

## [MODULE 1] Company Law- An Overview

### What is a Company?

- The word company is derived from a Latin word '*com = with or together, pains = bread*' it means a group of persons who took their meals together.
- A company is a voluntary association of persons formed for some common purpose with capital divisible into parts known as shares.
- Justice Lindley defines company "as an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business and who share the profits arising there from.
- According to the Companies Act, a company means a company formed and registered under the Companies Act.

### Lifting of Corporate Veil

- As the company is a separate legal entity, it has been provided with a veil, compared to that of individuals who are managing the company.
- But if the court feels that such veil has to been used for any wrongful purpose, the court lifts the corporate veil and makes the individual liable for such acts which they should not have done or doing in the name of the company.

#### Circumstances to lift the Corporate Veil

- The corporate veil can be lifted either under the **Statutory provisions** or **Judicial interpretations**
- The statutory provisions are Provided under the Companies Act, 1956.
- The other circumstances are decided through Judicial interpretations, which are based on facts of each case as per the decisions of the court.

#### Statutory Circumstance to lift the Corporate Veil

- **Reduction in membership-** Less than seven in public company and less than two if it is a private company.
- **Failure to refund application money-** After the issue of shares to the public, the company has to pay back the initial payment to the unsuccessful applicants (SEBI Guidelines- 130 Days), if they fail to do so, the corporate veil can be lifted.
- **Misdescription of companies name-** While signing a contract if the company's name is not properly described, then the corporate veil can be lifted.
- **Misrepresentation in the prospectus-** In case of misrepresentation, the promoters, directors and every other person responsible in this matter can be held liable.
- **Fraudulent Conduct-** In case the company is carried on with an intent to defraud the creditors, then the court may lift the corporate veil.
- **Holding and subsidiary companies-** A subsidiary has a distinct legal entity from the holding company other than in a few circumstances, so if otherwise shown, the court may under the Act, lift the corporate veil of the subsidiary company.

## Judicial Interpretations to lift the Corporate Veil

When the court feels that there are no statutory provisions which can pierce the corporate veil, and the identity of the company is not the one which has to exist, and the court has to interfere in order to avoid the activities that are done in the name of the company by persons managing them, it has been empowered to do so.

The circumstances are:

- **Protection of Revenue-** Whenever ever a company uses its name for the purpose of tax evasion or to circumvent tax obligations.
- **Prevention of fraud or Improper conduct-** The incorporation has been used for fraudulent purposes, like defrauding the creditors, defeating the purpose of law, etc.
- **Determination of the character of the company-** Enemy company or all the members being the citizens of the enemy country.

## Other Circumstances

**Where a company is used to avoid welfare legislation-** If a company is formed in order to avoid the benefits to the workers like bonus, or other statutory benefits.

**For determining the technical competence of the company-** To look into the competency of the company or the shareholders or promoters.

## **Memorandum of Association**

Memorandum of Association is the constitution or charter of the company and contains the powers of the company. No company can be registered under the Companies Act, 2013 without the memorandum of association. Under Section 2(56) of the Companies Act, 2013 the "memorandum" means the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this Act.

## Contents of Memorandum of Association

The Six Clauses are as follows:

- Name
- Objects
- Registered office
- Liability
- Capital
- Association or subscription

### **Name Clause**

- The memorandum must state the name of the company with 'limited' as the word ,in case of a public limited company and with 'private limited', in the case of a private limited company
- The company is free to choose any name but it must not be undesirable or must not resemble the name of any other registered company.

i.e. President, Prime Minister, Govt. etc

### **Registered Office Clause [Section 13(1)(b)]**

- The state in which the registered office of a company will be situated is mentioned in this clause.
- The registered office of the company is the official address of the company where the statutory books and records must normally be kept.

### **Object Clause [Section 13(1)(c)&(b)]**

This clause is quite important and must be very carefully drafted as it determines the activities of the company. In the object clause each and every detail of activities of the business to be carried out must be laid down.

