

Subject: Business Economics

Course: B.A., 2nd Semester, Undergraduate.

Paper No: 203

Paper Title: Legal Aspects of Business.

Unit No.: 3 (Three)

Title: Companies Act, 1956 Part-3

Lecture No: 3 (Three)

Title: Companies Act, 1956 Part-3

Academic Scripts

Introduction:

Hello Students, let's discuss the Companies Act 1956. In this session I explore the articles of association, prospectus, and allotment of shares, director's appointment and various types of meetings. This session must be very helpful to those who are establishing their own new company. It provides strong dialogue on company establishment and legal formalities for new entrepreneurs.

ARTICLES OF ASSOCIATION

Articles of association are the internal regulations of the company and are for the benefit of shareholders. These are the rules and regulations relating to the internal management of a company. The articles define the mode and form on which the business of the company is to be carried on.

Articles of Association

Unlimited companies, companies limited by guarantee and private companies must have their own Articles of Association.

Must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to Memorandum and duly witnessed.

Subject to the provisions of the Act and Memorandum, a company, by special resolution alter the Articles. [Section 31]

The alteration binds members in the same way as original Articles.

A company cannot in any manner deprive itself of the powers to alter its Articles.

Content of Article of Association

1. Rights of different classes of shareholder.
2. Use of common seal of the company.
3. Different classes of shares and their right.
4. Appointment , powers, duties, salary of MD, manager, and secretary.
5. Borrowing power of directors.
6. Voting rights of member .
7. Board meetings and proceedings.
8. Winding up company.

Limitation on Alteration

Must not exceed the power in the Memorandum.

Must not be inconsistent with the provisions of the Act.

Must not include anything illegal or opposed to public policy.

Must be bona fide for the benefit of the company.

Must not constitute fraud on minority.

Cannot be altered so as to have retrospective effects.

In case of listed companies approval of Stock Exchange is required.

Alteration of liabilities clause

The liabilities of members cannot be increased without their consent in writing. A member cannot by altering the memorandum of article be made to take more shares or to pay more for the shares already taken unless he agrees to do so in writing either before or after the adulteration.

Prospectus

Meaning of Prospectus: Section 2 (36)

Prospectus means any document described or issued as a prospectus.

Prospectus includes any notice, circular, advertisement or other documents,

"Any document described or issued as a prospectus and includes

any notice,

circular,

advertisement, or

other document

inviting deposits from the public or

for the subscription or purchase of any shares in, or debenture of a body corporate." [(Section 2(36))]

Dating to prospectus

Section 55 states that every prospectus must be dated, and that is deemed to be the date of publication of the prospectus.

Difference between Article of Association and Memorandum of Association

o Memorandum controls external operations of the company whereas articles control internal operations of the company.

O Memorandum are the conditions introduced for the benefits of creditors, buyers, debtors, sellers and outside public whereas articles govern the relationship between the company and the shareholders, members amongst the members. It is just like the partnership deed in a partnership.

What constitute a Prospectus?

An invitation to public.

Invitation be by or on behalf of the company.

Invitation must be to subscribe or purchase.

Must relate to shares / debentures or other instrument.

Judicial Pronouncements

Statement in lieu of Prospectus

Promoters are required to prepare a draft prospectus known as statement in Lieu of Prospectus.

A copy of it must be filled with the RoC at least three days before any allotment of shares is made.

It contains similar particulars as are required for a prospectus.

No minimum subscription is required to be stated.

Allotment of Shares: Rule to be observed

1. A prospectus shall be filed with Registrar. No allotment of shares shall be made to public unless the minimum subscription amount stated in the prospectus is raised and received by the company.
2. Application for shares should be made in prescribed form.
3. No allotment shall be made until the beginning of the 5th day after a date on which prospectus is issued.
4. Companies intending to offer must make an application to one or more stock exchanges for permission.
5. The whole of the application money should have been paid and received by company in cash.
6. All moneys received shall be deposited in a Scheduled Bank until the certificate to commence business is

The rights and duties of shareholders are defined from time to time of issue of shares. The rights of shareholders are fixed which can't be altered unless the Companies Act gets modified.

