STUDY MATERIAL

EXECUTIVE PROGRAMME

COMPANY LAW & PRACTICE

GROUP 1
PAPER 2

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EXECUTIVE PROGRAMME

COMPANY LAW & PRACTICE

In view of increasing emphasis on adherence to norms of good corporate governance, Company Law assumes greater importance in the corporate legislative milieu, as it deals with structure, management, administration and conduct of affairs of Companies. The Companies Act, 2013 was enacted with a purpose to consolidate and amend the law relating to companies and making Indian law at par with the best International Standards. It was one of the most significant legal reforms in India in the recent past. The law is focused at easing the process of doing business in India and improving corporate governance by making companies more accountable. The Companies Act aimed to improve the Corporate Governance and better transparency in the corporate sector which is important to infuse confidence amongst the investors in Indian market and abroad and to strengthen the regulations for the companies, keeping in view the changing economic environment as well as the growth of the economy.

Paper on Company Law & Practice is divided into two parts:- Part I deals with Company Law-Principles & Concepts, Part II deals with Company Administration and Meetings.

Part I emphasis on the provisions of Company Law that provide an outline of the way in which a company must do business and be managed so as to ensure that there are no defaults that may disrupt the smooth functioning of a business enterprise, and to uphold transparency and accountability. This part also covers the principles and legal fundamentals with respect to the raising of capital through various sources, allotment of securities, maintaining of records, disclosure and transparency, members and their shareholding, concerns of stakeholders. This also guides on the secretarial and strategic work involved in above stated matters.

Part II relates to the key practical issues for companies to consider when convening and holding a board or general meetings either virtually or physically or in hybrid mode, including an Annual General Meeting of the company. The fundamental role that a board of directors play in supporting, guiding the management team in generating long term added value for the shareholders and society at large and to account to the shareholders for companies long term performance. Right decision making is important for company's growth, board meetings leads to greater strategic decision making whereas the shareholder meetings leads to greater transparency and accountability. Company Secretary plays a vital role in preparation, Convening and conducting of the meetings. A key expectation of members of self-governing professions is that they accept legal and ethical responsibility for their work and hold the interest of the public and society as paramount. One of the essential traits of a profession is to be subject to strict codes of conduct enshrining rigorous ethical and moral obligations.

This study material is published to aid the students in preparing the paper on Company Law & Practice for Executive Programme. It is part of the educational kit and takes the students step by step through each phase of preparation emphasizing key concepts, principles, pointers and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with focus on knowledge of concepts, their application, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. This study material may, therefore, be regarded as the basic material and must be read along with the Bare Acts, Rules, Regulations, Case Laws.

The legislative changes made upto November, 2024 have been incorporated in the study material. The students are advised to refer to the updations at the Regulator's website, Supplement relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and other publications. Specifically, students are advised to read **"Student Company Secretary" e-Journal** which covers regulatory and other relevant developments relating to the subject. In the event of any doubt, students may contact the Directorate of Academics at **academics@icsi.edu**.

The amendments to law made upto 31st May of the Calendar Year for December Examinations and upto 30th November of the previous Calendar Year for June Examinations shall be applicable.

Although due care has been taken in publishing this study material, the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Important Note:

The new criminal laws i.e. Bharatiya Nyaya Sanhita 2023, Bharatiya Nagarik Suraksha Sanhita 2023 and Bharatiya Sakshya Adhiniyam 2023 have repealed Indian Penal Code 1860, Criminal Procedure Code 1973 and Indian Evidence Act 1872 (old criminal laws) respectively.

Therefore, by virtue of Section 8 of General Clauses Act 1897, the references to the old criminal laws, unless a different intention appears, be construed as references to the provision of new criminal laws.

EXECUTIVE PROGRAMME

Group 1

Paper 2

COMPANY LAW & PRACTICE

SYLLABUS

OBJECTIVES:

- **To provide conceptual understanding on the principles and provisions of the Company Law.**
- **To equip the students with working knowledge about management and administration of companies.**

Level of Knowledge: Working Knowledge

Part I : Company Law - Principles & Concepts (60 Marks)

1. **Introduction to Company Law**: ● Jurisprudence of Company Law ● Doctrine of *Ultra-vires* ● Doctrine of Indoor Management ● Doctrine of Constructive Notice ● Concept of Corporate Veil ● Applicability of the Companies Act ● Definitions and Key Concepts ● MCA 21.
2. **Legal Status and Types of Registered Companies:**

   Legal Status of Registered Companies: ● Corporate Personality ● Perpetual succession ● Separate property ● Transferability of shares ● Capacity to sue or be sued.