**Main object:-** this sub-clause contains the main objects of the company to be pursued on its incorporation

**Objects incidental or ancillary:-** it covers the objects which are incidental or ancillary to the attainment of the main object

**Other objects:-** this sub-clause will cover any objects which are not included in the 'main objects.'

### **Liability Clause [Section 13(2)]**

- This clause states the nature of liability of the members of the company.
- In the case of a company limited by share or by guarantee the fact that the liability of its members is limited must be made absolutely clear . In case of a company limited by shares the liability of a member is limited to the nominal value of the share held by him.
- If the share are fully paid up his liability is nil. But in case of partly paid-up shares the liability is limited to the amount which is unpaid.
- In case of a company limited by guarantee, the liability clause must state the amount which every member undertakes to contribute to the assets of the company in the event of its winding up.

### **Capital Clause [Section 13(4)(a)]**

- This clause states that amount of the capital with which the company is to be registered
- This clause should also state the number and face value of shares into which the capital of the company is divided
- The capital with which the company is 'registered' or 'nominal' or 'authorised'

## **Articles of Association**

A document that specifies the regulations for a company's operations. The articles of association define the company's purpose and lays out how tasks are to be accomplished within the organization, including the process for appointing directors and how financial records will be handled.

### Items covered by the Articles of Association include:

- Adoption of preliminary contracts
- Number and value of shares
- Allotment of shares
- Calls on shares
- Transfer of shares
- Forfeiture, reissue, surrender of shares
- Alteration of share capital
- Share certificates
- Conversion of shares into stocks
- Voting rights, proxies and polls
- Appointment, Remuneration, etc of Directors
- Borrowing powers
- Accounts and audit
- Procedure of winding up

- Seal of the Company
- Meetings and proceedings
- Dividends of the reserves

Companies which must have Articles of Association:

### **Unlimited Companies**

The Articles of such a company must state:

- Total number of members; and
- Share capital.

### **Companies limited by Guarantee**

- Articles of such company must state total number of members.

### **Private Companies limited by shares**

- Such companies must include requirements of Section 3(1)(iii).

### **No Article Company**

- A public limited company having share capital may be registered without Articles.

### **Doctrine of Ultra Vires**

- The powers exercisable by the company are to be confined to the objects specified in the MOA.
- So it is better to define and include the provisions regarding the acquiring of business, sharing of profits, promoting company and other financial, gifts, political party funds etc.
- If the company acts beyond the powers or the objects of the company that is specified in the MOA, the acts are considered to be of ultra vires. Even if it is ratified by the all the members, the action is considered to be ineffective.
- Even the charitable contributions have to be based on the object clause.

The consequences of the ultra vires transactions are as follows:

- Injunction (ban)
- Directors' personal liability.
- If a property has been purchased and it is an ultra vires act, the company can have a right over that property.
- The doctrine to be used exclusively for the company's interest.
- But the others cannot use this doctrine as a tool to attack the company.

### **Doctrine of Constructive Notice**

The MOA and AOA of every company are registered with the registrar of the company, which is a public office. It is the duty of every person dealing with the company to inspect the public documents. But whether a person actually reads them or not, he will be presumed to know the content of the company's documents. This kind of presumed notice about the contents of the company's documents is called Constructive Notice.

## Statutory reform of Constructive Notice

It is more or less an unreal doctrine. It does not take notice of the realities of business life. People know a company through its officers not through its documents.

## **Doctrine of Indoor Management**

The role played by the doctrine of indoor management is opposed to that of the rule of constructive notice. The rule of constructive notice protects company against the outsider, where as the doctrine of indoor management protects outsider against the company.