Criminally Liability for Mis-Statements in prospectus

(1) Where a prospectus issued after the commencement of this Act includes any untrue statement, every person who authorised the issue of the prospectus shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to 1 [fifty] thousand rupees, or with both, unless he proves either that the statement was immaterial or that he had reasonable ground to believe, and did up to the time of the issue of the prospectus believe, that the statement was true. (2) A person shall not be deemed for the purposes of this section to have authorised the issue of a prospectus by reason only of his having given - (a) the consent required by section 58 to the inclusion therein of a statement purporting to be made by him as an expert, or (b) the consent required by sub-section (3) of section 60.

Allotment of Shares

When a company wishes to raise capital, it may do so by bringing a fresh issue of shares in the market. The people who wish to purchase the shares of the company may apply for the number of shares desired by them in an application form accompanied by some money called 'application money'. After a specified time, the company issuing shares, scrutinizes all the applications and 'allots' the shares to the eligible applicants.

What is Allotment?

The Companies Act, 1956 does not define the term "allotment"

Allotment is governed by a number of general and special provisions. These are discussed below.

(A) General Provisions: As mentioned above, allotment leads to a contract between the company and shareholder. Thus, some general provisions of the Indian Contract Act, 1872 apply to allotment of shares. These are:

- proper authority- The allotment must be done by i.e. the Board of directors or as mentioned by the articles.
- reasonable time- The allotment must be done within a or else the applicant may refuse to accept the offer.
- communicated- The allotment must be A mere resolution is not enough, the decision to allot shares must be communicated to the shareholder.
- absolute and unconditional- The allotment must be If the shareholder had mentioned any conditions in the application, the allotment is valid only if the conditions are met and not otherwise.
- If the above provisions are not met, the allotment is null and void.

(B) Special Provisions: As per the Companies Act, 1956 there are certain conditions that must be satisfied for allotment of shares by a public company. These provisions differ depending on whether the issue is made to the public or not and also whether the company is allotting the shares for the first time. These are discussed from the following page:

(C) Special Provisions: As per the Companies Act, 1956 there are certain conditions that must be satisfied for allotment of shares by a public company. These provisions differ depending on whether the issue is made to the public or not and also whether the company is allotting the shares for the first time.

First Allotment of Shares – Initial allotment of shares can be done only if the company follows the following rules:

Registers its Prospectus - (Section 60(1)) – The company has to file a copy of the prospectus duly signed by the directors with the registrar on or before the date when the prospectus is made available to public.

- **Receives The Minimum Subscription – (Section 69)** – A public company can allot shares only if it receives the 'Minimum Subscription' for its shares along with the application money. The amount of minimum subscription is stated in the prospectus and cannot be less than 90% of the issue. If the company fails to receive the minimum subscription within 120 days of issue of the prospectus, then it will have to repay the money received from applicants for shares within the next 10 days. If the company fails to do so, the directors of the company will be jointly and severally liable to repay that money with interest (@ 6%p.a.) after the said time limit. However, these provisions should be read in combination with SEBI guidelines ¹².
- **Receives Application Money (Section 69)** – According to Section 69(3), the amount of application money cannot be less than 5% of the face value of the share.
- **Deposits the amount received in a Separate Account –** According to Section 69(4), the amount of application money received has to be deposited in a separate account in a scheduled bank till the company receives a certificate of commencement or till it raises the minimum subscription for the issue.
- **Follows the rules regarding the Subscription List (Section 72)** – A company can only start allotting shares from the fifth day after the issue of prospectus (or at a later time as prescribed in the prospectus). This time is known as the 'opening of the subscription list'. According to Section 74, while counting the fifth day, any day which is a public holiday under the Negotiable Instruments Act, 1881, is not to be included. Although a default in following the provisions of section 72 does not invalidate allotment but such a failure imposes on the company and every defaulting officer a fine extending upto Rs 50,000. The Companies Act, 1956 does not specify the number of days for which the subscription list is to be kept open. But as per the norms of the stock exchanges, the list must remain open for a minimum of 3 days and should be closed within 10 days.
- **Gets Shares listed on a Stock Exchange (Section 73)** - The company must apply to one or more recognised stock exchanges for listing its shares. The name of the stock exchange(s) where such permission is sought must be given in the prospectus. If the company fails to get the shares listed before the expiry of ten weeks from the date of the closing of the subscription lists the allotment is void. In such a case, the company has to refund without interest all money received from applicants within 8 days. If it fails to do so, the company and every defaulting director will be jointly and severally liable to pay back the money with interest at such rate as may be prescribed ¹³.

