide for a maximum of 11 Directors. At present there are 11 Directors holding position. The AOA have been amended to increase the maximum number of Directors to 13 for appointing X and Y as Additional Directors.

1. Generally the approval of Central Government is **not required** for increase in number of Directors due to appointment of Additional Directors **[Sec.260]**. But the total number of Directors including Additional Directors should not exceed the maximum number of Directors as stated in the AOA.
2. In the given case, the Company seeks to amend its AOA and increase the number of Directors to 13. Hence, Sec.259 applies and Central Government approval is required.
3. If a Company has already appointed the maximum number of Directors as fixed by AOA, the Board cannot exercise its power to appoint Additional Directors since the maximum cannot be exceeded except in accordance with Sec.259.
4. Hence, Central Government approval is required in above case.

11. An individual is not free to take up Directorship of more than a specified number of Companies. Discuss. [Sec.275 – 279]

1. **Maximum number of Directorships:** A person cannot hold office at the same time as –
   (a) Director in more than 15 Companies. **[Sec. 275]**
   (b) Small Shareholders Director in more than 2 Companies.
2. **New Appointments increasing Directorship [Sec.277]:**

Existing Directorship is 15. Appointment *in one more Company.* [Sec 277(1)]	Existing Directorship is less than 15. Fresh appointments in other Companies, taking the total beyond 15. [Sec 277(2)]
(a) New appointment will **not** take effect unless, **within 15 days** of such *appointment, the person* **vacates one** *of* earlier Directorships.	(a) **None** of the new appointments **will take effect** unless within 15 days of the last appointment, the *Director concerned* ***chooses the 15 Directorships*** he wishes to continue.
(b) The new appointment shall be **void after 15 days**, if the Office is not so vacated.	(b) All new appointments will **become void**, if the choice is not so made.

Note: For this purpose, "new appointment" means all appointments during a period of 15 days prior to the date of last appointment.

3. **Transitional provisions [Sec. 276]:** A person holding more than 15 Directorships as on commencement of Companies Amendment Act, 2000 (i.e. 13.12.2000) should within **2 months** –
   (a) Choose 15 Companies in which he wishes to be a Director.
   (b) Resign from other Companies (resignation will be with immediate effect from the date of despatch to the Company concerned)
   (c) Intimate the choice to the ROC of each Company under (a), and also to Central Government.

4. **Directorships excluded from maximum limit [Sec. 278]:** The Directorships in the following Companies are excluded from the ceiling limit of 15 Directorships –
(a) A Private Company which is neither a Subsidiary nor a Holding Company of a Public Company.
(b) An Unlimited Company.
(c) A Company incorporated u/s 25.
(d) Alternate Directorships.
(e) Foreign Companies.
Note: When the Company ceases to be in the exempted category, the Directorships held in these Companies will be included for the purposes of computing the ceiling limit, after the expiry of **3 months** from the date on which the exemption is lost.

5. **Penalty for non-compliance [Sec. 279]:** Any person holding Directorships in more than 15 Companies shall be punishable with a fine upto Rs.50,000 in respect of each Company above 15.

12. **Shyam is a Director in 14 Public Limited Companies as on 30.07.2007. He continues to be so till 24.09.2007. The following Companies appoint Shyam as a Director at their respective AGMs held on dates mentioned against their names.**

Company	Date of AGM
PQR Ltd	29.09.2007
BCD (P) Ltd	25.09.2007
City Traders Association (Sec. 25 Company)	26.09.2007
TSP Ltd	25.09.2007

State the options available to Shyam in respect of accepting or not accepting the appointment of the Directors of the above Companies.

1. **Directorship in Pvt. & Sec. 25 Company:** U/s 278, Directorships in a Private Company or Sec 25 Company is excluded from the maximum limit of 15 Directorships. Therefore, Shyam can accept appointments in BCD (P) Ltd and City Traders Association.

2. **Directorship in Public Companies:**
(a) Acceptance of appointments in PQR Ltd and TSP Ltd will result in holding of more than 15 Directorships by Shyam. Since the time gap between these appointments is less than 15 days, they constitute "new appointments".
(b) U/s 277(2), if the existing Directorship is less than 15 and fresh appointments in other Companies is made, taking the total beyond 15, the Director concerned should **choose the Directorships** he wishes to continue, **within 15 days from the last appointment.** Otherwise, **all new appointments** will become void.
(c) Hence, in the given case Shyam has to choose the Directorships he wishes to continue within 14.10.2007 (i.e. 15 days from date of last appointment, 29.09.2007). Otherwise appointments in both PQR Ltd and TSP Ltd will become void.

Alternative Viewpoint: Shyam's appointment in TSP Ltd will make the total Directorships to 15, which is within the prescribed limits. Hence, it is valid. However, his appointment in PQR Ltd will lead to 16 Directorships. Such appointment in PQR Ltd will become void and ineffective, if Shyam does not decide about which of the two Companies he should choose to continue as Director, within 15 days. [**Note:** The first view specified in the answer is considered more reasonable in the given case.]

13. **Ms. S already holds Directorships in 13 Public Ltd Companies. She was appointed as Director in the following Public Ltd Companies on the dates given below.**

Company	Date of appointment
A Ltd	29.02.2008
B Ltd	10.03.2008
C Ltd	11.03.2008
D Ltd	13.03.2008

A. S did not choose the Directorships as required u/s 277. State the legal implications thereof.
B. What would be the position if the appointment in D Ltd were made on 18.03.2008?
C. What would be the position if the appointment in C Ltd & D Ltd were made on 28.03.2008?

Situation	Analysis and Conclusion
A	1. Appointments in the 4 Companies are **within 15 days period.** Hence they constitute a batch of "new appointments". Sec 277(2) is applicable in this case. 2. All appointments will become void, if the choice is not made u/s 277(2).
B	1. Appointments made in B Ltd, C Ltd and D Ltd (i.e. within 15 days prior to the last date of appointment) constitutes "new appointments". Sec 277(2) is applicable in this case. 2. Appointment in A Ltd is within the ceiling limit and is hence **valid.** Appointment in B, C, D Ltd become void, if the choice is not made u/s 277(2).
C	1. Appointments in A Ltd & B Ltd and the next series of appointments in C Ltd and D Ltd are not a single series of "new appointments", as they are separated by more than 15 days. 2. Appointments in A Ltd & B Ltd are valid, since the ceiling limit of 15 is not exceeded. For appointments in C Ltd and D Ltd, Sec.277(1) is applicable. 3. Appointments in C Ltd and D Ltd will be void if any of the existing Directorships (including A Ltd and B Ltd) is not vacated within 15 days of such appointments.

14. **Who are qualified and disqualified from being appointed as a Director of a Company?**

A. **Qualifications:**
1. The Companies Act does not prescribe any specific educational or other qualifications for appointment as Directors.
2. If the AOA so provides, Qualification Shares must be held in the Company for being appointed as Director. **[Sec.270]**
3. The individual to be appointed should have a Director Identification Number (DIN) u/s 266B.

B. **Disqualifications:**
1. **Firm and Body Corporate [Sec.253]:** Firms, Body Corporate or Association of Persons cannot be appointed as Director. Only an Individual can be appointed as a Director.

Since the Office of the Director is in the nature of Trust, the Director acts in a fiduciary capacity in relation to the Company. Therefore, a Director should be a person who can be held responsible for the failure to carry out that Trust.	**Oriental Metal Pressing Works Pvt. Ltd vs BK Thakur (SC).**

2. **Disqualifications for Individuals [Sec.274]:** A person shall not be capable of being appointed as a Director if –
(a) He is found to be of **unsound mind** by a Court and the finding is in force.
(b) He is an **undischarged insolvent.**
(c) He has **applied to be adjudged as an insolvent** and application is pending.
(d) He has been **convicted by a Court** of an offence involving moral turpitude and sentenced to an imprisonment for a period of **not less than 6 months,** and a period of 5 years has not elapsed from the date of expiry of the sentence.
(e) He has not paid any call in respect of Shares held by him (either singly or jointly with others), and Six months have elapsed since the last day fixed for the payment of the call.

(f) He has been disqualified from appointment as a Director u/s 203 by the Court, i.e. he has been convicted of any offence in connection with the promotion, formation or management of the Company, or in case of a Company being wound–up, he has been found guilty of fraudulent conduct of business or misfeasance in relation to the Company. [However, he may be appointed as Director if the leave of the Court has been obtained for his appointment.]

(g) He is already a Director of a Public Company and that Company has –
(A) **Not filed** its Annual Accounts **and** Annual Returns for continuous 3 financial years, or
(B) **Failed** to –

• **repay** deposit or any interest thereon on due date, or • **redeem** its debentures on due date, or • **pay** dividend.	and such failure continues for a period of 1 year or more

For Point (g) above, the person concerned is disqualified from being appointed as Director of any other **Public Company** for a period of 5 years from the date of failure to file returns / accounts or has failed to repay deposits or interest or redeem debentures, or pay dividend.

