

Other Important Provisions –
Examination Oriented

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Producer Companies

Definitions [Section 581A]

- **Producer Company means:**
 1. A body corporate;
 2. Having objects or activities u/s 581B; **AND**
 3. Registered as 'Producer Company' under the Act
- **Producer means:**
 1. Any person engaged in any activity;
 2. Connected with or relating to any 'Primary Produce'

Definitions [Section 581A]

- **Producer Institution means:**
 1. A 'Producer Company'; or
 2. Any other institution:
 - having only 'Producers' or 'Producer Companies' as its members,
 - whether incorporated or not,
 - having any of the objects u/s 581B, **AND**
 - which agrees to make use of services of 'Producer Companies'

Definitions [Section 581A]

- **Primary Produce means:**
 1. **Produce of farmers** from agriculture/ animal husbandry/ horticulture/ floriculture/ pisciculture/ viticulture/ forestry/ forest products/ re-vegetation/ bee raising/ farming plantation products/ any other primary activity or service;
 2. **Produce of persons** from handloom/ handicraft/ other cottage industries;
 3. Any product arising from above as **by products**;
 4. Any product resulting from **ancillary activity** that would assist/ promote above said activities

Formation of a Producer Company and its Registration [Section 581C]

- **Applicant:**
 1. ≥ 10 **Individual** Producers; or
 2. ≥ 2 Producer Institutions; or
 3. Any combination of above
- **Application Enclosures:** MOA & AOA duly signed by subscribers;
- **Application to Whom:** ROC of State where Registered Office of Producer Company is **proposed** is to be situated;
- **Incorporation Conditions:**
 1. Object Clause of MOA to be as per Section 581B;
 2. Producer Company to be limited by Shares

Formation of a Producer Company and its Registration [Section 581C]

• **Promotion Expenses:**

1. Promoters can be reimbursed 'promotional expenses';
2. Producer Co. can reimburse promoters after its formation;
3. GM approval required;
4. Nature of Promotion Expenses:
 - All direct costs for promotion/ registration of producer co.;
 - Such as registration fees/ legal fees/ MOA, AOA printing/ any other lawful expense(s)

Formation of a Producer Company and its Registration [Section 581C]

• **Effects of Incorporation:**

1. Producer Co. will become Body Corporate;
2. Shall be limited by shares;
3. **Shall use 'Producer Company Ltd.' at the end of its name;**
4. **All the provisions shall apply as if it is a Private Limited Company;**
5. However, this does not mean that it is a Private Limited Co. or Public Co. u/s 3(1)(iii) & (iv);
6. It can never become or deemed to a Public Limited Co.;
7. **No limit to number of members**

Management of Producer Company

• **Number of Directors [Section 581O]:**

1. Minimum = 5;
2. Maximum = 15
3. During the first year of conversion **all** (i.e. even more than 15) the erstwhile directors shall continue for 1 year from transformation date

Management of Producer Company

- **Appointment of Directors [Section 581P]:**
 1. To be elected within 90 days from the **date of registration**;
 2. Election to be conducted within 1 year, if:
 - Producer company formed by conversion **and**
 - ≥ 5 directors already hold office
 3. Tenure of Office as per AOA but ≥ 1 year & ≤ 5 years;
 4. To be appointed by members at AGM;
 5. Retirement as per AOA (Reappointment possible);
 6. Additional directors $\leq 1/5^{\text{th}}$ of Total Directors

Management of Producer Company

- **Secretary of Producer Company [Section 581X]:**
 1. Mandatory appointment of WTCS;
 2. If 3 consecutive financial years Average Annual Turnover $> \text{Rs. } 5 \text{ Crores}$;
 3. To be ICSI member;
 4. Penalty upto Rs. 500 per day;
 5. Reasonable Efforts or Financial Position may be defences for default

Management of Producer Company

- **Meetings of BOD and Quorum [Section 581V]:**
 1. Atleast 4 BMs per calendar year;
 2. Atleast 1 BM per quarter;
 3. BM Notice to be in writing;
 4. BM Notice to be given to every director for the time being in India;
 5. BM Notice to Other directors at his usual address in India;
 6. Duty of chief executive to give notice;
 7. Atleast 7 days notice required;
 8. Reasons for shorter length notice to be recorded in writing;
 9. **Quorum** = Higher of $1/3^{\text{rd}}$ of Total **or** 3 Directors