(B) Subsequent Allotment of Shares- In case of subsequent allotment of shares, most of the above provisions apply. Thus, the company has to –

- Register its Prospectus - (Section 60(1))
- Receive Application Money (Section 69)
- Follow rules regarding the Subscription List (Section 72)
- Get the Shares listed on a Stock Exchange (Section 73)

It is, however, not required to ensure a minimum subscription and to deposit the money in a separate bank account.

In case of allotment of debentures, the company is required to follow the following special provisions as explained above –

- Register its Prospectus - (Section 60(1))
- Follow rules regarding the Subscription List (Section 72)
- Get the Debentures listed on a Stock Exchange (Section 73)

Board of Directors

- There are mainly two types of company directors - Executive Directors or Whole-Time Directors (MD, Technical Directors) and, Non-executive or part-time Directors who are professionals and serve on the board of many companies.
- Executive directors have employment stake in the company. They wield substantial power, enjoy maximum remuneration, perquisites, fees, commission and allowances.
- Part-time directors get only sitting fees for the board meetings attended by them and wield little or no powers.
- "A director includes any person occupying the position of director by whatever name called." [Section 2(13)]
- Only individual, and not a body corporate, association or firm, shall be appointed as director. [Section 253]
- "An individual who direct, control, manage, superintend the affairs of the company in the form of the board of directors."

Share: Share is defined as “an interest having a money value and made up of diverse rights specified under the articles of association”. Share capital: Share capital means the capital raised by the company by issue of shares. A share is a share in the share capital of the company including the stock.

Share gives a right to participate in the profits of the company, or a share in the assets when the company is going to be wound up.

Director elected by Small Shareholders- Section 151

Director elected by Small Shareholders- Section 151 According to section 151 of the Act every listed company may have one director elected by such small shareholders. For the purpose of this section, “small shareholder” means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum as may be prescribed.

Rights of Shareholders and Members

Right issue which shareholders hold of a company under Companies Act, 1956 are as follows:-

1) Rights attached to shares of any class can be varied with the consent of shareholders holding not less than 75% of issued shares.

2) **Rights of Dissenting Shareholders:** Protection by Companies Act is given to the shareholders who doesn't consent to or vote for variation of their rights. If there is any variance in any rights of any class of shareholders then holders of not less than 10% of shares of that class can apply to the court to have the variation cancelled. It won't have any affect till it is been approved by the court.

3) **Voting rights of the members:** - Every member of public company which have the shares holding equity have votes in proportions to his share in paid up equity capital.

4) Preference shareholders don't have any voting rights. They can vote only on matters which are directly related to the rights attached to preference share capital.

There is a right to vote for every equity shareholder at general meeting. No company can stop any member from his voting right on any ground. The members voting rights can be changed if member doesn't make payment or other sums which are due against.

Appointment of Director

The Companies Act, 2013 does not contain an exhaustive definition of the term “director”. Section 2 (34) of the Act prescribed that “director” means a director appointed to the Board of a company. A director is a person appointed to perform the duties and functions of director of a company in accordance with the provisions of the Companies Act, 2013.