[**Note:** Deposit means all deposit of money including Inter–Corporate Deposit, Security Deposit from Employees, etc. and not merely Deposit u/s 58A.]

Note: Disqualification contained in clauses 274(1)(a) to (f) applies to all Companies. Clause (g) applies only to appointment as Director in a Public Company.

C. **Additional disqualifications:**
1. **AOA:** A Private Company which is not a Subsidiary of a Public Company, may impose other additional grounds for disqualification through its AOA.
2. **Minors:** Minor cannot be appointed as a Director of a Company other than a Private Company which is not a Subsidiary of a Public Company.
3. **Ceiling Limit:** A person cannot hold Directorship in more than 15 Companies. [See **Q.No.11** above]
4. **Removal by Central Government:** A person removed from his office u/s 388E by Central Government, shall not be appointed as Director of any Company, for a period of 5 years.

In the absence of specific provisions in Sec 274, a person convicted of an offence involving moral turpitude cannot be appointed as Director pending disposal of appeal. Even if the interim stay of sentence or bail is granted, the person will still be disqualified to be a Director.	**Rama Narang vs Ramesh Narang 4 SCL 150 (SC)**

15. List the situations when disqualifications u/s 274(1) does not apply.

Clause	Nature of Disqualification	Person becomes qualified for appointment –
(a)	Unsound Mind	No Exceptions.
(b)	Undischarged Insolvent	
(c)	Application for Insolvency	
(d)	Conviction by Court for Offence involving moral turpitude	• After 5 years from date of expiry of sentence. • If Central Government removes the disqualification by Notification, either generally or in relation to any specified Company(ies). • If Central Government removes the disqualification of any person(s), by Notification in Official Gazette.
(e)	Non–payment of Calls	If Central Government removes the disqualification of any person(s) by Notification in Official Gazette.
(f)	Disqualified u/s 203 by Court Order	If leave of the Court is obtained for appointment.
(g)	Non–filing of Accounts, Returns, etc.	Refer **Q.No.18**, also see **Table in Q.No.19.**

16. Explain the effective date of disqualification u/s 274(1)(g).

Clause	Disqualification with effect from	Persons Disqualified
(A)	Last due date for filing Annual Accounts & Returns for any 3 continuous financial years.	All Directors on such due date.
(B)	Expiry of 1 year from the due date of repayment / redemption / payment.	All Directors of the relevant year, from the due date, to the expiry of 1 year from the due date.

Illustration:

(A) Last Date for filing Annual Accounts & Returns for the years ended 31.03.2006, 31.03.2007 and 31.03.2008 is 31.10.2008. All Directors holding office on 31.10.2008 will be disqualified from that date.

(B) Due date for redemption of debentures is 31.03.2007 on which A, B, C are Directors. Disqualification u/s 274(1)(g)(B) applies only if the failure continues for 1 year or more, i.e on or after 31.03.2008. So, Directors can be appointed during the period 01.04.2008 to 31.03.2008. Say, D & E are appointed as Directors during this period, all 5 Directors stand disqualified from 31.03.2008. D & E, though not Directors on the due date, still become disqualified because of continuation of failure.

17. Highlight the exceptions to disqualification contained in Sec 274(1)(g).

Exception to disqualification u/s 274(1)(g) is available in the following cases –

1. Nominee Directors **appointed by Public Financial Institutions** (PFI) and **Companies established under the Acts of Parliament** having non–obstante provisions over the Companies Act. **Example:** IDBI, LIC, UTI, etc, in their respective statutes shall not be liable to be disqualified for appointment as Directors by virtue of Sec 274(1)(g) of Companies Act.	**Cir.8 / 2002 dated 22.03.2001**
2. Nominee Directors appointed on the Boards of **assisted concerns or other Public Companies** by – (a) Public Financial Institutions as defined u/s 4A, (b) Central or State Government, and (c) Banking Companies.	**Cir.8 / 2002 dated 22.03.2001**
3. **Directors of Government Companies** and **Small Shareholders' Directors** are exempted from the applicability of Sec.274(1)(g).	**Notifn GSR 829(E) dated 21.10.2003**
4. Default of **Privately Placed Bonds** / Debentures/Debt instruments by Public Financial Institutions will **not** be considered as default to disqualify Directors u/s 274(1)(g).	**F.No. 2 / 5 / 2001 – CL.V dated 14.01.2003**

Applicability of disqualification u/s 274(1)(g)

Situation	Existing Directorship	Proposed Directorship	Applicability
I	Public Company	Any other Public Company	Applicable
II	Public Company	Same Public Company	Not applicable
III	Public Company	Private Company	Not Applicable
IV	Private Company	Private Company	Not Applicable
V	Private Company	Public Company	Not Applicable

18. **Summarize the duties of various persons in respect of disqualification u/s 274(1)(g) under Companies (Disqualification of Directors u/s 274(1)(g)) Rules, 2003.**

Persons	Duties, Responsibilities and Penal Provisions
1. Directors	Every Director in a Public Company should file e-Form 'DD-A', before he is appointed or re-appointed.
2. Disqualifying Company, i.e. Company in which default u/s 274(1)(g) has occurred	(a) **Duty:** Within 30 days of failure u/s 274(1)(g), the Company should **file e-Form 'DD-B'** to the ROC, furnishing the names and addresses of all the Directors of the Company during the relevant financial years. (b) **Exclusions:** Names of such Directors, who have been exempted from Sec. 274(1)(g) by the Central Government, shall be excluded. (c) **Conditions:** No unusual abbreviations or short forms shall be used in filling up the e-Form 'DD-B', which shall give such details as may be necessary to distinguish and identify each Director without any ambiguity.
3. Statutory Auditor of Disqualifying Company	(a) To report to the Members, whether any Director is disqualified u/s 274(1)(g). [Sec.227(3)(f)] (b) To furnish a certificate each year as to whether on the basis of his examination of the books and records of the Company, any Director is disqualified for appointment as a Director or not. (c) To report to Members whether during the year, any Director has been disqualified u/s 274(1)(g) from being re-appointed as Director, or being appointed as Director in another Company.
4. Statutory Auditor of Appointing Company	(a) To report to the Members, whether any Director is disqualified u/s 274(1)(g). (b) To furnish a certificate each year as to whether on the basis of his examination of the books and records of the Company, any Director is disqualified for appointment as a Director or not.
5. Registrar of Companies (ROC)	Upon receipt of the e-Form 'DD-B', the ROC should — (a) Immediately **register the document**, (b) Place one copy of it in the document file **for public inspection**, (c) **Forward** the other copy **to the Central Government**.
6. Central Government	(a) **Placing Names in Website:** Central Government shall place the names, addresses and other particulars on the website of the Department of Company Affairs. It may also publicize the names of disqualified Directors in such other manner, as it may consider appropriate. (b) **Updation of Website:** The Central Government shall take steps required to update its web-site to ensure that name of the person, in whose respect disqualification period has expired after 5 years, is deleted from the web-site.

Note: Non Compliance with these Rules renders the Company / other defaulters liable to a fine upto Rs.5,000 and further fine upto Rs.500 per day for continuing contravention.

19. **Can a Company, MRN (P) Ltd appoint Mr. Balak, a Minor as one of its Directors?**

1. **General:** Though the Companies Act does not prohibit appointment of Minors as Directors, they are not qualified to be appointed as Directors since they are **not competent to contract.** A Minor cannot file any valid consent to act as Director u/s 264, either with the Company or with the ROC.
2. **Private Companies:** Sec.264 applies only to Public Companies and their Private Subsidiaries. Therefore, a Private Company which is **not** a subsidiary of a Public Company, **may** appoint Minors as Directors, unless its AOA provide restrictions in this regard.
3. **Conclusion:** In the given case, if MRN (P) Ltd is **not** a Subsidiary of a Public Company, it **may** appoint Mr. Balak as one of its Directors.

20. **The following events take place in ABC Ltd –**

Financial Year	Events
2003 – 2004	Annual Accounts and Returns not filed. Deposits that matured on 20.06.2002 were repaid on 30.06.2003.
2004 – 2005	Annual Accounts and Returns not filed.
2005 – 2006	Annual Accounts and Returns not filed. Defaulted in payment of interest on Debentures.
2006 – 2007	Annual Accounts and Returns for FYs 2003–04, 2004–05, 2005–06 and 2006–07 filed. Interest due on Debentures remitted in full.