   Types of Registered Companies: ● Private Company ● Public Company ● Small Company ● Holding Company ● Subsidiary Company ● Associate Company ● Dormant Company ● Government Company.
3. **Memorandum and Articles of Association and its Alteration**: ● Memorandum of Association and Articles of Association ● Incorporation Contracts ● Alteration in MOA & AOA.
4. **Shares and Share Capital-Concepts**: ● Meaning and Types of Capital ● Issue and Allotment ● Issue of Share Certificates ● Further Issue of Share Capital ● Issue of shares on Private and Preferential basis ● Rights issue and Bonus Shares ● Sweat Equity Shares and ESOPs ● Issue and Redemption of Preference Shares ● Transfer and Transmission of Securities ● Buyback of Securities ● Reduction of Share Capital ● Payment of Stamp Duty ● Registers and Records.
5. **Members and Shareholders:** ● How to become a Member ● Register of Members ● Declaration of Beneficial Interest ● Significant Beneficial Owner ● Rectification of Register of Members ● Rights of Members ● Variation of Shareholders' Rights.
6. **Debt Instruments-Concepts**: ● Issue and Redemption of Debentures and Bonds ● Creation of Security ● Debenture Redemption Reserve ● Debenture Trust Deed ● Conversion of Debentures into Shares ● Overview of Company Deposits.
7. **Charges**: ● Creation of Charges ● Registration, Modification and Satisfaction of Charges ● Register of Charges ● Inspection of Charges ● Punishment for Contravention ● Rectification by Central Government in Register of Charges ● Purpose, Objective, Drafting and Issuing of Search Report.
8. **Distribution of Profits** : ● Profit and Ascertainment of Divisible Profits ● Declaration and Payment of Dividend ● Unpaid Dividend Account ● Investor Education and Protection Fund ● Right to Dividend ● Rights Shares and Bonus shares to be held in abeyance ● Secretarial Standards on Dividend ● Dividend Distribution Policy.

9. **Accounts and Auditors**: ● Books of Accounts ● Financial Statements ● National Financial Reporting Authority ● Auditors- Appointment, Resignation and Procedure relating to Removal, Qualification and Disqualification ● Rights, Duties and Liabilities, ● Audit and Auditor's Report ● Cost Audit ● Secretarial Audit ● Internal Audit.

10. **Compromise, Arrangement and Amalgamations-Concepts**: ● Introduction of Compromises ● Arrangement and Amalgamation ● ~~Oppression and Mismanagement~~ ● ~~Class Actions Suits~~.

11. **Dormant Company**: ● Legal framework for Dormant Companies ● Procedure to obtain the status of a Dormant Company ● Pre-requisite for obtaining the status of Dormant Company ● Benefits / exemptions provided to a Dormant Company ● Compliance requirements by Dormant Company ● Procedure to obtain the status of an Active Company from Dormant Company.

12. ~~**Inspection, Inquiry and Investigation**~~: ● ~~Powers for inspection~~ ● ~~Purpose of conducting Inspection~~ ● ~~Kinds of Investigation~~ ● ~~Power of Inspector to Conduct Investigation into Affairs of Related Companies~~ ● ~~Protection of employees during Investigation~~ ● ~~Seizure of Documents by Inspector~~ ● ~~Freezing of Assets of Company on Inquiry And Investigation~~ ● ~~Imposition of Restrictions upon Securities~~ ● ~~Inspector's Report~~ ● ~~Expenses of Investigation~~ ● ~~Preparation by a Company Secretary to face Investigation~~ ● ~~Establishment of Serious Fraud Investigation Office~~ ● ~~Process of Investigation by Serious Fraud Investigation Office.~~

PART II: Company Administration and Meetings (40 Marks)

13. **General Meetings:** ● Annual General Meeting ● Extraordinary General Meetings ● Other General Meetings ● Types of Resolutions ● Notice, Quorum, Poll, Chairman, Proxy ● Meeting and Agenda ● Process of conducting meeting ● Voting and its types-vote on show of hands, Poll, E-Voting, Postal ballot ● Circulation of Members' Resolutions ● Signing and Inspection of Minutes ● Secretarial Standard – 2 ● Duties of Company Secretaries before, during and after General Meeting ● Virtual Meetings : Technological Advancement in conduct of General Meetings ● Drafting of Notice and Minutes of Annual General Meeting and Extra-Ordinary General Meeting.