Minimum number of Directors

Minimum/Maximum Number of Directors in a Company- Section 149(1) Section 149(1) of the Companies Act, 2013 requires that every company shall have a minimum number of 3 directors in the case of a public company, two directors in the case of a private company, and one director in the case of a One Person Company. A company can appoint maximum 15 fifteen directors. A company may appoint more than fifteen directors after passing a special resolution in general meeting and approval of Central Government is not required. A period of one year has been provided to enable the companies to comply with this requirement.

Liability of an Independent Director-Section 149 (12) An independent director and a non-executive director except the promoter or key managerial personnel, shall be held liable only in respect of such acts of omission or commission by a company which had occurred with his knowledge, attributable through Board processes and with his consent or connivance or where he had not acted diligently.

Company Meetings

A company being an artificial person expresses its will or takes its decision through resolutions passed at regularly convened meeting of the general body of the shareholders, and the directors.

The companies Act provide the shareholders a forum of self-protection, which is general meeting of shareholders.

The shareholders can use the forum to appoint directors as well as auditors of their own choice who may safeguard them from the possible manipulation.

The business of the meeting is conducted in the form of resolutions proposed and passed.

Types of Company Meetings

Shareholders Meetings:

Statutory Meeting under Section 165;

Annual General Meetings under Section 166;

Extraordinary General Meetings:

Convened by directors on requisition under Sec 169.

Types of other Meetings

Meetings of the Board of Directors.

Meetings of the Board Committee.

Class Meetings of Shareholders.

Meetings of the Debenture holders.

Meetings of the Creditors.

Meetings of the Contributories in winding up

Statutory Meetings [Section 165]

Companies limited by guarantee and share shall, within one month and not more than six months from the date of commencement of business, hold a general meeting of the members to be called the Statutory Meeting.

Failure to hold Statutory Meeting renders the company liable to be wound up u/s 433(b).

This provision is not applicable to a private company. [Section 165(10)]

The board shall, at least 21 days before the day on which the meeting is held, forward a report to every member of the company called Statutory Report.

Annual general meeting (Sec. 166, 167 & 171): Every company shall in each year hold in addition to any other meeting an annual general meeting. Such meeting shall be specified in the notice calling it. Not more than 15 months shall elapse between the date of one general meeting and that of the next. The directors are responsible for calling a general meeting. A company may hold its first annual general meeting within 18 months from the date of its incorporation.

Resolutions: Matters in a company are decided by resolutions in the meetings. Items listed in the agenda to the notice of the meetings are decided by resolutions. Kinds of Resolutions: i) Ordinary resolutions; ii) Special resolutions; iii) Resolutions requiring special notice; iv) Board resolutions. Minutes of the Meeting: Every company shall keep the following books at the registered office of the company for purposes of recording the minutes: i) General meetings minute book; ii) Board meetings minute book; iii) Minutes of proceedings of committee of directors.

Kinds of Resolutions

Resolutions mean decisions taken at a meeting. A motion, with or without amendments is put to vote at a meeting. Once the motion is passed, it becomes a resolution. A valid resolution can be passed at a properly convened meeting with the required quorum. There are broadly three types of resolutions:-

1. Ordinary Resolution:

An ordinary resolution is one which can be passed by a simple majority. I.e. if the votes (including the casting vote, if any, of the chairman), at a general meeting cast by members entitled to vote in its favour are more than votes cast against it. Voting may be by way of a show of hands or by a poll provided 21 days' notice has been given for the meeting.