Loans to Members, etc. [Section 581ZK]

- AOA compliance;
- BOD approval;
- Credit facility may be given to Member in **connection with business of producer company** ≤ 6 months;
- **Other Loans** can be given on Security as per AOA and repayment period may exceed 3 months but not 7 years;
- Loans to directors and their relatives requires GM approval

Investments & Subscription by Producer Companies [Section 581ZL]

- Can make investment out of GR in approved securities/ FD/ Units/ bonds issued by Govt., Coop or Scheduled Bank;
- May acquire shares of other PC for promotion of its objects;
- Can also form JV/ Subsidiary with any body corporate for promotion of its objects;
- **Individually (by itself & without subsidiaries) investment in shares of other company (other than PC) $\leq 30\%$ (paid up capital + free reserves);**
- If above limit to be crossed then CG + SR required;
- Disposal of above investment with SR approval;
- Register of investments to be maintained

Vacation of Office by Director [Section 581Q]

- Court conviction for **moral turpitude and imprisonment ≥ 6 months;**
- While being a Director of a producer company, PC made a **default in repayment of loans/ advances ≥ 90 days;**
- He made a **default** in repayment of **loans/ advances taken from PC;**
- While being a Director of a producer company, PC made a **default in filing annual accounts and annual return** for any continuous 3 F.Y. on or after 01-04-2002;
- While being a Director of a producer company, PC made a **default in repaying deposits/ withheld price/ patronage bonus/ interest thereon on due date/ dividend ≥ 1 year;**
- PC defaulted in his election as director
- Section 581Q also applicable to director of Producer Institution

Finance, Accounts and Audit

- **Donations or Subscription by a Producer Company [Section 581ZH]:**
 1. SR required;
 2. **Purpose** = Promotion of Mutual Assistance principles or social & economic welfare of producer members or producers general public;
 3. **Ceiling**: $\leq 3\%$ of preceding year profit;
 4. **Political Contribution**: Prohibited in all forms

Finance, Accounts and Audit

- **General and Other Reserves [Section 581ZI]:**
 1. Every producer company to maintain GR in every F.Y.;
 2. GR to be maintained as per AOA;
 3. **If Insufficient Funds**: Contribution to reserves to be shared amongst members in proportion to their patronage of that F.Y.

Compromises, Arrangements and Amalgamations

Section 390

- **Company** = *means* company liable to be wound up under this Act;
- **Arrangement** = *includes* a reorganisation of the share capital
- **Compromise** = **Not Defined**
- **But it presupposes the existence of some dispute**

Section 391

- On application by applicants, **Court** may order a meeting;
- The **meeting** (of Creditors/ Members) would be held as per Court's directions;
- If **majority of 3/4ths in value (qty majority also needed)** of creditors or members agree to compromise/ arrangement, then it would be binding, subject to Court's Sanction;
- Voting may be in **person/ proxy**

Section 393

- **Certain information** to be furnished at meeting u/s 391;
- **Information Statement:**
 1. Terms of compromise/ arrangement;
 2. Effect of above on material interests of Directors/ MD/ Manager in their capacity as such/ as creditors/ as members;
 3. Effect on Debenturetrustees
- **Advertisement for notice of meeting** to mention place, date and the manner to obtain copies of Information;
- Such copy to be furnished **free of cost** on request

Section 394

- Deals with **reconstruction and amalgamation of companies**;
- If an **application is made to Court u/s 391** and:
 1. shown that **compromise/ arrangement is for the purpose of reconstruction or amalgamation** of company(s), and
 2. under the **“scheme”** whole/ part of undertaking, property or liabilities of “transferor company” is to be transferred to “transferee company”
- The **Court may order/** make provision for **certain matters**

Section 394

- **Certain Matters:**
 1. Transfer to transferee the whole/ part of the undertaking, property or liabilities;
 2. Allotment/ appropriation by the transferee;
 3. Continuation of legal proceeding by or against the transferor in the name of transferee;
 4. Dissolution without winding up of any transferor co.;
 5. Provision for those dissenting the scheme;
 6. Other consequential and incidental matters