1. **State whether the Director of ABC Ltd is disqualified, in case he is proposed to be appointed as Director in PQR Ltd on 15.06.2008.**
2. **Will it make any difference if Annual Accounts for 2005–06 have been filed in time?**
3. **Will your answer change if the appointment is proposed to be made in PQR (P) Ltd?**

Case 1:

1. **Disqualification u/s 274(1)(g)(B):**
   (a) ABC Ltd has repaid its deposits which matured on 20.06.2002 on 30.06.2003, i.e. after the expiry of 1 year from the date of default.
   (b) The disqualification is applicable only for a period of 5 years from the date of default. The disqualification period of 5 years expires on 20.06.2007 (5 years from the date of default i.e. 20.06.2002).
   (c) Default in payment of interest on debentures does not attract disqualification u/s 274(1)(g)(A).
   (d) Hence the Director is **not disqualified** from appointment u/s 274(1)(g)(B).
2. **Disqualification u/s 274(1)(g)(A):**
   (a) In the given case, the Company has defaulted in the filing of both annual accounts **and** annual returns for continuous 3 financial years.
   (b) Belated filing of accounts and returns does not result in rectification of default.
   (c) Therefore, the Director is **disqualified** u/s 274(1)(g)(A).
3. **Conclusion:** Hence, the Director of ABC Ltd **cannot** be appointed as Director in PQR Ltd.

Case 2: Intermittent Filing of Accounts:

1. Disqualification u/s 274(1)(g)(A) is applicable only if there is continuous failure in furnishing both Annual Accounts and Annual Returns for a period of 3 years.
2. If either of them is filed in the intervening period, the disqualification is not attracted.
3. Hence, if the Annual accounts of 2005–06 are filed in time, then the Director will not be subject to disqualification, and he will be **eligible** to be appointed as Director of PQR Ltd.

Case 3: Appointment in Private Company:

1. For applicability of Sec.274(1)(g), the conditions to be satisfied are –
   (a) The person should be **already a Director in a Public Company, and**
   (b) The appointment is proposed to be made in **any other Public Company.**
2. If the appointment is proposed to be made in PQR (P) Ltd, then the disqualifications u/s 274(1)(g) are not applicable.
3. Hence, the Director of ABC Ltd can be **appointed** as Director of PQR (P) Ltd.

21. Krishna, a Director of ABC Ltd made default in filing of Annual Accounts and Annual Returns with the ROC for a continuous period of 3 financial years ending 31st March 2005. Examine the validity of the following:

1. **Can Krishna continue to be a Director of ABC Ltd, and also EF Ltd where he is a Director? Also state whether he can be re–appointed as a Director in ABC Ltd, as well as EF Ltd.**
2. **Would your answer still be the same in case Krishna is a Nominee Director of a Public Financial Institution?**
3. **What would be your answer if the defaulting Company (ABC Ltd) is a Private Company?**

Case	Answer	Remark / Reason
1.	He can continue to be a Director of ABC Ltd or EF Ltd. However, he cannot be re–appointed as Director in EF Ltd.	Disqualification is for appointment in any other Public Company, it will not affect existing appointments.
2.	He may continue / be re–appointed as Director.	Exception applies to Nominee Director PFIs.
3.	He may continue / be re–appointed as Director.	Sec.274(1)(g) applicable only if defaulting Company is a Public Company.

22. State whether the following persons can be appointed as a Director of a Public Company –

1. **Amar, who has huge personal liabilities far in excess of his assets and properties, has applied to the Court for adjudicating him as an insolvent and such application is pending.**
2. **Balu who was caught red handed in a shop lifting case 2 years ago, was convicted by a Court and sentenced to imprisonment for a period of 8 weeks.**
3. **Chandan, a former Bank Executive was convicted by a Court 8 years ago, for embezzlement of funds and sentenced to imprisonment for a period of 1 year.**
4. **Dayal is a Director of DLT Ltd which has not filed its Annual Returns pertaining to the AGMs held in the calendar years 2005, 2006 and 2007.**

Person	Eligibility	Remark / Reason
Amar	Disqualified	An individual who has **applied to be adjudged as an insolvent** and application is pending is not qualified for appointment u/s **274(1)(c).**
Balu	Qualified	• An individual who is convicted by a Court for an offence involving moral turpitude for a period of 6 months or more, is not qualified for appointment u/s 274(1)(d). • Since Balu was sentenced to imprisonment for a period of **less than 6 months** [8 weeks (i.e. 2 months)], he is not subject to disqualification.
Chandan	Qualified	• An individual who is convicted by a Court for an offence involving moral turpitude for a period of 6 months or more, and a period of 5 years has **not lapsed** from the date of expiry of sentence is not qualified for appointment u/s 274(1)(d). • Here, Chandan was sentenced to imprisonment for a period of 1 year (i.e. 6 months or more) but 8 years has lapsed from the date of expiry of sentence. Therefore, he is not subject to disqualification.
Dayal	Qualified	• Director of a Public Company which has not filed its Annual Accounts **and** Annual Returns for continuous 3 financial years is disqualified from appointment as Director in any other Public Company u/s 274(1)(g). • Here, DLT Ltd has not filed its Annual returns for 3 financial years. Disqualification u/s 274(1)(g) is attracted only when both the documents are not filed for 3 continuous financial years. Since DLT Ltd has not furnished its Annual Returns only, Mr. D is not subject to disqualification.

23i. Ram is a Director of ABC Ltd, XYZ Ltd and PQR Ltd. ABC Ltd was regular in filing Annual Returns, but did not file Annual Accounts for the year ended 31.03.2007. Further, ABC Ltd failed to pay interest on loans taken from a Public Financial Institution from 01.01.2007 onwards, and also failed to repay the matured deposits on due date from 01.04.2007 onwards.
Ram is proposed to be appointed as Additional Director of MN Limited on 01.06.2008. MN Ltd has sought a declaration from Ram, to the effect that the disqualification u/s 274(1)(g) is not applicable in his case. Ram seeks your advice on the following –

1. **Whether it is in order for him to give declaration sought by MN Ltd in view of the defaults committed by ABC Ltd?**
2. **Whether he can continue as a Director in XYZ Ltd and PQR Ltd and also seek re-appointment when he retires by rotation at the AGMs of the respective Companies to be held in September 2008.**
3. **Advise Ram on the above. Would your answer be different, if Ram resigned his office of Director in ABC Ltd on 31.12.2007?**

1. **Analysis:**

Default by ABC Ltd	Effect u/s 274(1)(g)	Conclusion
Failure to file annual accounts for the year ended 31.03.2007.	Failure is for 1 year only, and in respect of Annual Accounts only.	Disqualification is **not applicable.**
Failure to pay interest on loan taken from Public Financial institutions from 01.01.2007.	Default is in respect of payment of interest on **loan** (not on Deposits from Financial Institutions)	Disqualification is **not applicable.**
Failure to repay matured deposits from 01.04.2007.	Failure to repay matured deposits for a period of 1 year or more attracts disqualification. Here default continues for more than 1 year. (i.e. from 01.04.2007 to 01.06.2008)	Disqualification is **attracted.**

2. **Conclusion:**
   (a) Since disqualification u/s 274(1)(g) is attracted, Ram **cannot** give the declaration sought by MN Ltd.
   (b) Disqualification u/s 274(1)(g) is in respect of appointment in **any other Public Company**, it does not affect the existing appointments. Hence, he can continue as Director in XYZ Ltd and PQR Ltd. However, he cannot seek re-appointment when he retires by rotation, till the expiry of 5 years from the date of default.

3. **Effect of Resignation from ABC Ltd (i.e. Defaulting Company):**
   (a) If Ram has resigned from his office on 31.12.2007, he does not hold office on the date when the default becomes effective, i.e. 1.4.2008 [1 year from the date of default].
   (b) So Ram will **not** be subject to disqualification u/s 274(1)(g), and he can give the declaration as required by MN Ltd.
   (c) He can also seek re-appointment in XYZ Ltd and PQR Ltd.

24. Lakshmann is the Director of ABC Ltd failed to repay matured deposits from 01.04.2007 onwards and the default continues. But ABC Ltd is regular in filing Annual Accounts and Annual Returns. Lakshmann is also a Director of PQR Ltd and XVZ Ltd. Answer the following questions
   1. Whether Lakshman is disqualified u/s 274(1) (g) and if so, whether he is required to vacate his office of Director in PQR Ltd and XYZ Ltd?
   2. Is it possible for Board of Directors of DSF Ltd to appoint Lakshman as an additional Director at the Board meeting to be held on 15.05.2008? Would your answer be different if Lakshman ceased to be a Director of A8C Ltd, by registration on 01.03.2006?

