Indian Companies Act – 2013 Part –I

Topics =
• Company –Concept, Features, Role of Promoters (S. 2(69) S. 92), Duties and liabilities of the Promoter Effects of Pre-Incorporation contracts, Consequences of non-registration, and Lifting of Corporate Veil. • Classification of Companies Distinction between Private Company and Public Company, Advantages and disadvantages of Private Company and Public Company. – Common Procedure for Incorporation of Company, • Memorandum of Association (MOA) & Article of Association(AOA) – Concept , Clauses of MOA, AOA- Contents, Doctrine of constructive notice, Doctrine of Ultra Vires, Doctrine of Indoor Management. • Prospectus – Concept, Kinds, Contents, Private Placement

Chapter 1

Company :

Concept – A company means a group of persons who have come together or who have contributed money for some common purpose and who have incorporated themselves into a distinct legal entity in the form of a company for that purpose.

S. 2(20) defines company as " Company means a company incorporated under this Act or under any previous company law."

Company is a voluntary association of persons formed for some common purpose with capital divisible into parts known as shares.

Justice Lindlay 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"

Features /Characteristics of a Company

A company as an entity has many distinct features which together make it a unique organization. The essential characteristics of a company are following:

1. Separate Legal Entity:
Under Incorporation law, a company becomes a separate legal entity as compared to its members. The company is distinct and different from its members in law. It has its own seal and its own name, its assets and liabilities are separate and distinct from those of its members. It is capable of owning property, incurring debt, and borrowing money, employing people, having a bank account, entering into contracts and suing and being sued separately.

2. Limited Liability:
The liability of the members of the company is limited to contribution to the assets of the

company upto the face value of shares held by him. A member is liable to pay only the uncalled money due on shares held by him. If the assets of the firm are not sufficient to pay the liabilities of the firm, the creditors can force the partners to make good the deficit from their personal assets. This cannot be done in the case of a company once the members have paid all their dues towards the shares held by them in the company.

3. Perpetual Succession:
A company does not cease to exist unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time to time but that does not affect life of the company. Insolvency or Death of member does not affect the existence of the company.

4. Separate Property:
A company is a distinct legal entity. The company's property is its own. A member cannot claim to be owner of the company's property during the existence of the company.

5 Transferability of Shares:
Shares in a company are freely transferable, subject to certain conditions, such that no share-holder is permanently or necessarily wedded to a company. When a member transfers his shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares.

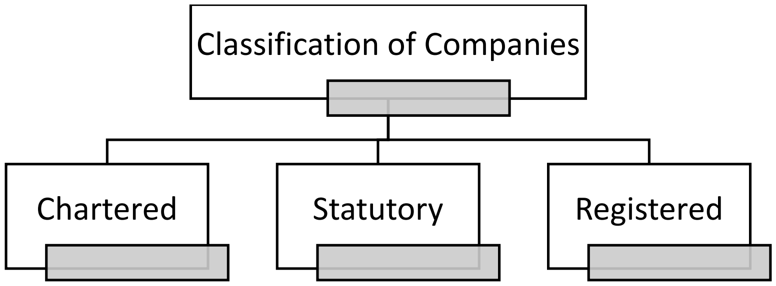
6. Common Seal:
A company is an artificial person and does not have a physical presence. Thus, it acts through its Board of Directors for carrying out its activities and entering into various agreements. Such contracts must be under the seal of the company. The common seal is the official signature of the company. The name of the company must be engraved on the common seal. Any document not bearing the seal of the company may not be accepted as authentic and may not have any legal force.

7. Capacity to sue and being sued:
A company can sue or be sued in its own name as distinct from its members.

8. Separate Management:
A company is administered and managed by its managerial personnel i.e. the Board of Directors. The shareholders are simply the holders of the shares in the company and need not be necessarily the managers of the company.

9. One Share-One Vote:
The principle of voting in a company is one share-one vote i.e. if a person has 10 shares, he has 10 votes in the company. This is in direct distinction to the voting principle of a co-operative society where the "One Member - One Vote" principle applies i.e. irrespective of the number of shares held, one member has only one vote.