2. Special Resolution:

A special resolution is one in regard to which is passed by a 75 % majority only i.e. the number of votes cast in favour of the resolution is at least three times the number of votes cast against it, either by a show of hands or on a poll in person or by proxy. The intention to propose a resolution as a special resolution must be specifically mentioned in the notice of the general meeting. Special resolutions are needed to decide on important matters of the company. Examples where special resolutions are required are :-

1. To alter the domicile clause of the memorandum from one State to another or to alter the objects clause of the memorandum.
2. To alter / change the name of the company with the approval of the central government
3. To alter the articles of association
4. To change the name of the company by omitting "Limited" or "Private Limited". The Central Government may allow a company with charitable objects to do so by special resolution under section 25 of the Companies Act, 1956.

3. Resolution requiring Special Notice:

There are certain matters specified in the Companies Act, 1956 which may be discussed at a general meeting only if a special notice is given regarding the proposal to discuss these matters at a meeting. A special notice enables the members to be prepared on the matter to be discussed and gives them time to indicate their views on the resolution. In case special notice of resolution is required by the Companies Act, 1956 or by the articles of a company, the intention to propose such a resolution must be notified to the company at least 14 days before the meeting. The company must within 7 days before the meeting give the notice of the proposed resolution to its members. Notice of the resolution is required to be given in the same way in which notice of a meeting is given, or if that is not practicable, the company may give notice by advertisement in a newspaper having an appropriate circulation or in any other manner allowed by the articles, not less 7 days before the meeting.

The following matters requiring Special Notice before they are discussed before the meeting :-

1. To appoint at an annual general meeting appointing an auditor a person other than a retiring auditor.
2. To resolve at an annual general meeting that a retiring auditor shall not be reappointed.
3. To remove a director before the expiry of his period of office.
4. To appoint another director in place of removed director.
5. Where the articles of a company provide for the giving of a special notice for a resolution, in respect of any specified matter or matters.

Please note that a resolution requiring special notice may be passed either as an ordinary resolution (Simple majority) or as a special resolution (75 % majority).

Circulation of Member's Resolution

generally, the Board of Directors prepare the agenda of the meeting to be sent to all members of the meeting. A member, by himself has very little say in deciding the agenda. However, there are provisions in the Companies Act which enable members to introduce motions at a meeting and give prior notice of their intention to do so to all other members of the company. If members having one twentieth of the total voting rights of all members having the right to vote on a resolution or if 100 members having the right to vote and holding paid-up capital of Rs1,00,000 or more, require the company to do so, the company must :-

Give to the members entitled to receive notice of the next annual general meeting, notice of any resolution which may be properly moved and is intended to be moved at that meeting; and

1. Circulate to members entitled to have notice of any general meeting sent to them, any statement of not more than 1,000 words with respect to the matter referred to in any proposed resolution, or any business to be dealt with at that meeting.

The expenses for this purpose must be borne by the requisitionists and must be tendered to the company. The requisition, signed by all the requisitionists, must be deposited at the registered office of the company at least 6 weeks before the meeting in the case of resolution and not less than 2 weeks before the meeting in case of any other requisition together with a reasonable sum to meet the expenses. However, where a copy of the requisition requiring notice of resolution has been deposited at the registered office of the company and an annual general meeting is called for a date six weeks or less after the requisition is deposited, the copy though not deposited within the prescribed time is deemed to have been properly deposited.

The company is required to serve the notice of resolution and/or the statement to the members as far as possible in the manner and so far as practicable at the same time as the notice of the meeting ; otherwise as soon as practicable thereafter.

However, a company need not circulate a statement if the Court, on the application either of the company or any other aggrieved person, is satisfied that the rights so conferred are being abused to secure needless publicity or for defamatory purposes. Secondly a banking company need not circulate such statement, if in the opinion of its Board of directors, the circulation will injure the interest of the company.

Summary:

In this session we covered legal process related to establishment of companies. This lesson delivers, how allotment of shares, members and companies meeting are contributing their own role for the success of company. Article of association and prospectus contributes the main procedure to get entry into company. Resolution given the whole idea of how it's required for special concern in companies act. And given complete specifics for resolution which is significant to the companies while transiting resolution. I hope this lecture must very helpful to the students and those who want to start their own new company.