1. **Disqualification:**
   (a) Lakshman is **disqualified** w.e.f. 01.04.2008 i.e. one year from the date of default in repayment of matured deposits. [Sec 274(1)(g)(B)].
   (b) However, he need not vacate his office of Director in PQR Ltd & XYZ Ltd.
   (c) He can continue till the expiry of his present term of office, but cannot seek re-appointment as Director in PQR Ltd or XYZ Ltd, for a period of 5 years from the date of default by ABC Ltd.

2. **Additional Director:**
   (a) DEF Ltd **cannot** appoint Lakshman as Additional Director on 15.05.2008, since he is disqualified u/s 274(1)(g)(B).
   (b) However, if Lakshman has resigned from Directorship of ABC Ltd on 01.03.2008 itself, disqualification u/s 274(1)(g)(B) does not apply to him.
   - John is **disqualified** w.e.f. 10.04.2008 i.e. one year from the date of default in repayment of matured deposits. [Sec.274(1)(g)(B)].
   - He cannot be appointed as Director of JKL Ltd.

25. **What do you understand by the term "Director Identification Number" (DIN)?**

1. **DIN:** DIN means an Identification Number, which the Central Government may allot to any individual, intending to be appointed as Director or to any existing Directors of a Company, for the purpose of his identification as such. (Note: DIN is in the format of an 8 digit number, for e.g. 02182161).

2. **Application for DIN (Sec. 266A):** To be made to Central Government, in Form DIN-1, by –
   (a) Individual intending to be appointed as Director of a Company, or
   (b) Director appointed before commencement of Companies Amendment Act, 2006 (within 60 days from that date).
   Note: Individual who has been already allotted a DIN u/s 266B should not apply, obtain or possess another DIN **[Sec. 266C]**.

3. **Allotment of DIN [Sec. 266B]:** Within 1 month from the date of receipt of application, the Central Government shall allot a DIN.

4. **Intimation to Companies [Sec. 266D]:** Within 1 month from the receipt of DIN from the Central Government, the Director shall intimate his DIN to all Companies in which he is a Director. Intimation shall be given in Form DIN-2.

5. **Intimation to ROC [Sec. 266E]:** Within 1 week from the date of receipt of intimation from the Director, the Company shall furnish the DIN of all its Directors to the ROC in Form DIN-3.

6. **Quoting DIN [Sec. 266F]:** DIN shall be quoted by every person or Company in any return, information or particulars in relation to the Director or containing any reference to the Director.

7. **Penalty [Sec. 266G]:** Individual, Director or the Company in default shall be punishable with a fine of Rs.5,000. In case of continuing offence, a further fine of Rs.500 for every day after the first day will be attracted.

26. **Describe the procedure to obtain the DIN as enumerated under the Companies Act, 1956 read with the relevant Rules.**

Procedure for obtaining DIN

1. Check whether the computer system through which the DIN application is being made has the requisite hardware and the software as well as the internet facility.
2. Download the DIN Application Form from the website of Ministry of Corporate Affairs, using the Internet facility.
3. Fill up and submit the DIN Application Form **electronically**.
4. Make a note of the **Provisional DIN** which will be generated and displayed on the said Application Form, after electronic submission of the DIN Application.

5. Print the DIN Application Form, and sign and submit the same to the Ministry of Corporate Affairs – DIN Cell along with the following papers / documents –
   (a) **Passport Size Photo** of the Applicant attested by a Magistrate / Notary Public / Practising CA or CS or CWA / Gazetted Officer.
   (b) Attested Copy of any one of the following as a **proof of Identity** – (i) Passport, (ii) Election / Voter Identity Card, (iii) Driving License, (iv) Income Tax PAN Card, (v) Any other document which will prove the Identity of the Applicant.
   (c) Attested copy of any one of the following as a **proof of residence** – (i) Passport, (ii) Election / Voter Identity Card, (iii) Ration Card, (iv) Driving License, (v) Electricity Bill, (vi) Telephone Bill, (vii) Bank Account Statement, (viii) Any other document which will prove the residence of the Applicant.

On submission of the above, the DIN Cell of the Ministry of Corporate Affairs will allot **Final DIN** and send an intimation letter to the Applicant.

27. The AOA of a Company prescribes that Directors acquire Qualification Shares compulsorily. State in such circumstances whether holding of such Shares can be made compulsory? If so, to what extent the AOA can prescribe the limits?

Mr. A has been appointed as a Director in a Public Limited Company. State –
1. Whether the Director should possess any Share Qualification?
2. If so, what is the number of share(s), which he should acquire and at what value?
3. Whether the AOA of the Company can insist on the Director for compulsory acquiring of Share Qualification?

1. **Requirement:** The Companies Act, 1956 does not prescribe for any Share Qualification for being a Director of a Company. However, AOA (Regulation 66 of Table A) provides for holding of **atleast 1 share** in the Company for being its Director.

2. **Applicability:** Provisions relating to Share Qualification of a Director do **not** apply to a Private Company, unless it is Subsidiary of a Public Company. [Sec.273]. However, a Private Company may provide for Share Qualification of Directors in its AOA. In such case, every Director should acquire qualification shares, failing which he has to vacate his office.

3. **Directors – Included and Excluded:**

Included Directors	Excluded
• Additional Director. • Director filling a casual vacancy. • Alternate Director. • Managing Directors and Whole Time Director. • Non–Executive Director	• Directors appointed by the Central Government u/s 408. • Director appointed by BIFR u/s 16 of Sick Industrial Companies (Special Provisions) Act, 1985. • Nominee Director appointed by a Financial Institution established under a Special Act of Parliament by virtue of any overriding provision contained in such Act. • Directors who are not required to hold qualification shares vide any overriding provision contained in AOA. • Small Shareholders' Director.

4. **Time Limit:**
   (a) **2 months [Sec.270]:** Qualification Shares must be acquired within a period of **2 Months** after his appointment as Director.
   (b) **Period lower than 2 Months:** A Director cannot be required to – (i) hold qualification shares before his appointment, or (ii) obtain such shares within a period shorter than 2 months after his appointment. Any such provision in the AOA shall be void.

5. **Amount :**
   (a) **Maximum Amount:** The nominal value of Qualification Shares should not exceed **Rs.5,000.**
   (b) **Per Share > Rs.5,000:** Where the Nominal Value per Share is higher than Rs.5,000, share qualification will be holding of one share only.

6. **Included and Excluded Share Holdings – for Qualification Shares:**

Included Holdings	Excluded Holdings
Unless the AOA provides otherwise, the following Shares are considered for Qualification Shares – (a) Shares **already held** by the Director prior to his appointment. (b) Shares **held** *in joint names* **[Grundy vs Briggs].** (c) **Mortgaged Shares.** [However, if AOA requires unencumbered qualification shares, then Mortgaged Shares will not be considered.] (d) **Beneficial Holding:** AOA may provide that Qualification Shares must be held by a Director in his own right, as a beneficial owner. In the absence of such a provision, beneficial ownership of shares is not necessary. **[Grundy vs. Briggs]** (e) **Shares received as Gift:** Even if the shares are received by way of a secret gift from the Promoters of the Company, which constitutes gross breach of trust on the part of the Director, such Shares will be included for Qualification Shares. (f) **Kinds of Shares:** Any kind of Shares may be obtained for Share Qualification. Holding of Preference Shares would also be a valid compliance. If the AOA provides that a specific type of Shares must be held as Qualification Shares, then that particular kind of shares only, will be included.	Holding of Share Warrants is not considered as holding of Qualification Shares. Share Warrants are not considered at all for determining qualification shares.

7. **Qualification Shares for New Company [Sec.266]:** The requirements u/s 266 in respect of Qualification Shares should also be satisfied. This means that the person concerned should have –
   (a) Signed the MOA for Shares not being less in number or value than that of his Qualification Shares, if any, or
   (b) Taken his Qualification Shares, if any, from the Company and paid or agreed to pay for them, or
   (c) Signed and filed with the ROC, an understanding in writing to take from the Company his Qualification Shares, if any, and pay for them, or
   (d) Made and filed with the ROC, an affidavit to the effect that shares, not being less in number or value than that of his Qualification Shares, if any, are registered in his name.

8. **Consequences of failure to hold Qualification Shares:**
   (a) **Automatic Vacation of Office:** If the Director fails to obtain Qualification Shares within 2 months or at any time thereafter, ceases to hold the Qualification Shares, his office is automatically deemed to be vacated. No notice thereof is required. **[Sec.283(1)]**
   (b) **Penalty for Continuing as Director:** If a person acts as a Director when he knows that Directorship held by him has become vacant, he is punishable with fine of upto Rs.5,000 per day for the period he acts as a Director. **[Sec.283(2A)]**
   (c) **Penalty u/s 272:** A Director acting without Qualification Shares is punishable with fine upto Rs.500 for every day during which he continues as Director. [However, Sec.272 is **not applicable** to a Private Company.]