Important Issues

- **Reduction of Share Capital:** if forms a part of scheme of arrangement, the requirements of Companies Act as regards reduction of share capital are not applicable [*Asian Investments Limited, Re*];
- **Section 372A is different from Section 391**, i.e., compliance with Section 372A is not necessary where shares of one company are exchanged for another under scheme of compromise or arrangement;
- A **successor of existing member** cannot make application u/s 391

Important Issues

- Order sanctioning amalgamation is an instrument under Stamp Act. **Stamp duty**, thus, **payable** on conveyance of property [*Litaka Pharmaceuticals Limited, Bombay HC*];
- The fact that “transferor” and “transferee” have **different business is not a ground for refusing sanction** to their amalgamation [*EITA India Ltd.*];
- If “**transferee**” is a **private company**, simply because its membership would increase by more than 50 after amalgamation, its **conversion into public limited not a pre-condition**. It can be done later [*Winfield Agro Services Pvt. Limited*]

Section 395: Reconstruction by Sale of Shares/ Takeover

- Transferee company can make offer to transferor company to acquire its shares;
- Offer to mention the last day upto which it is to be accepted;
- Offer can be kept open for a maximum period of 4 months;
- Shareholders holding $\geq 90\%$ of value of shares to accept the offer;
- Acceptance of offer to given before its expiry;
- Transferee company has the right (*not obligation*) to acquire shares from dissenting shareholders;
- It can exercise such right within 2 months of expiry of the offer

Section 395: Reconstruction by Sale of Shares/ Takeover

- **Dissenting shareholders** can apply to the Court for non-acquisition of their shares;
- Only those dissenting shareholders can apply to whom transferee served notice of acquisition;
- Application to court can be made within 1 month of transferee's notice;
- Courts in general do not intervene where valuation of shares made by experts (such as Chartered Accountants) [*M G Investment & Industrial Co. Ltd. Vs. New Shorrock Spg. & Mfg. Co. Ltd.*];
- It may intervene if there is unfairness or demonstrated that amount offered for shares is inadequate;
- Onus of proof for above lies on dissenting shareholders;
- If application is not made or rejected, shares to be acquired on the same terms as originally offered to all shareholders;
- If application allowed, transferee cannot acquire shares

Winding Up

Winding Up??

- Also known as **Liquidation**;
- Represents the **last stage of company's life**;
- It's a **proceeding by which**:
 1. Company is **dissolved**;
 2. Assets are disposed/ realised;
 3. Debts are paid off;
 4. Surplus, if any, distributed amongst members

Modes of Winding Up

1. Winding up by **Court/ NCLT** (Or **Compulsory Winding Up**);
2. **Voluntary Winding Up**:
 - **Members' VWP** (relevant for solvent cos.)
 - **Creditors' VWP** (relevant for insolvent cos.)
3. Winding up subject to **supervision of the Court/ NCLT**

Compulsory Winding Up (Section 433)

1. Company passes **SR**;
2. **Violation of Section 165:**
 - Default in delivering statutory report to ROC;
 - Default in holding statutory meeting;

Exceptions: The Court/ NCLT may instead direct that:

 - Statutory report be delivered; or
 - Statutory meeting be held

Compulsory Winding Up....contd.

3. Does **not commence its business** within a year of incorporation; **or**
4. **Suspends its business** for a whole year
Exceptions for both: The Court/ NCLT may not order winding up if:
 - There are **reasonable prospects** of the company to start business within reasonable time;
 - There are convincing reasons for such delay, e.g., **temporary causes**

Compulsory Winding Up.....contd.

4. **Number of members** fall below the Statutory Minimum; **AND**
 - **Business carried** on > 6 months; **AND**
 - Existing **Members are aware** of fact of carrying on the business

Compulsory Winding Up.....contd.

5. Inability to pay debts [Section 433 & 434]:

- Debt > Rs. 500; **AND**
- Creditor served demand of debt notice at Registered Office of the Co.; **AND**
- Company neglected to pay or compound or secure the debt for **3 weeks**

Notes:

- i. Creditor by assignment also covered;
- ii. Court may **dismiss petition** if **bona fide dispute**;
- iii. Court may **instead direct furnish security** for debt payment, i.e. to avoid misuse of section 433;
- iv. If **decree awarded by Court unsatisfied**, winding up may be ordered;
- v. The court **may** order winding up only if satisfied about inability to pay debts

Compulsory Winding Up.....contd.