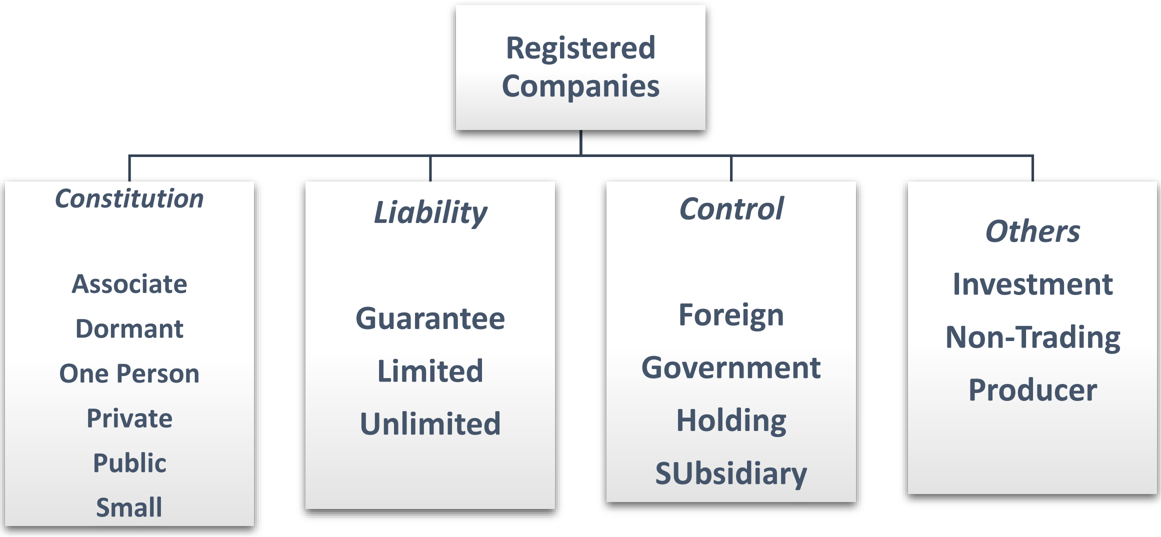
Classification /Types of Companies



A. Chartered Company
The company which have formed and incorporated under a special charter granted by the king or queen. Eg East India Company, Bank of England.

B. Statutory Company
These are companies which are created by means of a special Act of Parliament or any state legislature. Eg RBI, Railway

C. Registered Company
Company formed and registered under companies Act 1956 is called registered companies. Registered companies are further classified as under –



1. **On the basis of Constitution**

a. **Associate** – An Associate company is a corporation in which a parent company possesses a stake. Thus an associate company may be partly owned by another company or group of companies. A company will be treated as an associate company of another company, if the former is having –
   - i. At least 20% of the total share capital of the latter; or
   - ii. Having significant influence over the latter's decision making process under an agreement ; or
   - iii. Both are joint venture companies

b. **Dormant** – Dormant company is formed and registered under this Act, for a future project or to hold an asset or intellectual property. Dormant company has no significant accounting transaction, for the last 2 years such a company or an inactive company may make an application to the Registrar for obtaining the status of a dormant company. However, a dormant company is still required to have minimum directors, hold minimum two board meetings.

c. **One Person Company (OPC) -** Means a company which has person as a member. OPC requires one person who is natural person, who is citizen and resident of India. OPC enjoys the benefits of a private company, no board meeting is necessary. It encourages entrepreneurship.

d. Private – A private company is one –
   i. Minimum two (except OPC) and maximum 200 members.
   ii. No minimum paid up capital required.
   iii. Restricts transfer of shares.
   iv. Prohibits invitation to the public for subscription.

e. Public- is a company which –
   i. Is not a private company
   ii. Whose minimum number are seven and maximum is unlimited
   iii. No minimum paid up capital required.

f. Small – Companies Act, 2013 identifies some companies as small companies based on their capital or turnover. Small companies enjoys certain exemptions A small company requires no Company Secretary, no auditors on rotation. Only two board meetings in a year are required.

2. On the basis of Liability of Members:

a. Limited Company by Shares

Majority of registered companies will be company limited by shares. In case of limited companies liability of members will be limited to the amount unpaid on the shares.

b. Limited Company by Guarantee

Here liability of each member is limited by the memorandum to such amount as he may guarantee by the memorandum to contribute to the assets of the company in the event of its winding up.

Such companies are formed for the promotion of art science, culture, sports etc.

c. Unlimited Company

A company not having any limit on the liability of its members is termed as unlimited company.

The members are liable for the debts of the company at the time of winding up.

3. On the basis of control:

a. Government Company

A company is said to be Government Company when 51% of the paid up capital is held by the central government or by any state government or partly by central govt or partly by one or more state govt.

b. Foreign Company

A foreign company is a company incorporated outside India and having a place of business in India.

c. Holding and Subsidiary Company
A company which controls another company is known as the holding company and the so controlled company is known as subsidiary company.

