

## UNIT-3

### THE COMPANIES ACT, 1956

#### INTRODUCTION

Generally speaking, a company means a voluntary association of individuals formed for some common purpose. It has no strictly technical and legal meaning. It is a legal device for the attainment of common social or economic objectives.

#### MEANING OF COMPANY

- A company is an artificial person created by law.
- A company means a group of persons associated together for the attainment of a common end, social or economic.
- According to **Justice James** “A company is a association of persons united for a common object.”
- According to **Justice Marshal** “A joint stock company is an artificial person-invisible, intangible and existing only in the eyes of law.”
- **Section 3(1)(i) of the Companies Act, 1956** defines a company as: “a company formed and registered under this Act or an existing Company”.
- ‘Existing Company’ means a company formed and registered under any of the earlier Company Laws.

#### CHARACTERISTICS OF A COMPANY

##### **1. Separate Legal Entity**

- A company is in law regarded as an entity separate from its members. It has an independent corporate existence.
- Any of its members can enter into contracts with it in the same manner as any other individual can and he cannot be held liable for the acts of the company even if he holds virtually the entire share capital.
- The company’s money and property belongs to it and not to the shareholders (although the shareholders own the company).

##### **2. Limited Liability**

- A company may be a company limited by shares or a company limited by guarantee. In a company limited by shares, the liability of members is limited to the unpaid value of the shares.

##### **3. Perpetual Succession**

- Being an artificial person a company never dies, nor does its life depend on the life of its members.
- Members may come and go but the company can go on forever. It continues to exist even if all its members are dead. The existence of company can be terminated only by law.
- It means that a company’s existence persists irrespective of the change in the composition of its membership.

##### **4. Common Seal**

- Since a company has no physical existence, it must act through its agents and all such contracts entered into by its agents must be under a seal of the company. The common seal acts as the official signature of the company.

## 5. Transferability of Shares

- The capital of a company is divided into parts called shares. These shares are, subject to certain conditions, freely transferable, so that no shareholder is permanently wedded to the company. When the joint stock companies were established the great object was that the shares should be capable of being easily transferred.