Director can act for 2 months without possessing the Qualification Shares. If a Director resigns within 2 months without obtaining Share Qualification, he cannot be called as a Contributory, if the Company goes into winding-up. Agreement to be a Director does not imply an agreement to take Shares in the Company of which he is appointed Director.	**Zamir Ahmed vs Dr.D.R Banaji 27 CC 634**
A Company had 3 Member-Directors who held the entire Share Capital. The AOA provided for restriction on transferability of shares. It also required holding of Qualification Shares by the Director. The provision is binding and valid. Non-compliance thereof would result in termination of Directorship of the person appointed.	Aruna Suresh Mehra vs Jifcon Tools (P) Ltd

28. The AOA of DEF Ltd mentioned that X and Y will act as Directors of the Company from the date of incorporation. The Company was incorporated on 2^nd Jan 2008. The AOA also provided that the Directors will have to obtain Qualification Shares within 1 month from the date of appointment as Director. X purchased these shares on 28^th Feb 2008 and Y purchased these shares on 28^th March 2008 thus violating the provisions contained in AOA. Examine the validity of the appointments of X and Y as Directors.

1. AOA stipulating 1 month time limit for acquiring Qualification Shares is **void. [Sec.270(2)]**
2. Directors have to acquire Qualification Shares within 2^nd March 2008. Since Y has not acquired Qualification Shares by that date, he shall be deemed to have vacated his office as such. **[Sec.283]**
3. The appointment of X is not affected, if he has acquired Qualification Shares before 2^nd March 2008.

29. The AOA of MKP Limited incorporated with an Authorised Share Capital of Rs.50 Crores divided into 5 Crores Equity Share of Rs.10 each, contained the following clause: "The Qualification of a Director shall be the holding of atleast 1,000 Equity Shares in the Company and such Director, if not already so qualified, shall have to obtain his qualification within a period of 30 days from the date of his appointment as a Director".
1. Examine the validity of the above clause.
2. Redraft the above clause which would confirm to the provisions of Companies Act.

1. Nominal Value of 1000 Shares of Rs.10 is Rs.10,000. This should be restricted to Rs.5,000, i.e. hence 500 shares of Rs.10 each. Time Limit for acquiring must be 2 months instead of 30 days as given in AOA.
2. **Revised Clause:**
   "The Qualification of the Director shall be the holding of **atleast 500 Equity Shares** in the Company, and such a Director if not already so qualified, shall have to obtain his qualification within a period of 2 **months** from the date of appointment as a Director."

30. In the General Meeting of X Ltd held on 02.05.2008, Anup was appointed as a Director. On that day, he was not holding any Equity Shares in X Ltd. As per the AOA of X Ltd, the Share Qualification is the holding of 500 Equity Shares. On 15.06.2008 Anup applied for 1,000 Equity Shares in X Ltd and the shares were allotted on 10.07.2008. Anup claims that he was holding the Qualification Shares within the time specified in the Act. Comment.

Balu has been appointed as Director of ACE Ltd on 02.04.2008. The AOA of the Company provide that the Qualification of a Director shall be holding of atleast 10 Shares in the Company. Balu applied for 10 Equity Shares of the Company on 31.05.2008. But the Shares were allotted only at the Board Meeting held on 19.08.2008. Examine whether Balu has complied with the requirements relating to Qualification Shares, if not what are the consequences?

Where the Director has applied for registration of shares in his name and the application is pending as at the expiry of 2 months, the Director has not fulfilled the requirements of Share Qualification.	**Ram Autar Jalan vs Coal Products of India Ltd 410 CC 715 (SC)**

So, Anup and Balu have **not** acquired the Qualification Shares within the 2 months time limit.

31. Can the AOA of a Company be amended, subsequent to the appointment of Directors, increasing the amount of Qualification Shares to be held?

1. The amount of Share Qualification can be increased by way of alteration to AOA, but only within the limits specified u/s 270. However, such restriction is not applicable to a Private Company.
2. A Director already holding qualification shares will **not** be bound by a subsequent increase in the amount of qualification.

30 Jyoti

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P.K.SIKDAR'S ADVANCE LEARNING
23 C, EKDALIA PLACE
KOLKATA – 700019
M: 98301 65501
Web: www.pksal.com

ICWAI Group - III Final (New Syllabus)

6

Subject: Corporate Laws

Topic: Prospectus

Prospectus

1. *Prospectus means*
   - (*i*) any document *described or issued* as a prospectus;
   - (*ii*) any *notice, circular, advertisement or other document* inviting deposits from the public;
   - (*iii*) documents inviting offers from the public for the *subscription of shares or debentures* in a company. [Sec. 2(36)]

   Note: The term 'issued' means issued to the public (*i.e.*, issued generally) and not only to a group selected persons.

   As per SEBI guidelines, 2000, the expression 'advertisement' includes notices, brochures, pamphlets, circulars, showcards, catalogues, hoardings, placards, posters, insertion in newspaper, pictures, films, cover pages of offer documents or any other print medium, radio, television programmes through an electronic medium.

   The share application form should be a part of the memorandum containing salient features of the abridged prospectus, being attached to it along a perforated line. The abridged prospectus and the share application form should have the same printed number. The investor may detach the share application form along the perforated line after he has had the opportunity to study the contents of the abridged prospectus, before submitting the same to the company or its designated bankers.

2. *A prospectus must be in writing*
   - (*i*) An oral invitation to subscribe for shares in a company is *not* a prospectus;
   - (*ii*) An advertisement in a television or film is *not* considered to be a prospectus.

Dating of prospectus (Sec. 55)

The date of prospectus is normally taken as the *date of the publication* of the prospectus.

Registration of prospectus

1. A copy of every prospectus is required to be registered with the Registrar;
2. The registration must be made *on or before* the date of its publication;
3. The copy must be signed by every person whose name appears in prospectus as:
   - (*a*) director;
   - (*b*) proposed director; or
   - (*c*) his agent in writing.
4. The copy for registration must be accompanied with the following documents:
   - (*a*) consent of the expert to the issue, *if any;*
   - (*b*) a copy of every contract relating to appointment and remuneration of managerial personnel;
   - (*c*) a copy of every material contract *other than*
     - – a contract entered into in the *ordinary course* of business; or
     - – a contract entered into *two years* before the date of the prospectus.

     Note: The phrase 'material contract' is nowhere defined in the Act.
   - (*d*) a written statement relating to the adjustments, *if any,* in relation to any profits or losses or assets and liabilities dealt with any reports set out in the prospectus. The statement should be signed by an expert;
   - (*e*) The consent in writing of the person, *if any,* named in the prospectus as
     - – the auditor;
     - – legal advisor;
     - – attorney;
     - – solicitor;
     - – banker; or
     - – broker of the company;

     to act in that capacity.

Issue of prospectus (Sec. 60)

The prospectus must be *issued* within 90 days of its registration. The company and every person who knowingly issues a prospectus *without registration* is punishable with a fine upto Rs. 50,000.

Cases when application form need not be accompanied with prospectus.

No application form can be issued for shares or debentures unless it is accompanied by a memorandum containing such salient features as may be prescribed. In other words, the issue of prospectus is a must alongwith application. However, application forms need not be accompanied with the prospectus in the following cases:

1. where the shares and debentures are *not offered* to the public;
2. where the shares or debentures are offered to the *existing members or debenture-holders* of the company;
3. where the shares or debentures offered are *uniform* in all respects with shares or debentures *previously issued* and *quoted* on a recognized stock exchange;
4. where the shares or debentures are offered to *underwriters* in lieu of their underwriting agreement.

Shelf prospectus (Sec. 60-A)

Need for shelf prospectus: The public financial institutions normally approach the capital markets more than once in the course of a 365-day period. Under the Companies Act, a company must issue a detailed prospectus each time it is approaching the capital market. While this holds good in principle, it definitely leads to needless repetition—more so when a company takes recourse to capital markets more than once in a given year. *A way out is through a shelf prospectus for a given time period. Such a prospectus has a limited life during which it remains on the shelf and is updated for any changes that have occurred between two successive offerings.*

In the first instance, this shelf prospectus facility could be limited to public sector banks and financial institutions and those companies specialising in infrastructure finance. If the procedure succeeds and demonstrates that the interest of the investors are protected, then the facility may be gradually extended by SEBI to other sections of corporate India.

The Companies (Amendment) Act, 2000 has introduced the concept of shelf prospectus.

1. 'Shelf Prospectus' means a prospectus issued by any financial institution or bank for one or more issues of securities or class of securities specified in that prospectus.
2. Any public financial institution public sector bank or scheduled bank whose main job is financing shall file a shelf prospectus.