### **The rule had its genesis in Royal British bank Vs Turquand**

## Exceptions to Doctrine of Indoor Management

Where the outsider cannot claim the relief on the grounds of "Indoor management"

### **Exceptions:**

- Knowledge of irregularity
- Suspicion of irregularity
- Forgery
- Knowledge of the Articles
- Acts outside the Apparent Authority

## **Doctrine of Alter Ego**

- The term alter ego can be described as the part of someone's personality, that is usually not seen by the others. A company is deemed to be one and the same as the owner of the company and vis-a-vis. The principle of alter ego can only be applied in one direction that is to make the company liable for an act committed by a person or group of persons who control the affairs of the company as they represent the alter ego of the company.
- A corporation is a separate legal entity distinct from its members. It acts through living persons and the persons who acts for the company are not acting as an agent or a servant but are acting as an alter ego as they are an embodiment of the company and their mind is the mind of the company.

## **The Principle of Non-Interference (Rule in Foss Vs Harbottle)**

### Meaning

- In the day-to-day working of a company, certain decisions need to be taken regarding the management of the company and these decisions are generally taken by the majority members. In this process of decision-making, there may arise certain occasions wherein the interests of the majority shareholders may come in conflict with that of the minority shareholders.
- In such a case, if the decisions taken, are not in the larger interest of the company as a whole, but only caters to the interest of one particular group, the minority group whose interest may have been violated can raise its voice against such an action.

## Advantages of the Rule

- To prevent multiplicity of action over the same matter.
- To prevent unnecessary litigation (legal action) by refusing to hear complaints about matters which are in competence of the general meeting. The court will not waste time by giving orders if they could validly be reversed shortly afterwards by the general meeting.

## Disadvantages of the Rule

- It may produce an unfair or unsatisfactory result. It can be abused to the detriment of the company as a whole.
- There is a possibility the company will not take action as no one to take action on its behalf especially at the time when the wrongdoer are the one who control the company.
- The members particularly the minority are also at a disadvantage. The value of their investment is affected.
- Because of this unfair result, the law provides exceptions to the rule where the shareholder may be allowed to take action against the wrongdoer for the wrong done to the company.
- There also statutory remedies conferred on members.

## **Majority Shareholder**

- A majority shareholder is a person or entity who holds more than 50% of shares of a company.
- If the majority shareholder holds voting shares, they dictate the direction of the company through their voting power.

A majority shareholder is often the founder of the company or, in the case of long-established businesses may be the descendants of the founder. By controlling more than half the voting interest, the majority shareholder is a key stakeholder and influencer in the business operations and strategic direction of the company.

## **Rights of Minority Shareholder**

### **• Oppression and Mismanagement of the Company**

Oppression is a means of exercising authority or power in a burdensome, cruel or unjust manner. Example of oppression could be: -not calling a general meeting, depriving the member of right to dividend etc.

### **• Reconstruction and amalgamation of the Company**

In case of reconstruction and amalgamation, minority shareholders may be suppressed in taking decisions of the company by making the public aware about the proposed scheme in newspapers to seek any objections, against the scheme from the shareholders if any objections are found, then any interested person (including a minority shareholder) may appear before the court to initiate a class action.

### **• Rights of Shareholders to be informed through collect disclosures**

The right of the company members to attain the timely information must be expressed clearly in the statute. The financial information and disclosures need to be provided to shareholders in a simple format.

- **Right of Minority to be heard**

An appropriate mechanism should be established for ensuring that provisions relating to “Minority Interest” do not obstruct the board or management to perform their functions genuinely. Management should, be protected from undue and unjustified interference from unscrupulous shareholder

- **Rights of Shareholders during meeting of the company**

Minorities have the right to attend the general meetings, right to direct the court for the appointment of a general meeting, to appoint proxies so that they can attend and vote at general meeting, making proposal at shareholders meeting.

- **Fair evaluation as a means of safeguarding minority interests**

The appointment of the independent valuer is required to be appointed by the audit committee where such a committee would ensure that shareholders must have the right to approach the tribunal if the process appears to be unfair. These principles for valuation of shares could also applied in case of companies that are delisted and have a shareholder base of 1000 or more.