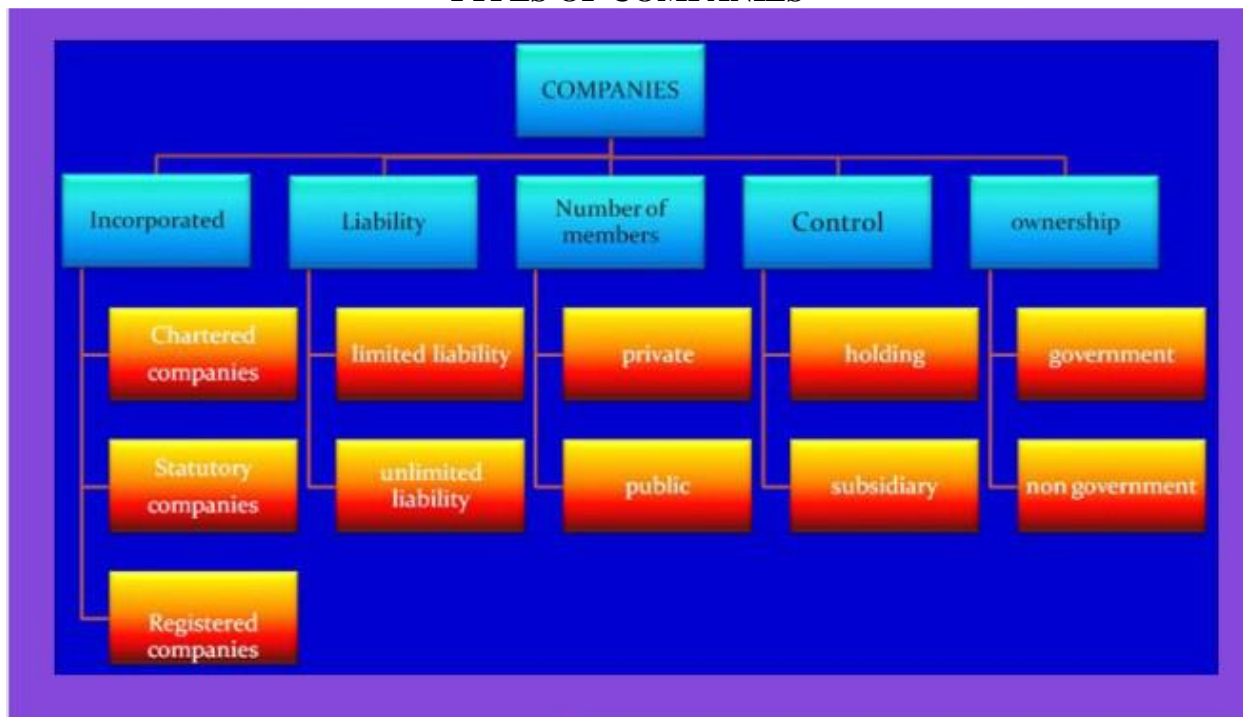
## 6. Separate Property

- As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name. Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property.
- The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

## 7. Can Sue in its Name

- A company, being a legal person, can enforce its rights through suits and by the same token, it can be sued for breach of its legal duties

## TYPES OF COMPANIES



### (A) ON THE BASIS OF INCORPORATION

#### 1. Chartered Companies:

These companies are incorporated under the Royal or a special charter granted by the British King or Queen. The powers and nature of business of the companies of this type are defined in the charter.

#### 2. Statutory Companies:

These are companies which are created by a special Act of legislature e.g. RBI, SBI, LIC, etc. These are mostly concerned with public utilities as railways, tramways, gas and electricity companies and enterprises of national level importance.

### **3. Registered Companies:**

These are the companies which are formed and registered under the Companies Act, 1956 .

#### **(B) ON THE BASIS OF LIABILITY**

##### **1) Companies with limited liability-**

###### **(a) Limited by Shares:**

Where the liability of the members of a company is limited to the amount unpaid on the shares, it is known as company limited by shares. If the shares are fully paid, the liability of the members holding such shares is nil. It may be a public or a private company.

###### **(b) Limited by Guarantee:**

Where the liability of the members of a company is limited to a fixed amount which the members undertake to contribute to the assets of a company in the event of its being wound up, the company is called a company limited by guarantee. These companies are not formed for the purpose of profit but for the promotion of art, science, charity, sports or for some similar purposes. They may or may not have a share capital.

##### **2) Companies with unlimited liability:**

Sec 12 specifically provides that any 7 or more persons may form an incorporated company with or without limited liability. In such case every member is liable for the debts of the company. An unlimited company may or may not have a share capital. If it has a share capital, it may be a public company or a private company. It must have its own Articles of Association.

#### **(C) ON THE BASIS OF NUMBER OF MEMBERS**

##### **1) Private Company:**

A company which has a minimum paid-up capital of Rs 1,00,000 or such higher paid up capital as may be prescribed, and by its articles.

- a. Restricts the right to transfer its shares, if any
- b. Limits the number of its members to 50.
- c. Prohibits any invitation to the public to subscribe for any shares in, or debentures of, the company,
- d. Prohibits any invitation or acceptance of deposits from persons other than its members, directors or their relatives.

##### **2) Public Company:**

A public company means a company which-

(a) has a minimum paid-up capital of Rs. 5 lakh or such higher paid-up capital, as may be prescribed;

(b) is a private company which is a subsidiary of a company which is not a private company;

Every public company, existing on the commencement of the Companies Act, 2000, with a paid-up capital of less than Rs. 5 lakh, within a period of two years from such commencement, enhance its paid-up capital to Rs. 5 lakh.

#### **(D) ON THE BASIS OF CONTROL**

##### **1) Holding Companies:**

A company is known as the holding company of another company if it has the control over that other company. A company is deemed to be the holding company of another if, but only if, that other is its subsidiary.

## **2) Subsidiary company:**

A company is known as a subsidiary of another company when control is exercised by the holding company over the former called a subsidiary company.

## **(E) ON THE BASIS OF OWNERSHIP**

### **1) Government Company:**

A government company means any company in which not less than 51% of the paid-up share capital is held by-

- a) The central government, or
- b) Any state government, or governments, or
- c) Partly by central government and partly by one or more state government.