14. **Directors:** ● DIN requirement ● Types of Directors ● Appointment / Reappointment, Disqualifications, Vacation of Office, Retirement Resignation and Removal ● Loans to Directors ● Disclosure of Interest ● Duties of Directors ● Rights of Directors.

15. **Board Composition and Powers of the Board:** ● Board composition ● Powers of Board ● Restrictions on Powers of Board ● Board Committees, Overview of Inter-Corporate Loans, Investments, Guarantees and Security ● Related Party Transactions.

16. **Meetings of Board and its Committees** : ● Frequency, Convening and Proceedings of Board and Committee meetings ● Agenda Management ● Meeting Management ● Resolution by Circulation ● Types of Resolutions ● Duties of Company Secretaries before, during and after Board/ Committee Meeting ● Virtual Meetings :Technological Advancement in conduct of Board Committee ● Need and Scope of Secretarial Standards ● Secretarial Standard – 1 ● Drafting of Notice, Agenda and Minutes of Board and Committee Meetings.

17. **Corporate Social Responsibility-Concepts**: ● CSR Committee ● Policy ● ~~CSR Expenditure~~ ● Activities ● ~~Ongoing Project~~ ● ~~Impact Assessment~~.

18. **Annual Report-Concepts**: ● Board's Report ● Annual Return ● Annual Report ● Secretarial Standard on Report of the Board of Directors.

19. **Key Managerial Personnel (KMP's) and their Remuneration** : ● Appointment of Key Managerial Personnel ● Managing and Whole-Time Directors, Manager, Chief Executive Officer and Chief Financial Officer ● Company Secretary – Appointment, Role and Responsibilities, Company Secretary as a Key Managerial Personnel ● Functions of Company Secretary ● Officer who is in default ● Remuneration of Managerial Personnel.

ARRANGEMENT OF STUDY LESSONS
COMPANY LAW & PRACTICE
GROUP 1 • PAPER 2

PART I : COMPANY LAW - PRINCIPLES & CONCEPTS

Sl. No.	Lesson Title
1.	Introduction to Company Law
2.	Legal Status and Types of Registered Companies
3.	Memorandum and Articles of Associations and its Alteration
4.	Share and Share Capital - Concepts
5.	Members and Shareholders
6.	Debt Instruments - Concepts
7.	Charges
8.	Distribution of Profits
9.	Accounts and Auditors
10.	Compromise, Arrangement and Amalgamations - Concepts *(i)
11.	Dormant Company
12.	~~Inspection, Inquiry and Investigation~~ *(ii)

PART II: COMPANY ADMINISTRATION AND MEETINGS

13.	General Meetings
14.	Directors
15.	Board Composition and Powers of the Board
16.	Meetings of Board and its Committees
17.	~~Corporate Social Responsibility - Concepts~~ *(iii)
18.	Annual Report - Concepts
19.	Key Managerial Personnel (KMP's) and their Remuneration

*(i) Only topics, "Oppression and Mismanagement; Class Actions Suits" are deleted from the Executive Programme

*(ii) Lesson 12 is deleted from the Executive Programme.

*(iii) Lesson 17 is deleted and the topics, "Policy; Activities and CSR Committee" are relocated in Lesson 18. The topics, "CSR Expenditure; Ongoing Project; Impact Assessment" are deleted from the Executive Programme.

LESSON WISE SUMMARY
COMPANY LAW & PRACTICE

Lesson 1: Introduction to Company Law

A Company is a legal entity, allowed by legislation, which permits a group of people, as shareholders, to apply to the regulators for an independent organization to be created, which can then focus on pursuing set objectives, and empowered with legal rights which are usually only reserved for individuals, such as to sue and be sued, own property, hire employees or loan and borrow money.