4. **Others:**

a. Investment Company – It means a company whose principal business is the acquisition of shares, debentures or other securities.

b. Non-Trading Company – This is also called 'association not for profit or charitable companies The objects of these companies shall be promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other work.

c. Producer Company – The object of these companies is one or more of the following – production, harvesting, procurement, grading, pooling, handling, marketing, selling, export of primary produce of the members or import of goods and services for their benefit. . The share capital of the Producer Company shall consist of equity shares only.

Distinguish between Private company and Public Company

No.	Private Co.	Public Co.
1.	Minimum no of members is 2	Minimum no of members is 7
2.	Maximum no members is 50	No maximum limit
3.	Minimum paid up capital is Rs 1 lakh	Minimum paid up capital is 5 lakh
4.	Name must end with the word 'Pvt Ltd'	Name must end with the word 'Ltd'
5.	Can commence business immediately after incorporation	It shall have to wait until it receive the certificate for commencement of business.
6.	It cannot invite public to subscribe its shares and debentures	It can invite public to subscribe its shares and debentures
7.	Minimum subscription is not required for allotment of shares. 9	Minimum subscription is required for allotment of shares.

8.	Need not hold statutory meeting of the members.	It has to hold a statutory meeting and file a stat: report.
9.	Quorum required for a meeting is 2.	Quorum required for a meeting is 5
10.	There is restriction of transfer of shares	Shares can be freely transferred.
11.	Not required to issue prospectus.	Must issue prospectus.
13.	Two directors	Three directors

<u>Advantages and Disadvantages of Public and Private Company</u>

Private Limited Company - Advantages

1. **Members:** You can start a private limited company with a minimum of only 2 members (and maximum of 200), as per the provisions of the Companies Act 2013.
2. **Limited liability:** The liability of each shareholder or member is limited. This means that if the company runs into a loss, the company shareholders are liable to sell their company shares to clear the debt or liability. The individual or personal assets of shareholders or members are not at risk.
   Perpetual succession: As per company law, perpetual succession means that the company continues its existence even any owner or member dies, goes bankruptcy, exits from the business and transfers his shares to another person.
3. **Prospectus:** Prospectus is a detailed statement that must be issued by a company that goes public. However, private limited companies do not need to issue a prospectus because the public is not invited to subscribe for the shares of the company.
4. **Number of directors:** A private limited company needs a minimum of only 2 directors. At least one director on the board of directors must have stayed in India for a total period of not less than 182 days in the previous calendar year. The directors and the shareholders can be the same people.
5. **Capital:** Minimum share capital required is only Rs. 1 lakh.

Disadvantages of a Private Limited Company

1. The shares in a **private limited company** cannot be sold or transferred to anyone unless other shareholders agree on the same.
2. There is no option to invite public to subscribe to the shares.
3. It is mandatory that you should mention Pvt. Ltd. at the end of a company name.

4. A private limited company can have a maximum of only 200 members. Thus it cannot enjoy more financial facilities as can be enjoyed by having mor members.

Advantages of a Public Limited Company

1. The shareholders have limited liability.
2. A company can raise additional capital by issuing more shares or debentures.
3. Greater borrowing power.
4. A board of directors with experience/ expertise can be appointed.
5. Shareholders can sell/transfer their shares freely.

Disadvantages of a Public Limited Company

1. There is a loss of overall ownership.
2. There is a loss of control of the business.
3. Decisions take longer and there may be disagreement.
4. The personal touch may be lost.
5. When setting up a company, significant expenses are incurred.
6. There are more statutory regulations to conform.
7. Profits are shared amongst a far greater number of people.
8. Public disclosure of the financial affairs is necessary.
9. Published accounts have to be prepared.

Common Procedure for Incorporation of Company,

1. Application for obtaining Director Identification Number (DIN) from the Ministry of Corporate Affairs.
2. Search for a company name – This step requires search of company name and the availability of names can be checked at the website of Ministry of Corporate Affairs (MCA). Availability of company names can be checked at http://www.mca.gov.in/DCAPortalWeb/dca/MyMCALogin.domethod=setDefaultProperty&mode=16
3. Application of proposed name – An application for proposed company name is to be filed with the Registrar of Companies (ROC)
4. Drafting of Memorandum of Association (MOA) and Articles of Association (AOA) – Some of the most critical documents involved in incorporation of a company are MOA and AOA. MOA covers the fundamental provisions involves in the company's formation and an AOA covers the rules and regulations governing the internal management of a company.
5. Filling of forms with the ROC – The procedure for incorporation of company requires filing of some essential Forms with the ROC, like Form INC -& (form for incorporation of Company), Form INC – 22 (form for notice of situation of registered office), Form DIR -12 (providing information about particulars of appointment of Directors)
6. ROC fees and Stamp Duty payment.
7. Thereafter, documents filed for incorporation of company will be verified by ROC.