### **2) Non-Government Companies:**

All those companies which are registered and incorporated under the Companies Act but which are not government companies are known as non-government companies. It implies that if 51 per cent or more of the paid up share capital is held by the private sector, it is called a non government or private sector company. Tata Iron and Steel Company Ltd. (TISCO), Reliance Industries Ltd. (RIL) and Hindustan Lever Ltd. (HLL) are a few examples.

### **3) Foreign Company:**

It means any company incorporated outside India which has an established place of business in India. Where a minimum of 50% of the paid up share capital of a foreign company is held by one or more citizens of India or/and by one or more bodies corporate incorporated in India, whether singly or jointly, such company shall comply with such provisions as may be prescribed as if it were an Indian company.

## **FORMATION OF COMPANY**

A company is an association of persons formed for some common purpose. The process of formation of a company can be divided under the following four stages:

- i) Promotion
- ii) Incorporation
- iii) Capital subscription
- iv) Commencement of business

### **1. PROMOTION**

- Promotion is the first stage in formation of a company.
- This stage covers all the preliminary steps incidental to the formation of the company.
- It covers the questions like whether it should be a private company or a public company, what business is to be done by the company, when it is to be done, what its capital should be and whether it would be worth to form a new company or take over the business of an already established concern.
- Promotion begins with the conception of an idea and it goes on to include preliminary investigations into the feasibility and preparation of necessary documents, making preliminary contracts, arrangement of finance etc.

### **Promoters**

A promoter is a person who does the necessary preliminary work incidental to the formation of a company.

A promoter is one who “plans to form a company, prepares memorandum of association and articles of association, gets them registered, looks for directors, enters into preliminary contracts and makes arrangements for advertising and circulating the prospectus and placing the capital.”

## **Functions of promoters**

### **1. Planning**

- Plans regarding the nature of business to be started.
- Decide what business should be done, when it should be done, where it should be done and how it should be done.
- Decide the amount of capital required and the sources from which the capital will be acquired.
- In this way, the promoters determine the scope of the company.

### **2. Nomenclature**

Promoters decide the name of the proposed company, location of the registered office and objective of the company.

### **3. Arrangement of necessary infrastructure**

The promoters arrange the necessary infrastructural facilities like land, building, machinery and other equipments.

### **4. Preparation of documents**

The promoters get memorandum of Association and Articles of Association prepared with the help of legal experts, to be submitted to the Registrar for the registration of the company.

### **5. Arrangement of capital**

- Make necessary arrangements for acquiring the capital.
- If the company to be incorporated is a public company and invitation is to be given to the public for the purchase of its shares, the promoters also have to prepare the prospectus.

### **6. Consent of directors**

The promoters decide the first directors of the company and get their consent to act as directors.

### **7. Appointments**

Promoters appoint the banker, the auditor, the legal adviser and the broker of the company. They also enter into pre-incorporation or preliminary contracts for the incorporation of the company.

### **8. Miscellaneous**

The promoters submit the necessary documents along with the required fees to the Registrar of companies after completing the necessary legal formalities and get the certificate of incorporation.

## **2. INCORPORATION**

- It is the second stage in the formation of a company.
- The act of forming a corporation or company is called incorporation.
- It is the process of uniting a group of persons into a legal body by following the prescribed procedure.
- Before applying for registration, it must be ascertained from the Register of companies whether the proposed name has been approved.
- The following documents are to be filed with the Registrar:

- 1) The memorandum of association duly signed by the subscribers.
- 2) The articles of association, if any, signed by the subscribers.
- 3) The agreement, if any, which the company proposes to make with an individual for appointment as its managing or whole time director or manager.
- 4) A list of persons who have consented to become the directors of the company and their written consent to act as such and to take up the qualification shares.
- 5) A declaration stating that all the legal requirements of the Companies Act and other formalities relating to registration have been complied with.
- 6) Within 30 days of the incorporation of the company, a notice of the situation of the registered office of the company shall be given to the Registrar.

- If the Registrar is satisfied that all the aforesaid requirements have been complied with by the company, he will register the company and issue the certificate of incorporation.