A company is regarded as a distinct legal entity and is said to cast a veil between the company and its human constituents, 'the corporate veil'. This veil can be pierced for the purpose of imposing some form of liability on a company's shareholders and / or directors. There are many court cases and exceptions to this which have been discussed in detail in this Lesson.

To understand a piece of legislation it is important to understand what was the need of this legislation?, what practices were being followed?, what were the expectation of the stakeholders?, what led to creation of legislation?

Company Legislation in India owes its origin to the English Company Law. The Companies Acts passed from time to time in India have been following the English Companies Acts, with certain modifications. Even the Companies Act, 1956, was based on the U.K. Companies Act, 1948.

The first legislative enactment for registration of Joint Stock Companies in India was passed in the year 1850 which was based on the English Companies Act, 1844. This Act recognised companies as distinct legal entities but did not introduce the concept of limited liability. The concept of limited liability, in India, was recognised for the first time by the Companies Act, 1857 closely following the English Companies Act, 1856 in this regard. Till 1956, the business companies in India were regulated by this Act of 1913. Based on Bhabha committee report Companies Act, 1956 was introduced.

As the business evolved need was felt to introduce the Company Law in a fresh manner considering the changes in the systems and procedures worldwide. The Companies Act, 2013 was passed after decade long deliberations with stakeholders.

This Lesson gives an overview of the developments of company law and discusses the features of a company form of business alongwith the various principles of company law like doctrine of *ultra-vires*, Doctrine of Indoor Management, Doctrine of constructive notice, etc.

Lesson 2: Legal Status and Types of Registered Companies

A company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members. A company is rather a legal device for the attainment of social and economic end. It is therefore, a combined political, social, economic and legal institution. Thus, the term company has been described in many ways. "It is a means of cooperation and organisation in the conduct of an enterprise". It is "an intricate, centralised, economic and administrative structure run by professional managers who hire capital from the investor(s)".

Since a corporate body (i.e. a company) is the creation of law, it is not a human being, it is an artificial juridical person (i.e. created by law) and it is clothed with many rights, obligations, powers and duties prescribed by

law. It can, however, do everything what a natural person can do except certain acts which require personal execution. Thus, a company cannot marry or divorce; it cannot vote in an election.

On incorporation, the company acquires a separate legal entity status distinct from and independent of its members. Unlike a partnership, which has no separate existence from its partners, a company has a separate corporate existence. It is different from the members who constitute it.

This lesson highlights and explains the characteristics of various forms of companies like Private Limited Company, Public Limited Company and Inactive Companies. It also provides an overview of certain other types of companies, such as Small Company, Holding Company, Subsidiary Company and Associate Company.

Further, the lesson covers the concepts of various types of companies, their legal basis, special provisions and privileges for some classes of companies, distinction between different types of companies etc. It further explains what is a Government Company and the exemptions available to them. Companies may be classified on the basis of their incorporation, number of members, size, basis of control and motive. Company Secretary should be aware of the distinctive features of different entities.

Lesson 3: Memorandum and Articles of Associations and its Alteration

The memorandum and articles of association of a company are the most important documents for the formation of a company and for its functioning thereafter. These are the charter documents of the company.

The memorandum of association contains the name, situation of registered office, objects, capital and liability and subscription clauses. The articles are its bye-laws or rules and regulations that govern the management and internal affairs and the conduct of its business. Both the documents are required to be registered with the Registrar of Companies at the stage of incorporation of the company. Before dealing with a company, it is advisable to read the memorandum and articles of the company to understand aspects, such as powers of Board, scope of company's activities etc. and its relationship with the outside world.

Since Memorandum sets out the constitution of a company and is therefore the foundation on which the structure of the company is built. It defines the scope of the company's activities and its relations with the outside world. Company Secretary in employment should work within the four walls of the MOA and also subject to the provisions of AOA.

This chapter includes the concept of Memorandum of Association and Articles of Association, their purpose, contents and registration. Alterations that can be carried out in the Memorandum and Articles of Association and effect of such alterations. It also explains the legal effect of these documents.