   The term 'financing' for the purpose of Sec. 60-A means making loans to or subscribing in the Capital of a private industrial enterprise engaged in infrastructure financing or such other company of to notified by the Central Government.
3. The 'Shelf Prospectus' shall be valid for one year from the date of the opening of the first issue of securities under the prospectus.
   A company filing a shelf prospectus with the Registrar is not required to file prospectus every time it seeks to make a public issue during the validity period of 'shelf prospectus'.
4. An 'Information Memorandum' shall be supplied to the public along with shelf prospectus at the time of first as well as subsequent issues.
5. In order to raise further capital by subsequent issues under the shelf prospectus within its validity period of one year, the issue is required to issue on 'information memorandum' indicating the changes that have taken place during the intervening period relating to matters, *namely*—
   (*a*) material facts as to new charges created;
   (*b*) changes in the financial position as have occurred between the first offer of securities previous offer of securities and succeeding offer within one year, prior to making of a second or subsequent offer of securities under the shelf prospectus.
6. An update 'information memorandum' is to be filed every time an offer of securities is made and such memorandum together with the 'shelf prospectus' shall constitute the prospectus.

Information Memorandum (Sec. 60-B)
[The Companies (Amendment) Act, 2000]

With a view to explore the demand for shares and price at which shares may be offered to the public, a public company may, before issuing prospectus, circulate information memorandum

1. 'Information memorandum' means a process undertaking before filing of a prospectus by which
   (*a*) a demand for the shares etc. proposed to be issued by a company is explored; or
   (*b*) the price and the terms of issue for such shares is assessed by means of a notice, circular, advertisement or documents.
2. A public company making an issue of shares may circulate 'information memorandum' to the public before filing of a prospectus.
3. A company raising subscription by an 'information memorandum' shall file a prospectus before the opening of the subscription lists and the offer as a red-herring prospectus, at least three days before the opening of the offer.
4. 'Red herring prospectus' means a prospectus which does not have complete particulars on the price and the quantity of shares offered.
5. Any misrepresentation in the 'information memorandum' and 'red-herring prospectus' shall carry same obligations as are applicable in the case of a prospectus. Any variation between the 'information memorandum' and the 'red-herring prospectus' shall be highlighted as variations by the issuing company.
6. The application or proposed subscriber has a right to withdraw his application on any intimation of variation within 7 days from the date of such intimation.
7. Upon the closing of the offer of securities, a final prospectus shall be filed in the case of a listed public company with SEBI and ROC and in any other case with ROC only.

Contents of prospectus (Sec. 56)

The prospectus *shall* contain all material information which *shall* be *true* and *adequate* so as to enable the investors to make an informed decision on the investment in the issue.

The important contents of prospectus are as follows:

Part I

1. **General Information**
   - Name and address of registered office of the company;
   - Authority for the issue;
   - Eligibility for the issue;
   - Registration and approvals;
   - Names of regional stock exchange and other stock exchanges where application is made for listing of present issue;
   - Impersonation;
   - Declaration about the refund of the issue if minimum subscription is *not* received;
   - Date of *opening* of the issue, Date of *closing* of the issue, Date of *earliest closing* of the issue;
   - Name and address of auditors and lead managers;
   - Underwriting of the Issue
     – Names and addresses of the underwriters and the amount under-written by them.
2. **Capital structure of the company**
   - Authorised share capital;
   - Issued, subscribed and paid up Capital;
   - Size of the present issue (extent of promoters contribution);
   - Issue through this Draft Offer Document;
   - Paid up Capital after issue;
   - Securities Premium Account;
3. **Terms of the present issue**
   - Terms of payments;
   - How to apply?;
   - Any special tax benefits to
     – company;
     – resident shareholders;
     – non resident shareholders;
     – foreign institutional investors;
     – mutual funds.
4. **Particulars of the issue**
   - Objects of the issue;
   - Project cost;
   - Means of financing (including contribution of promoters).
5. **Company, management and project**
   - Brief history of the company;
   - Present business;
   - Main objects of the company;
   - Subsidiaries of the company;
   - Subsidiary(ies) of the company, *if any*;
   - Promoters and their background;
   - Details about Board of directors;
   - Location of project;
   - Plant and machinery, technology process *etc.*;
   - Collaboration agreements;
   - Infrastructure facilities for raw material, water, electricity *etc.*
   - Nature of product, approach to marketing and export possibilities;
   - Future prospects
     – Commencement of production; and
     – the expected year when the company would be able to earn cash profits and net profits;
   - Stock market data for shares/debentures of the company
     – High/low price in each of the last 3 years; and
     – monthly high/low during the last 6 months.
6. **Particulars in regard to the company and other listed companies under the same management** which made any capital issue during the last 3 years:
   - Name of the company;
   - Year of the issue;
   - Type of the issue (Public/Rights/Composite);
   - Amount of issue;
   - Date of closure of issue;
   - Date of completion of delivery of share/debentures certificates;
   - Date of the completion of the project, where object of the issue was financing of the project;
   - Rate of dividend paid.
7. **Outstanding litigation pertaining to —**
   - Matters likely to affect operation and finance of the company including disputed tax liabilities of any nature;

- Litigation
  - filed by the company;
  - filed against the company;
  - filed against the promoters of the company;
  - filed against the promoter group company;
  - filed against the directors of the company.
- Particulars of defaults, *if any*, in meeting any
  - statutory dues;
  - institutional dues;
  - dues towards debenture-holders, fixed depositors.
- Any material developments after the date of the latest balance sheet and their likely impact.

8. **Management perception of risk factors,** *viz.*,
   - Sensitivity to foreign exchange rate fluctuations;
   - Difficulty in availability of raw materials or in marketing of products, cost/time over-run *etc.*

Part II

A. **General Information**
   - Consent of Directors, Auditors, Solicitors/Advocates, Managers to the Issue, Registrar to the Issue, Bankers to the Issue and Experts;
   - Experts' opinion obtained, *if any;*
   - Change, *if any*, in directors and auditors during the last 3 years, and reasons thereof;
   - Authority for the issue and details of resolutions passed for the issue;
   - Procedure and time schedule for allotment and issue of certificates;
   - Names and addresses of Company Secretary, Legal adviser, Lead manager, Co-managers, Auditors, Bankers to the Company, Bankers to the Issue and Brokers to the Issue.

B. **Financial Information**
   A report by the auditors of the company with respect to
   - its profits and losses and assets and liabilities; and
   - the rates of dividends paid by the company during the last 5 years.

C. **Statutory and Other Information**
   - Minimum Subscription;
   - Expenses of the Issue;
   - Underwriting commission and brokerage;
   - Issue of shares otherwise than for cash;
   - Debentures and redeemable preference shares and other instruments issued by the company outstanding as on the date of prospectus;
   - Details of purchase of property;
   - Details about directors, whole time directors and managing director;
   - Rights of members regarding voting, dividend, lien on shares;
   - Restrictions, if any, on transfer and transmission of shares/debentures;
   - Revaluation of assets, *if any* (during last 5 years);
   - Material contracts and inspection of documents.

Liability for misrepresentation in prospectus

If there is any misrepresentation of a *material fact* in a prospectus, there may arise:

(*i*) Civil liability
  (*a*) against the company;
  (*b*) against the directors, promoters and experts.
(*ii*) Criminal liability

Civil liability for misstatement in prospectus (Sec. 62)

The Golden Rule as to drafting of prospectus

The golden rule as to drafting of prospectuses was laid down in *New Brunswick and Canada Rly and Land Co. v. Muggeride* in the following words.

"Those who issue prospectus holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state every thing with strict and scrupulous accuracy and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature or extent and quality of the privileges and advantages which the prospectus holds as inducement to take shares."

Any one who subscribed for shares or debentures on the basis of a fraudulent statement in a prospectus has remedies against the company and its directors, promoters and experts.

1. **Remedies against the company**

   If there is a *misrepresentation* of a material information in a prospectus and if it has induced anyone to purchase shares, he can
   (*i*) rescind the contract;
   (*ii*) claim damages from the company.

   The contract to accept allotment of shares or debentures can be rescinded if the following *conditions* are satisfied:

(1) **The statement must be a *material misrepresentation* or concealment, of a fact.**

The misrepresentation is *material* when it is likely to influence a reasonable person in his judgment whether or not to apply for the shares. It is *different* from a *statement of opinion* or *expectation*.

(2) **The shareholder should have relied on the *contents* of the prospectus.**

Jennings v. Broughton, (1854) 23 L.J. Ch. 999

A person had *himself inspected* a coal mine and relied on his own observation rather than on the contents of the prospectus. Held, he was not entitled to rescind the contract

(3) **The statement must be *untrue* in the form and context in which it is included.**

Rex v. Lord Kylsant, (1932) 1 K.B. 442

A prospectus was issued by a company stating that it had *consistently* paid dividend during the last six years from the date of prospectus, thus giving the impression of a *financially sound company*. However, the company had in each of these years *incurred* considerable *trading losses* and was able to pay dividend only out of *realised capital profits*. This fact was concealed. *Held*, the prospectus was *false* because of what it *concealed, omitted or implied*.