### **3. CAPITAL SUBSCRIPTION**

A private company or a public company not having share capital can commence business immediately on incorporation. Public companies raise its capital by inviting the public to subscribe to its share capital. The steps involved are:

- a) Obtaining SEBI clearance.
- b) Entering into an agreement with the underwriter.
- c) Applying to stock exchange for listing of shares.
- d) Inviting public to subscribe to its share capital through a prospectus.
- e) Allotment of shares.

### **4. COMMENCEMENT OF BUSINESS**

- It is the last stage in the process of formation of a company.
- A private company can commence business immediately after incorporation.
- In the case of a public company, the certificate for the commencement of business has to be obtained by submitting the following statements to the Registrar:
  - a) A declaration that a copy of prospectus is filed with him.
  - b) A declaration that minimum subscription has been received.
  - c) A declaration that the directors have taken up the qualification shares and have paid for them.
  - d) A certificate issued by a director or secretary to the effect that all conditions for the commencement of business have been fulfilled.

### **DOCUMENTS OF COMPANIES**

- Memorandum of Association (MoA)
- Article of Association (AoA)
- Prospectus

### **THE MEMORANDUM OF ASSOCIATION (MoA):**

- The MoA is a document which contains the fundamental rules regarding the constitution and activities of the company.
- It is the charter of the company defines its reason for existence.
- It lays down the area of operation of the company.
- It also regulates the External Affairs of the company.
- It also defines the scope of its activities.

- Enables the shareholders, creditors and people who deal with the company to know the range of its activities.

### **Contents of MoA : Sec 13**

#### **1) The Name Clause**

- The name of the company should be stated in this clause.
- The name should not be identical or similar to that of a company already registered. It should not be misleading.
- It should not also use names of World Bodies like U.N.O., W.H.O., World Bank etc.
- If it is a Public Limited Company, the name of the company should end with the word 'Limited' and if it is a Private Limited Company, the name should end with the words 'Private Limited'.

#### **2) The Registered Office Clause**

- Every company shall have a registered office from the day on which it begins to carry on business.
- A company can have only one registered office.
- A registered office is the place where the company keeps all its books of accounts, common seal and the shareholders register along with other statutory documents.
- The company should intimate the location of registered office to the registrar within thirty days from the date of incorporation or after the date of change.

#### **3) The Object Clause**

- This clause specifies the objects for which the company is formed.
- It is difficult to alter the objects clause later on.
- This clause mentions all possible types of business in which a company may engage in future.
- The object clause helps the creditors to know as to what their money is being used for and gives a better sense of security.

#### **4) The Capital Clause**

- This clause mentions the maximum amount of capital that can be raised by the company.
- The division of capital into shares is also mentioned in this clause.
- A private company needs a minimum capital of one lakh rupees and a public limited company needs a minimum capital of five lakh rupees.

The memorandum of association must be subscribed by at least 7 persons in case of public limited and 2 persons in case of private limited companies.

#### **5) The Liability Clause**

- This clause states the liability of the members of the company.
- The liability may be limited by shares or by guarantee.
- In case of company limited by shares, if the shares are fully paid liability of the members is nil.
- In case of company limited by guarantee, the liability clause must state the amount each member has to pay at the time of liquidation of the company.
- In case of unlimited company, liability of the members is unlimited and personal assets of members can be used.

## 6) The Association Clause

- It contains the names and addresses of the first subscribers.
- The subscribers to the Memorandum must take at least one share.
- Each subscriber must write the number of shares held by him.

NOTE : The MoA must be signed by at least seven subscribers in the case of Public Company and two in the case of Private company.

### **ARTICLE OF ASSOCIATION (AoA)**

- The AoA are the rules, regulations and by laws for the internal management of the company.
- They are framed with the object of carrying out the aims and objects as set out in the MoA.
- AoA should be printed, divided into paragraphs and serially numbered.
- Alteration of AoA is done by passing a special resolution.