- **Right of Minority Shareholders to seek information**

Every individual shareholder has the right to know about all the information of the company. They have the right to receive Notice of General Meetings (the AGM or the EGM), annual report and audited accounts and quarterly and annual accounts etc.

## **Application of Company Law to Banking and Insurance Sector**

### **Section 1(4) of the Companies Act, 2013**

The provisions of this Act shall apply to -

- Companies incorporated under this Act or under any previous company law.
- Insurance companies, except in so far as the said provisions are inconsistent with the provisions of the Insurance Act, 1938 or the Insurance Regulatory and Development Authority Act, 1999.
- Banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949.

Exceptions provided under the following sections:

### **Section 67: Restrictions on purchase of company or giving of loans by it for purchase of it's shares**

- It imposes restrictions on the companies limited by shares or by guarantee and having a share capital including a private company to purchase its own shares unless the consequent reduction of capital is effected and sanctioned under the provisions of this Act.
- No public company shall give by means of loan, guarantee, the provisions of security or otherwise any financial assistance for the purpose of, a purchase or subscription made by any person for any shares in the company or in it's holding company.

### **Section 73(1) : Prohibition on acceptance of deposits from public**

- On and after the commencement of this Act, no company shall invite, accept or renew deposits under this Act from the public except in the manner provided under this chapter.
- Provided that nothing in this sub-section shall apply to a banking company and non-banking financial company as defined in the Reserve Bank of India Act, 1934 and to such other company as the Central Government may after consultation with the Reserve Bank of India, specify in this behalf.
- Provisions regarding prohibition on acceptance of deposits from the public are not applicable to banking companies and non-banking financial companies.

### **Section 129(1) : Financial Statement**

- The financial statements shall give a true and fair view of the state of affairs of the company or companies, to comply with the accounting standards notified under Sec. 33 (Central Government to prescribe Accounting Standards) and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III.
- Provided that the items contained in such financial statements shall be in accordance with the accounting standards.
- Provisions not applicable to Insurance and Banking company or any company engaged in the generation or supply of electricity or to any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company.

### **Section 170(3): Power of Board**

The Board of Directors of a company shall exercise the following powers on behalf of the company by means of resolution passed at meeting of the Board namely-

- to make calls on shareholders in respect of money unpaid on their shares;
- to authorise buy-back of securities under section 68;
- to issue securities, including debentures, whether in or outside India;
- to borrow monies;
- to invest the funds of the company;
- to grant loans or give guarantee or provide security in respect of loans;
- to approve financial statement and the Board's report;
- to diversify the business of the company;
- to approve amalgamation, merger or reconstruction;
- to take over a company or acquire a controlling or substantial stake in another company.

### **Section 180(1)(c): Restrictions on Power of Board**

- Section 180(1)(c) to borrow money, where the money to be borrowed, together with the money already borrowed will exceed aggregate of its [paid-up share capital tree reserve and securities premium] apart from temporary loan obtained from the company's bankers in the ordinary course of business.
- Provisions not applicable to Banking Companies: The acceptance by a banking company, in the ordinary course of it's business, of deposits of money from public, repayable on demand or otherwise, and withdraw-able by cheque, draft, order or otherwise shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

## **Section 186: Loan and Investment by Company**

This Act provides that inter-corporate investments not to be made through more than two layers of investment companies. “Layer” in relation to a holding company means its subsidiary or subsidiaries [explanation (d) of Section 2 (87) of the Act].

### What is an Investment Company?

A company whose principal business is the acquisition of shares, debenture, or other securities.

### Section 186(1) not applicable to following cases:

- A company acquires any company which is incorporated outside India. Such company has investment subsidiary beyond two layers as per the law of such country.
- A subsidiary company from having any investment subsidiary for the purpose of meeting of the requirement under any law framed under any law for the time being in force.