(4) **The deceived shareholder must have been an original allottee.**

It is for this very fact that a purchaser of shares in the open market cannot proceed against the company.

Peek v. Gurney (1873) L.R. 6 H.L. 377

A company issued a prospectus containing false statements. X, relying on the prospectus, applied for and was allotted shares. Later on, he sold these shares to Y. The company was wound up and Y had to pay nearly £ 1,00,000 as a contributory. *Held*, Y could not succeed in an action against the directors of the company as the directors could not be made liable *ad infinitum* for all the subsequent dealings which may take place with regard to those shares upon the stock exchange.

Loss of right of rescission

The option to *rescind* a contract to take shares is *lost* in the following circumstances:

(1) **By affirmation**

If a shareholder with full knowledge of misrepresentation *upholds* the contract, he cannot afterwards rescind it. He will *lose* his right to rescind the contract where he:

(*a*) attempts to *sell* his shares;
(*b*) executes a *transfer*;
(*c*) pays *call* money;
(*d*) receives *dividend*;
(*e*) *attends* and *votes* at general meeting of the company.

(2) **By unreasonable delay**

A person who does not rescind a contract to take shares from a company within a *reasonable time* after becoming aware of misrepresentation, *loses* the right to rescind;

(3) **By commencement of winding up**

The right of rescission is lost on the commencement of the winding up of the company. But where a shareholder has started active proceedings to be relieved of his shares, the passing of the winding up order during their pendency would not prevent him getting the relief [*Shiromani Sugar Mills Ltd. v. Debi Prasad*, AIR (1958) All. 508].

Damages for deceit

Deceit is a *tort*. It means fraud. Nothing *less* than *fraud* must be *proved*. Any person induced by a fraudulent statement in a prospectus to subscribe for shares is entitled to sue the company for damages. He must prove the same matters in claiming damages for deceit as in claiming rescission of the contract.

2. **Remedies against the directors, promoters and experts**

The term 'expert' *includes*

(*a*) an engineer;
(*b*) a valuer;
(*c*) an accountant;
(*d*) any other person whose profession gives authority to a statement made by him.

Notes: 1. The report of an expert cannot be *included* in a prospectus if he is in *anyway* connected with the *formation, promotion* or management of the company (Sec. 57).

2. Even if he is unconnected or unconcerned or impartial, his report in his capacity cannot be included

(*a*) unless he has given his written consent to the issue of the prospectus and has not withdrawn such consent before the delivery of the copy of the prospectus to the Registrar;
(*b*) unless a statement as to his consent and non-withdrawal of it appears in the prospectus (Sec. 58).

3. If the report of the expert is published in contravention of the provisions of Sec. 57 or 58, every person who is knowingly a party to the issue of the prospectus shall be punishable with fine which may extend to Rs. 50,000 (Sec. 59).

Following persons are liable, under Sec. 62 of the Companies Act, 1956, to pay compensation for any loss or damage to subscribers for any shares or debentures on the basis of fraudulent statement in the prospectus—

(i) every person who is a director of a company at the time of the issue of the prospectus;
(ii) every person who has authorised himself to be named as a director in the prospectus;
(iii) every promoter;
(iv) every person who authorises the issue of the prospectus.

A company cannot be *restrained* from issuing a prospectus on the complaint by a complete stranger who *alleges* that the proposed prospectus *includes untrue statements* and the investing public might be *cheated* [*Kisan Mehta v. Universal Luggage Mfg. Co. Ltd., Bombay* (1988) 63 Comp. Cas. 398 (Bom.)]

Defences of directors, promoters, etc.

A director etc. *shall not* be liable if he puts up the following defences:

(1) Withdrawal of consent
A director etc. is *not* liable if he *withdrew* his consent before the issue of the prospectus and it was issued *without* his *authority*.

(2) Absence of consent
Where a prospectus was issued without a director's knowledge or consent and on becoming aware of its issue, he immediately gave *reasonable public notice* of that fact, he is *not* liable.

(3) Ignorance of untrue statement
Sometimes a director may be ignorant of the untruth of the statements made in the prospectus. Such a director can save himself by showing that, on becoming aware of the untrue statement he withdrew his consent by a reasonable public notice. This is required to be done before allotment.

(4) Reasonable grounds for belief
A director will be able to *defend* himself if he can show that he had reasonable grounds to believe that the statement was true. It is *not* sufficient for him to say that he was *honest*. He should further *prove* that his honest belief was *based* upon *reasonable grounds*.

Criminal liability for misstatements in prospectus (Sec. 63)

1. A complaint under Sec. 63 may be filed by any of the following persons—
   (a) any shareholder of the concerned company;
   (b) the Registrar of Companies;
   (c) any person specially authorised by the Central Government for making a complaint under Sec. 63; or
   (d) any of the officers of the SEBI.
2. Where a prospectus contains any untrue statement, every person who authorises the issue of the prospectus is punishable with
   (i) imprisonment *upto* 2 years;
   (ii) fine *upto* Rs. 50,000; or
   (iii) both.
3. He will *not be liable* if he proves *either*, that
   (i) the statement was *immaterial*; or
   (ii) he had *reasonable grounds* to believe and did upto the time of allotment believe that the statement was true.

   Note: The provisions of Sec. 63 shall be *administered* by SEBI for companies already listed or companies which propose to get listed. For other companies, the administration is to be by the Central Government (Sec. 55-A).

Deemed prospectus or prospectus by implication (Sec. 64)

1. Offer for sale means an invitation to the general public to purchase shares of a company through an intermediary, such as
   (i) an issuing house;
   (ii) a merchant banker; or
   (iii) even an existing shareholder.

   The existing shareholders may dilute their holdings by offering their shares to the public by means of an offer for sale.
2. Where a company allots or agrees to allot any shares in, or debentures of the company to an *Issuing House* with a view to all or any of those shares or debentures being offered for sale to the public, any document by which the offer for sale to the public is made by the *Issuing House is deemed to be a prospectus issued by the company*. All enactments and rules of law in regard to a prospectus are applicable thereto (Sec. 64).
3. *An allotment* of shares or debentures *to an Issuing House is deemed to have been made* with a view to the shares or debentures being offered for sale to the public, if it is shown—
   (i) that the offer of shares or debentures for sale was made *within 6 months after the allotment*;
   (ii) that at the date when the offer was made, the *whole consideration* to be received by the company in respect of shares or debentures *had not been received by it*.
4. The following *additional information* is required to be given in the document deemed to be prospectus:
   (i) (a) The *net* amount of the 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*.
   (ii) The persons making the *offer of sale* to the public are to be *deemed directors* of the company for the purpose of *registration of the prospectus*.
   (iii) Where the Issuing House is *a company or a firm*, it is *sufficient* if the prospectus is *signed*
   (a) on behalf of the company, by 2 directors of the company; or
   (b) by not less than one half of the partners in the firm,
   as the case may be.

Book Building Process

1. Book Building means a process undertaken by which a *demand* for the securities proposed to be issued by a company is *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 notice, circular, advertisement.
2. SEBI has introduced the facility of book building in the capital issuance process to provide the issuer company and lead merchant banker the flexibility of price and demand discovery.
3. All companies which are going for public issue shall avail 100% book building process or *75% of net offer* to public through book building process and 25% at the price determined through book building process.
   Note: The price shall be determined after observing the market response.
4. A *'merchant banker'* shall be appointed who shall nominate a *book runner*. Book runner shall collect application forms with application monies to the extent of securities proposed to be allotted or subscribed by institutional buyers and underwriters just a day prior to opening of public issue. Allotment for private placement portion shall be made on the second day from the closure of public issue. The securities allotted under *placement portion* and *public portion* are *parri passu* in every respect.
5. Book building shall be for the portion other than the promoters' contribution and allotment made to,
   (*i*) permanent employees
   (*ii*) shareholders of promoter's company.
6. The brokers shall be paid commission/fee for services rendered by them and brokers should not charge any fee from clients/investors *in lieu* of his services.
7. The *suggestions/observations*, etc., made by SEBI in draft prospectus shall be *incorporated* by the Book Runner within 21 days of the date of issue with SEBI.
8. The application forms shall be circulated to brokers and the *bid* shall be *open* for at least 3 working days and not more *than* 7 working days which may be extended to a maximum of 10 working days.
   On the basis of bids received, the book runner of the company *will* determine the *issue price* of securities and then the *number* of securities to be offered shall be decided by dividing issue size by the price which has been decided.
9. In a 100% book building process, *not less than 25%* (now 35% *w.e.f.* March 29, 2005) of the net offer is available to *public* for allocation to retail individual investors and *at least* 25% (15% *w.e.f.* March 29, 2005) of the net offer is available to *non-institutional investors, e.g.*, investors other than retail individual investors and qualified institutional buyers (QIB) and not *more than 50%* of net offer to public is available for allocation to qualified institutional buyers.