### **Contents of AoA:**

1. Division of share
2. Procedure of holding and conducting the meetings.
3. Voting rights of members and rules regarding methods of voting.
4. Matters relating to terms of appointment, powers duties, qualification and remuneration of directors.
5. Methods to increase or decrease capital.
6. Rules regarding common seal of the company.
7. Rules relating to issue of share capital.
8. Declaration of dividend and rules regarding its payment.
9. Rules relating to accounts, audit charging of depreciation and creation of reserves etc.
10. Methods of securing loans.
11. Procedure of winding up of a company.

### **PROSPECTUS**

Sec.2 (36) defines a prospectus as “any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for subscription to or purchase of any shares in or debentures of a body corporate”.

“Certificate of Lieu of Prospectus” is issued by a public company, where the company doesn’t invite public subscription.

### **Contents of Prospectus:**

1. Date of issue of prospectus.
2. Name and register office of the company.
3. Consent of Central Govt. for the present issue/compliance with the with the SEBI guidelines. Voting rights, dividend, expenses on issue etc.
4. Name of the stock exchange.
5. Punishment for fictitious application.
6. Refund of issue if 90% min. subscription not received.
7. Names and addresses of leading managers.
8. Issue of allotment letter or refund within 10 weeks with interest.
9. Date of opening and closing of issues.
10. Credit rating from CRISIL (Credit Rating Information Services of India Limited)



11. Terms of Underwriting & Risk Factors.
12. Capital Structure of the company
13. Terms and particulars of the issue.
14. Restriction on transfer and transmission of shares.

### **SHARES**

- A share is the interest of a shareholder in a definite portion of the capital.
- It expresses a proprietary relationship between the company and the shareholder.
- Section 2(46) defines a share as, “A share in the share capital of a company and includes stock except where a distinction between stock and shares is expressed or implied.”

### **STOCK**

- When shares are fully paid up, they may be converted into stock.
- Stock is simply a set of shares put together in a bundle.
- It is the aggregate of fully paid shares legally consolidated.
- The aggregate can be split up into fractions of any amount without regard to the original nominal amount of shares.

### **TYPES OF SHARES**

According to Section 86 of the Companies Act, a company can issue only two types of shares –

- (a) Preference shares; and
- (b) Equity shares.

#### **Preference shares:**

- Preference share with reference to any company limited by shares, are those which have two characteristics:
  - a. They have a preferential right to be paid dividend during the lifetime of a company; and
  - b. They have a preferential right to the return of capital when the company goes into liquidation.
- Various kinds of preference shares are:
  1. Cumulative and non-cumulative preference shares
  2. Convertible and non-convertible preference shares
  3. Participating and non-participating preference shares
  4. Redeemable preference shares

### **Equity shares:**

- All shares which are not preference shares are equity shares.
- Equity shareholders have the residual right of the company.
- They may get higher dividend than preference shareholders if the company is prosperous or get nothing if the business of the company flops.
- In the winding up, the equity shares are entitled to the entire surplus assets remaining after the payment of the liabilities and the capital of the company, unless the articles confer right on the preference shares a right to participate in the distribution of surplus assets.

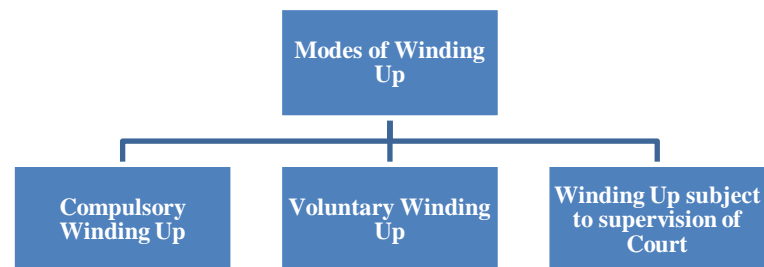
### **APPLICATION AND ALLOTMENT OF SHARES**

A prospectus issued by a company inviting the public to subscribe to the shares of a company is a mere invitation. An application for shares is an offer by a prospective shareholder to take shares. When an application is accepted it is an allotment. Allotment creates a binding contract between the company and the applicant. Allotment as such has not been defined in the Companies Act. It is the appropriation by the directors to an applicant by a resolution of a certain number of shares in the company in response to an application.