8. Pursuant to verification of documents, the ROC will issue a "Certificate of Incorporation" to the Company. Thereafter, the company can commence functioning.

PROSPECTUS

Concept

Sec. 2(36) of the Companies Act describes a prospectus as **"any document 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 the subscription or purchase of any share in, or debentures of a body corporate."**
In other words, it is a document which invites deposits from the public or invites offers from the public for the subscription of shares in, or debentures of, a company.

KINDS OF PROSPECTUS

1. Red Herring Prospectus

A prospectus for stocks and bonds are issued in different stages – the first stage is the preliminary prospectus, which contains the details of the business and proposed financial action. It is nicknamed as *Red Herring*.

The word *Red Herring* means to distract or mislead someone from an important issue. When a company decides to attract investors to invest in their company, they use a prospectus named Red Herring Prospectus.

Details available on Red Herring prospectus are :

It is basically a prospectus which is used in the public issue to attract different investors. In this prospectus, the *price* and *quantum* are not mentioned or disclosed. According to **Section 32** of the Act, an RHP means a prospectus which does not have complete particulars on the price of the securities offered and quantum of securities to be issued. A company may issue an RHP prior to the issue of a prospectus. The company shall file RHP with Registrar at least three days prior to the opening of the subscription list and the offer. Here price means the actual price to be issued per share in the IPO and *quantum* means the quantity or the total number of shares to be offered in the IPO.

2. Abridged Prospectus

According to **Section 2(1)** of the Act, abridged prospectus means a memorandum containing such salient features of a prospectus as may be specified by the SEBI by making regulations in this behalf. It means that a company cannot issue application form for purchase of securities unless such form is accompanied by an abridged prospectus.
Reading the entire prospectus may be too much time consuming for an investor. Instead, they go through the abridged prospectus, which gives them the basic idea about the company.
The abridged prospectus contains all the important and materialistic information. No company will issue the share buying from without the abridged prospectus attached to it so that investors can take a well-informed decision.

3. Shelf Prospectus

Shelf means *'life' or 'validity'* of a prospectus. Only selected companies bring their shelf prospectus. All companies are not eligible for designing a shelf prospectus. Normally finance-based companies are eligible for bringing out their shelf prospectus.
Shelf prospectus has validity with a maximum of one year. There are various companies which frequently raise funds (ex. banks) for issuing loans.
Every time they raise funds from the public, they require approval from the Stock Exchange and Registrar of Companies(ROC). Only the companies which have been prescribed by the SEBI can issue a Shelf prospectus with the Registrar.
Also, every time a company wishes to raise funds again, they must file their prospectus to the regulators for approval. If any company submits their Shelf prospectus, they don't have to file the prospectus again and again while raising funds for that particular year.

4. Deemed Prospectus

Deemed means to presume something. When a company agrees to allot shares to an issuing house(which is a different company) which they will later sell to the public, then the document by which offer is made is deemed to be a prospectus.
The document by which the issuing house offers share to the public is said to be deemed prospectus.
Any one condition from the following two conditions should be fulfilled:

- The issuing house should issue the shares to the public 6 months after the agreement with the company whose shares are to be issued.
- The issuing house shouldn't give the share price to the company until they bring it to the public.

CONTENTS OF PROSPECTUS

The following important matter are included in the prospectus:

- The prospectus contains the main objectives of the company, the name and addresses of the signatories of the memorandum of association and the number of shares held by them.
- The name, addresses and occupation of directors and managing directors.
- The number and classes of shares and debentures issued.
- The qualification share of directors and the interest of directors for the promotion of company.
- The number, description and the document of shares or debentures which within the two preceding years have been agreed to be issed other than cash.
- The name and addresses of the vendors of any property acquired by the company and the amount paid or to be paid.
- Particulars about the directors, secretaries and the treasures and their remuneration.
- The amount for the minimum subscription.
- If the company carrying on business, the length of time of such businesses.
- The estimated amount of preliminary expenses.
- Name and address of the auditors, bankers and solicitors of the company.
- Time and place where copies of balance sheets, profits and loss account and the auditors report may be inspected.
- The auditor's report so submitted must deal with the profit and loss of the company for each year of five financial years immediately preceding the issue of prospectus.
- If any profit or reserve has been capitalized, the particulars of such capitalization will be stated in the prospectus.