Statement in lieu of prospectus (Sec. 70)

1. Where a public company *does not invite public* to subscribe for its shares but arranges to get money from *private sources*, it need not issue a prospectus to the public.
2. The promoters are required to prepare a draft prospectus known as a 'statement in lieu of prospectus' which should contain the information given in Schedule III of the Act.
3. A company having a share capital which does *not* issue a prospectus shall *not allot* any of its shares or debentures *unless* at least three days before the allotment, there has been *delivered* to the Registrar for registration a *'statement in lieu of prospectus'*.
   For example, X Ltd., a public company limited by shares wishes to go for private placement/allotment of shares on Friday, 28th March, 2003, it is required to file a statement in lieu of prospectus with the Registrar latest by Tuesday, 25th March, 2003.
4. The statement shall be *signed* by every person who is named therein as a
   (*i*) director;
   (*ii*) proposed director; or
   (*iii*) his agent authorised in writing.
5. A private company is *not* required to file a 'statement in lieu of prospectus' at the time of allotment.
6. If a company acts in violation of Sec. 70, the company and every director of the company, who wilfully permits the contravention, shall be punishable with fine upto Rs. 10,000.
7. Where a 'statement in lieu of prospectus' includes any *untrue statement*, any person who authorised its issue shall be punishable with
   (*i*) imprisonment upto 2 years;
   (*ii*) fine upto Rs. 50,000; or
   (*iii*) both.
8. He will be protected if he proves *either*, that
   (*i*) the statement was *immaterial*, *or*
   (*ii*) he had *reasonable grounds* to believe that the statement was true.

Acceptance of Public deposits (Sec. 58-A)

1. The Central Government may prescribe the
   (*i*) limits up to which;
   (*ii*) manner in which; and
   (*iii*) conditions subject to which deposits may be invited or accepted by a company. The company shall however consult the Reserve Bank of India before doing so.
2. A company shall *not accept any deposit* —
   (*i*) from the *public* if the amount of such deposit together with the amount of deposits outstanding on the date of acceptance or renewal *exceeds 25 per cent of the total of the paid-up capital and its free reserves*.

(ii) against *unsecured debentures* or from a *shareholder*, etc., (not being a deposit accepted by a private company from its shareholders) if the amounts of such deposit together with the amount of deposits outstanding on the date of acceptance or renewal *exceeds 10 per cent of the total of the paid-up capital and its free reserves.*

3. A company can *accept* or *renew* any deposit where it is repayable
   (i) *after* the expiry of *6 months;* and
   (ii) *not later* than *36 months*

   from the date of acceptance or renewal of such deposit.
4. Every company *shall* before the *30th day of April* of each year deposit or invest, as the case may be, *a sum which shall not be less than 15 per cent* of the amount of its deposits maturing *during the year ending 31st day of March next* following in any or more of the *securities prescribed* in this regard.
5. A company *shall not* invite any deposit *unless*—
   (i) *such deposit is invited as per the rules made by the Central Government in this behalf;*
   (ii) an advertisement, including there in a statement showing the financial position of the company, has been issued by the company, in the prescribed form and manner;
   (iii) the company *is not* in default in the repayment of any deposit or part thereof and any interest thereon in accordance with the terms and conditions of such deposit.
6. Every company *shall*, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a receipt for the amount received by the company *within a period of 8 weeks from the date of receipt of money.*

   The said receipt shall be *signed* by an officer of the company duly authorised by the company in this behalf.
7. Every deposit accepted by a company, unless renewed in accordance with the rules made under Sec. 58-A, be repaid in accordance with the terms and conditions of such deposit.
8. Every company accepting deposits shall keep at its registered office one or more registers which shall contain the following particulars, namely:
   (i) *name* and *address* of the depositor;
   (ii) *date* and *amount* of each deposit;
   (iii) *duration* of the deposit and the date on which each deposit is *repayable;*
   (iv) *rate* of interest;
   (v) *date* or dates on which payment of interest will be made;
   (vi) any other *particulars* relating to the deposit.

   The register of deposits *shall* be kept for a minimum period of 8 years from the financial year in which the latest entry is made in the register.
9. Where a company omits or *fails to make repayment of a deposit* in accordance with the above provisions,
   (i) the company *shall* be punishable with fine which *shall not be less than twice the amount* in relation to which the repayment of the deposit has NOT been made;
   (ii) every officer of the company who is in default *shall* be punishable with
      (a) imprisonment for a term which may extend to 5 years; and
      (b) fine.

   An ordinary employee who had signed fixed deposit receipts on behalf of the company could not be made liable towards depositors. There cannot be any *decree* against such an employee [*B.N. Narayan* v. *Lakshmi*
10. Where a company *accepts* or *invites* any deposit in contravention of the provisions of Sec. 58-A—
   (i) the company *shall* be punishable where such contravention relates to the
      (a) acceptance of any deposit, with fine *which shall not be less* than an amount equal to the amount of the deposit so accepted;
      (b) *invitation* of any deposit, with fine which *may extend to Rs. 10,00,000 but shall not be less than Rs. 50,000;*
   (ii) every officer of the company who is in default *shall be* punishable with
      (a) imprisonment for a term which may extend to 5 years; and
      (b) fine.
11. Sec. 58-A *shall not* apply to
   (i) a banking company; or
   (ii) such other company as the Central Government may specify in this behalf.

Small depositors (Sec. 58-AA)

A small depositor is a depositor who has deposited in a financial year a sum not exceeding Rs. 20,000 in a company and *includes* his successors, nominees and legal representatives. The provisions relating to acceptance of money from small depositors are as follows:

1. Every company accepting deposits from small depositors shall intimate to the Company Law Board* any default made by it in repayment of any such deposit.
2. (a) Such an intimation shall be given within 60 days from the date of default.
   (b) It shall include particulars in respect of names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereon.

Note: The intimation under this section shall be given on a monthly basis.

3. Where a company has made a default in repayment of any deposit to a small depositor, the Company Law Board*, on receipt of intimation about default in repayment *shall*—
   (*a*) exercise, on its own motion, powers given to it under Sec. 58A(9);
   (*b*) pass an appropriate order within a period of 30 days from the date of receipt of intimation.

   However, the Company Law Board* may pass order after expiry of 30 days, after giving the small depositors an opportunity of being heard. It shall not be necessary for a small depositor to be present at the hearing of such proceeding.

Note: * The powers of Company Law Board are transferred to the National Company Law Tribunal by the Companies (Amendment) Act, 2002. The Government is in the process of formation of the Tribunal. As on date, the powers are exercised by Company Law Board.

4. No company shall accept further deposits from small depositors' *unless* each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereon. This means that a company cannot accept fresh deposits if it has defaulted in repaying any small deposit.

   However, nothing contained in this sub-section shall apply to—
   (*a*) deposit which has been *renewed* by the small depositor voluntarily; or
   (*b*) any deposit, whose repayment has become *impracticable* due to the death of the small depositor or whose repayment *has been* stayed by a competent Court or authority.
5. Every company, which has on any occasion made a default in repayment of a deposit or interest thereon to a small depositor, shall state, *in every future advertisement and application form inviting deposits from the public, the total number of small depositors and amount due to them in respect of which such default has been made.*
6. Where any interest accrued on deposits of the small depositors has been waived, the fact of such waiver shall be mentioned by the company in every advertisement and application form inviting deposits after such waiver.
7. Where a company had accepted deposits from small depositors and thereafter obtains any loans for the purpose of working capital from any bank, it shall first utilize the funds obtained for the repayment of any deposit or any interest thereupon to the small depositor before applying such funds for any other purpose.
8. Every application form, issued by a company to a small depositor for accepting deposits from him, shall contain a statement to the effect that the applicant has been apprised of—
   (*a*) every post default by the company in the repayment of deposit or interest thereon;
   (*b*) the waiver of interest and reasons therefore.
9. Whoever, knowingly fails to comply with the provisions of this section or comply with any order of the Company Law Board (National Company Law Tribunal) shall be
   (*a*) punishable with imprisonment upto 3 years;
   (*b*) liable to a daily fine of not less than Rs. 500 for the period such non-compliance continues.
10. If a company or any other person contravenes any provision of this section, every person, who at the time the contravention was committed, was a director of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.