### **WINDING UP OF COMPANY**

- Winding up is the last stage of putting an end to the life of the company, when all other strategies for its survival fails.
- It is a process whereby the assets are sold, liabilities are paid and surplus, if any, is distributed to the shareholders (contributories)
- Winding up of a company may be defined as “Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator called a liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights.”

### **Modes of Winding up:**



#### **(1) Compulsory Winding Up:**

- A company may be wound up by an order of the Court. This is called compulsory winding up or winding up by the Court.
- Grounds for compulsory winding up:
  1. By special resolution of the company
  2. Default in filing statutory report to the registrar or holding statutory meeting.
  3. Failure to commence business within one year or suspension of business for a whole year.
  4. Reduction of membership below the minimum.

5. Company's inability to pay its debts.
6. Just and Equitable clause.

The Court does not choose to wind up a company at its own motion. It has to be petitioned. The petition for winding up may be brought by anyone of the following:

1. Petition by Company
2. Petition by Creditors
3. Petition by Contributors
4. Petition by Registrar
5. Petition by any Person authorised by the Central Government.

Advertisement of petition: Every petition for winding up a company shall be advertised 14 days before the hearing, stating the date on which petition was presented and the names and addresses of petitioners.

#### **Consequences of winding up:**

- (i) Intimation to Official Liquidators and Registrar.
- (ii) A copy of winding up to be filed with the Registrar.
- (iii) Order of winding up deemed to be notice of discharge.
- (iv) Pending suits shall not be proceeded.
- (v) Official Liquidator to be Liquidator.

#### **(2) Voluntary Winding Up**

- Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up'.
- In voluntary winding up, the company and its creditors are left free to settle their affairs without going to the Court.
- A company may be wound up voluntarily under the following circumstances:
  - a. By ordinary resolution when the period fixed for the duration of the company in the articles has expired or when the article has specified an event and the event had happened.
  - b. By a special resolution. Within 14 days of the resolution, inform the public (newspaper)

#### **2 types:**

##### **(a) Members' Voluntary Winding Up (Sections 490-498):**

- A members' voluntary winding up takes place only when the company is solvent.
  - A declaration of solvency must be filed with registrar.
  - It is initiated by the members and is entirely managed by them.
- Provisions:
- Appointment and remuneration of liquidators.
  - Notice of appointment of liquidator to be given to Registrar.
  - Board's power to cease on the appointment of a liquidator.
  - Power to fill vacancy in office of liquidator.
  - Power of liquidator to accept shares, etc as consideration for sale of property.
  - Duty of liquidator to call creditor's meeting in case of insolvency.
  - Final meeting and dissolution.

##### **(b) Creditors' Voluntary Winding Up (Sections 500-509):**

- The creditors move the resolution for voluntary winding up of a company.

- There is no solvency declaration made by the directors of the company.
- In other words, when a company is insolvent, that is, it is not able to pay its debts, it is the creditors' voluntary winding up.
- Meeting of the creditors.
- Provisions:
  - Meeting of creditors.
  - Notice of resolution to be given to Registrar.
  - Appointment and remuneration of liquidator.
  - Appointment of committee of inspection.
  - Board's power to cease on the appointment of a liquidator.
  - Power to fill vacancy in office of liquidator.
  - Power of liquidator to accept shares, etc as consideration for sale of property.
  - Duty of liquidator to call creditor's meeting in case of insolvency.
  - Final meeting and dissolution.

### **(3) Winding Up Subject to Supervision of the Court**

- Any contributory, creditor or the liquidator may apply to the court after passing a special resolution to that effect.
- The court may make an order that voluntary winding up shall continue under its supervision.
- The court will protect the minority interest, majority shareholders and creditors.
- The court may also pass an order stating it as compulsory winding up.

### **Suggested Readings:**

- 1) Avtar Singh, Company law, Lucknow, Eastern
- 2) Khergamwala J.S. The Negotiable Instrument Acts. Bombay, N.M. Tripathi.
- 3) Ramaiya, A. Guide to the Companies Act. Nagpur, Wadhwa.
- 4) Shah, S.M. Lectures on, Company Law. Bombay, N.M. Tripathi.
- 5) Tuteja S.K. business Law for Managers, New Delhi, Sultan Chand.