- **Winding up by the Court is a Discretionary Power;**
- Case Law: **Tata Iron and Steel Co. vs. Micro Forge (India) Ltd.;**

• **Ratio of Case Law:**

1. Winding a last resort;
2. Court should consider its impact and consequences
3. **Winding up may not be justified** in following cases:
 - Profitability/ Reserves/ Soundness of Co. beyond question;
 - High Sales/ Turnover but temporary cash crisis;
 - Believed that Co. can come out of crisis;
 - Inability to debt payment due to economic and market conditions

Compulsory Winding Up.....contd.

6. Just & Equitable Ground [Section 433(f)]:

- Court must be satisfied;
- Order under it allowed only if no other remedy available (i.e. compelling reasons are there);
- Circumstances should be just & equitable to **all** (i.e. petitioner/company/shareholders/creditors)

Compulsory Winding Up.....contd.

- **Cases of Just & Equitable Grounds:**
- 1. Where the **main object** of the company has **substantially failed** [*German Date Coffee Co., Re*];
- 2. **Deadlock in the Management** of the Co. [*Yenidje Tobacco Co. Ltd., Re*]. In this case the company was making huge profits inspite of disagreement & bitter relations amongst management and shareholders;
- 3. **Complete Mismanagement** with no possibility of remedying it [*Rajamundry Electric Supply Corp. Ltd. Vs. Nageshwara Rao*];
- 4. **Oppression of Minority Shareholders** [*Anglo Continental Produce Co. Ltd.*];
- 5. Where Company **never had any business** or property [*London & County Coal Co., Re*]

Defunct Companies [Section 560]

- **Defunct Company??**
- 1. Not carrying on business; **OR**
- 2. Not in operation
- If company has ceased to carry on business, ROC may strike it off the Register;
- **Conditions:**
- 1. ROC has a reasonable cause to believe about (1) or (2) above;
- 2. ROC to send letter to company to make enquiry about (1) or (2) above

Defunct Companies [Section 560]

- If reply not recd within 1 month, then, within 14 days, ROC sends registered letter referring to the first letter;
- In above, he mentions that if not replied within 1 month, notice will be published in OGz to strike off the name;
- If ROC:
- 1. Receives reply as to non-carrying of business; or
- 2. Does not receive reply;
- **THEN:**
- 1. Publication in OGz; **AND**
- 2. Send notice that within 3 months of this notice name will struck off (i.e. opportunity of being heard)

Restoration of Company's Name [Section 560(5)]

- **Application** is to be made:
 1. By company or any member or any creditor;
 2. Before the expiry of 20 years from the publication in OGz
- The **Court may order restoration** if:
 1. The company was carrying on business; **or**
 2. It will be just to restore the name
- **Effect of Restoration:**
 1. Company as well as parties placed in the same position

Other Provisions:

- A **floating charge** created within preceding 12 months of commencement of winding up is void [Section 534].

EXCEPTIONS:

1. Valid if company was solvent immediately after creating of charge;
2. Valid to the extent of cash paid to the company as a consideration for the charge (Intt. @ 5% p.a. or CG Rate, also allowed)

Other Provisions: Noting Req'd.

- Legal Representatives would not be liable for any sum beyond the value of the estate of the deceased in their hands (**Official Liquidator vs. Parthasarthy Sinha**);
- **Arrangement b/w Co. and Creditors binding** if 3/4th majority (value + qty) of creditors approved [Section 517]. However, appeal lies to NCLT within 3 weeks from completion of arrangement;
- According to **Section 531**, any transfer of property, movable or immovable made within 6 months before the commencement of winding up will be deemed to be a **fraudulent preference** and hence invalid in the eyes of law;
- A voluntary t/f of property within preceding 12 months of commencement of winding up is void against liquidator [Section 531A]

Order of Payment of Liabilities [Section 529A & 530]

- **Payment of Liabilities – Order of priority:**

1. Overriding preferential payments u/s 529A;
2. Costs and Expenses of winding up;
3. Preferential payments u/s 530;
4. Creditors secured by a floating charge;
5. Unsecured creditors