### Limits for Loans / Guarantee / Security / Investment

In pursuant to provisions of section 186(2) of the Act, no company shall directly or indirectly give any loan to any person or other body corporate, give any guarantee or provide security in connection with a loan to any other body corporate or person and acquire by way of subscription, purchase or otherwise, the securities of any other body corporate, exceeding 60% of its paid-up share capital plus free reserves plus securities premium account or 100% of its free reserves plus securities premium account, whichever is more.

### Approval from Members:

- Though the section 186(2) makes restriction as above, section 186(3), empowers a company to give loan, guarantee or provide any security of acquisition beyond the limit but subject to prior approval of members by a special resolution passed at a general meeting.
- Disclosure of particulars of loan, guarantee given and security provided In pursuant to provisions of Section 186(4) of the Act, it is duty of the company to disclose in the Financial Statement the full particulars of the loan, guarantee given and security provided and its utilisation.

### Section 186(5): Approval of Board and Public Financial Institutions

In pursuant to provisions of Section 186(5) of the Act, every company shall take consent of all the directors present at the board meeting before making any investment, giving loan and guarantee and providing security. In case of company has already taken loan etc., from any Public Financial Institutions, then it is mandatory to take prior approval from such Public Financial Institution.

### Companies Registered under Securities Exchange Board of India (SEBI)

Section 186(6) of the Act provides that those companies which are registered under Section 12 of SEBI Act, 1992 and other prescribed companies can take inter-corporate loans or deposits exceeding the prescribed limit. The intention of government is clear, if the company is registered

under SEBI, this section is not applicable for the part of limit but, simultaneously, prescribed a condition that:

Provided that such companies shall furnish details of loans or deposit in their Financial Statements.

Register to be maintained:

- Section 186(10) of the Act mandates every company to maintain a register which shall contain particulars of loan or guarantee given or security provided or investment made.
- This register shall be opened for inspection and copies may be furnished to be members who demands for the same on payment of prescribed fee.

Exception (1) of Section 186:

- Banking Company, Insurance Company, Housing Finance Company, etc.
- Any Company whose main business of acquisition of shares or securities, etc.

Penalty: For Company:

- Every company which contravenes the provisions of this section shall be liable to a penalty which shall not be less than ₹25,000 but which may extend to ₹5.00 lakhs
- Every officer of the company who is default shall be punishable with imprisonment for a term which may extend to two years and fine which shall not be less than ₹25,000 but which may extend to ₹1.00 lakhs.

**Section 189: Register of contracts or arrangements in which directors are interested**

- Every company shall keep one or more registers giving separately the particulars of all contracts or arrangements to which sub-section (2) of section 184 or section 188 (Sec. 184 - Disclosure of interest by director, Sec. 188 -Related party transactions) applies, in such manner and containing such particulars as may be prescribed and after entering the particulars, such register or registers shall be placed before the next meeting of the Board and signed by all the directors present at the meeting.
- Every director or key managerial personnel shall, within a period of thirty days of his appointment, or relinquishment of his office, as the case may be, disclose to the company the particulars specified in sub-section (1) of section 184 relating to his concern or interest in the other associations which are required to be included in the register under that sub-section or such other information relating to himself as may be prescribed.
- The register referred to in sub-section (1) shall be kept at the registered office of the company and it shall be open for inspection and such office during business hours and extracts may be taken therefrom, and copies thereof as may be required by any member of the company shall be furnished by the company to such extent, in such manner, and on payment of such fees as may be prescribed.

- The register to be kept under this section shall also be produced at the commencement of every annual general meeting of the company and shall remain open and accessible during the continuance of the meeting to any person having the right to attend the meeting.
- Nothing contained in sub-section (1) shall apply to any contract or arrangement:
  - for the sale, purchase or supply of any goods, materials or services if the value of such goods and materials or the cost of such services does not exceed five lakh rupees in the aggregate in any year; or
  - by a banking company for the collection of bills in the ordinary course of its business.
- Every director who fails to comply with the provisions of this section and the rules made thereunder shall be liable to a penalty of ₹25,000.

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