Private Placement

According to the Companies Act, 2013, primarily there are four modes of increasing the share capital. The four modes are Public issue, Right issue, Bonus issue and Private Placement. Private placement is one of the mode for **increasing the share capital.** Hence, it is very important to understand the details of the same. In this article, we look at the provisions relating to private placement under Companies Act, 2013.

Private Placement means any offer of securities to subscribe to securities to a select group of persons by a company other than by way of public offer, through issue of a private placement letter.

Rules for private placement:

1. Private placement can be done by issue of private placement offer letter.

2. Private Placement shall be made only to a select group of persons who been identified by the Board and whose number shall not exceed fifty or such higher number as may be prescribed.
3. Qualified institutional buyers and employees of the company being offered securities under a scheme of employees' stock option are excluded in calculating the number.
4. No private placement can be made unless allotment with respect to any offer or invitation made earlier if any have been completed or the offer should have been withdrawn or abandoned.
5. All money received under private placement to be made by cheque or demand draft only. No cash to be accepted.
6. Allotment of securities shall be done within 60 days of receipt of the application failing which the application money shall be refunded within 15 days of the expiry of 60 days or else interest at the rate of 12% per annum shall be required to be paid from the sixtieth day.
7. Private Placement offer shall be made only to such persons whose names are recorded by the company prior to the invitation to subscribe.
8. Company should refrain from making any advertisement of the offer to the public.
9. A company making an allotment of securities shall maintain proper record of the name, address, number of securities allotment and a return of allotment shall also be filed with the Registrar.
10. Any private placement issue not made in compliance of the provisions of S.42 shall be deemed to be public offer and all provisions of this Act.

Memorandum of Association

The Memorandum of association is the constitution of the company. Everything that the company does must be in conformity with this document. Exceeding what this document provides for would amount to an ultra vires act. Every shareholder is advised to read this important document while investing in the company.

Contents:

1. Name clause
2. Registered Office Clause
3. Liability Clause
4. Capital Clause
5. Objects Clause

1. Name Clause:

Every company needs a name. Such name must not be one that is undesirable by the government or one that infringes trade mark of another company. The Trade Mark Act 1999 governs this procedure of granting a name to the company. The company can use the name permanently once it acquires central government approval. The name should be one that gives correct information about the company, incorrect usage of the world international, intercontinental etc for companies that have only a local operation are not allowed. A private company must affix the word private limited after its name and a public limited company must affix the word limited after its name. A company can alter its name if its wishes too, but it would need central government approval.

2. Registered Office Clause:
Every company must have a registered office in any Indian state. A company can have only one registered office. A registered office is the place where the company keeps all its books of accounts and the shareholders register along with other statutory documents. Any shareholder can access a registered office to inspect the books of accounts of the company and other documents. Failure to maintain such statutory books in the registered office would attract a fine or a penalty to the officer whose duty it was to do so. A registered office can be shifted from one state to another state only if its beneficial to the shareholders and if it would improve the locale of the company. Prior permission of the company law board would be needed to this along with special resolution passed by the shareholders.

3. Liability Clause:
The liability clause would specify the kinds of liability the shareholders and the members would have. Liability can be limited or unlimited. Under limited liability the shareholder is expected to pay up only the amount of the share he has invested in. Under unlimited liability the shareholder can be held liable much more than the value of the share he has invested in, moreover unlimited liability can lead to personal liability too.

4. Capital Clause:
This clause specifies the authorized capital of the business. . A private company needs a minimum capital of one lac rupees and a public limited company needs a minimum capital of five lac rupees. The capital of the company cannot go below the minimum level but it can exceed it depending on what’s provided in the articles of association.

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. Objects Clause:
This clause contains the objects of the company. That is the purpose for which such company is formed. The object clause shows to us the kinds of business the company is entitled to carry on. The company can carry on business that are ancillary to the ones mentioned in the objects clause but it cannot carry on one which is not germane to the original objects. The objects clause helps the creditors to know as to what their money is being used for and gives a better sense of security. The objects can be altered by passing a special resolution, the conformity of the company law board is not a necessity here.