Contributory

- It means *every person* liable to contribute to the assets of a company in the event of its being wound up;
- It also *includes* the holder of fully paid up shares [Section 428];
- **Persons Liable as Contributories:**
 1. Present & past members [Section 426];
 2. Legal representatives of a deceased member [Section 430];
 3. Official assignee or receiver of a contributory [Section 431];
 4. Liquidator of a company which is a member [Section 432];
 5. Directors and managers whose liability is unlimited [Section 427]

Nature of Contributory Liability

- The liability of contributory is not *ex-contractu* but *ex-lege* [Section 429];
- **Ex-contractu** = as a result of contract of membership;
- **Ex-lege** = as a result of his name appears in the register of members;
- Even if allotment is void **or** shares are sold but purchaser has not got his name registered in the register, he is a contributory (*ex-lege*);
- **In the absence of rectification of the register, his liability is absolute u/s 429 [Mohd. Akbar vs. Official Liquidator]**

Nature of Contributory Liability.....contd.

- **Special Points:**
- 1. In respect of unpaid calls, members of company in liquidation are liable **even though**:
 - The calls were made before liquidation; **AND**
 - The suit for their (i.e. unpaid calls) realisation had become time barred

[Pokhar Mal vs. Flour & Oil Mills Co. Ltd.]

Prevention of Oppression and Mismanagement

The Majority Rule or Supremacy of Majority

- The 'majority rule' was laid down in Foss vs. Harbottle;
- It is also called as '**Rule in Foss vs. Harbottle**;
- As per this Rule, the will of the majority **must** prevail

Oppression [Section 397]

- The term "oppression" has not been defined in the Act.
- The conduct is generally said to be oppression only when it is **burdensome, harsh and wrongful, (F & C Relevant)**
- A bonafide exercise of power given under the Act does not amount to oppression, e.g. removal of director u/s 284
- Allotment of further shares without offering to other members on pro-rata basis *plus* BM held against section 286 *plus* member who was not offered shares removed from directorships is oppression [Bhagirath Agarwala vs. Tara Properties (P) Limited]

Oppression [Section 397]

- U/s 397 it's the right of the minority shareholders to seek remedy against the oppression by the majority stakeholders;
- It must be established that the **affairs of the company** are being conducted –
 - in a manner oppressive to any member(s)
 - in a manner prejudicial to the company
- **The oppression must affect a person in his capacity of being a member**

Oppression [Section 397]

- The conduct of the company must indicate a continuous wrong. Also, **the acts constituting oppression must continue till the date of making the application.** Lack of probity (i.e. uprightness or honesty) or fair dealings must be shown (*Shanti Prasad Jain vs. Kalinga Tubes Ltd.*)
- The application must make out a prima facie that the degree of oppression is so severe that it is very fair and equitable for winding up of the company.

Mismanagement [Section 398]

- U/s 398 its the right of the minority shareholders for claiming the relief from mismanagement;
- The term 'mismanagement' has not been defined by the Act. It means some **unfair abuse of power** by the persons in charge of the management of the company.
- **Example:** Where the company is run overriding the wishes and interest of majority shareholders involving the company into costly litigations, the management can be said to be prejudicial to company
- An unwise and inefficient management does not amount to oppression, though it may amount to mismanagement under section 398.

Invoking Section 398

- Section 398 may be invoked in either of the following two situations:
 - A. The affairs of the company** are being conducted in a manner which is
 - Prejudicial to the public interest
 - Prejudicial to the interests of the company
 - B. That due to a 'material change' in the management or control of the company, it is likely that the affairs of the company will be conducted in a manner**
 - Prejudicial to the public interest
 - Prejudicial to the interests of the company

Right to Apply u/s 397 & 398 [Section 399]

Application to CLB is made:

- For a **company having a share capital**, requisite number is **lower of** –
 1. 100 members
 2. 1/10th of the total number of members
 3. 1/10th of **issued** share capital of the company
- For a **company not having the share capital**, requisite number of members means 1/5th of the total number of its members.
- **CG may permit lesser number also subject to security etc.**

Special Points as to Members

- The applicant must be member at the time of making application;
- If after making application, applicant's name is struck off, application is not affected;
- In case of Joint Application, either both should sign **or** Other's consent should be attached;
- Subsequent withdrawal of consent does not affect the application (***Rajahmundri Electric Supply Corporation Vs. Nageshwara Rao***)