Company Secretary who is holding key position in the company must be aware of the procedural aspects of alteration of various clauses contained in the Memorandum of Association and of various regulations of Articles of Association of the Company which may be permissible under the provisions contained in Section 13 and Section 14 of the Companies Act, 2013 to be read with relevant Rules framed thereunder.

Lesson 4: Share and Share Capital - Concepts

Importantly share capital refers to the funds that a company raises in exchange for issuing an ownership interest in the company in the form of shares. "Share capital" may also describe the number and types of shares that compose a company's share structure. There are two general types of share capital, which are equity and preference shares.

For running a company it is important to understand the options available to fund the projects of the company. The Company Law permits various options which can be availed to generate funds. There are various ways to raise capital which include preferential allotment, employee stock option, issue of rights shares and issue of shares with differential voting rights. It involves various approvals, disclosures, filings, maintenance of records,

etc. which are prescribed under Chapter IV of the Companies Act, 2013 read with Companies (Share Capital and Debentures) Rules, 2014.

There are several compliances that need be done pre and post the securities are issued such as issue of share certificates, dematerialization, register of members, allotment of securities. The Lesson also introduces to the basic modalities of issue of securities and allotment thereunder.

Lesson 5: Members and Shareholders

Member is subscriber to the memorandum of the company who shall be deemed to have agreed to become member of the company or every person holding shares of the company and whose name is entered as a beneficial owner in the records of a depository. A person whose name is entered in the register of members of a company becomes a member of that company. The register includes every single detail about the member like name, address, occupation, date of becoming a member, etc. It also includes every person who holds company's shares and whose name is entered as the beneficial owners in depository records. An individual who owns the share of a public or a private company is known as a 'Shareholder.'

The terms shareholders and members are commonly used as synonyms, as one can become a member of the company, except by way of holding shares. In this way, a member is a shareholder and a shareholder is a member. The statement is true but not completely, as it is subject to certain exceptions, i.e. a person can become the holder of shares through transfer, but is not a member, until the transfer is entered in the register of members.

This Lesson gives an insight on secretarial practices expected to be known by the prospected Company Secretaries on maintaining register of members, declaration of beneficial interest, significant beneficial owner, variation of shareholoders' rights, etc.

Lesson 6: Debt Instruments - Concepts

The word 'debenture' has been derived from a Latin word '*debere*' which means to borrow. Section 2(30) of the Companies Act, 2013 define "debenture" which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not. An issue of debenture plays a great role in long-term planning and decision-making. In modern competitive business era, every company needs fund for any business opportunity. This financing can be fulfilled only by issuing owner's capital and debt capital. The issue of debenture, in one side creates the obligation for the payment of interest at a fixed rate and in another side, it causes an increase in ' earning per share' due to comparatively less number of shares issued.

The power to issue debentures can be exercised on behalf of the Company at a meeting of the Board under the provisions of Section 179 (3) of the Companies Act, 2013. Further, Section 71 read with Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014, deals with the provisions relating to the issuance of debentures. Companies need to follow certain procedures for issue of debentures to raise money. These have been elaborated under the Companies Act, 2013 and have been discussed in this Lesson.

Deposits have been defined under the Companies Act, 2013 ("2013 Act") to include any receipt of money by way of deposit or loan or in any other form by a company. However what shall not constitute deposits has been prescribed under law in consultation with the Reserve Bank of India. The Lesson provides an overview of the issue and redemption of debentures and bonds, creation of security, debenture redemption reserve, debenture trust deed, conversion of debentures into shares and company deposits.

Lesson 7: Charges

A charge is a right created by any person including a company referred to as "the borrower" on its assets and properties, present and future, in favour of a financial institution or a bank, referred to as "the lender", which has agreed to extend financial assistance.

Section 2(16) of the Companies Act, 2013 defines charges so as to mean an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage. The following are the essential features of the charge which are as under:

1. There should be two parties to the transaction, the creator of the charge and the charge holder.
2. The subject-matter of charge, which may be current or future assets and other properties of the borrower.
3. The intention of the borrower to offer one or more of its specific assets or properties as security for repayment of the borrowed money together with payment of interest at the agreed rate should be manifested by an agreement entered into by him in favour of the lender, written or otherwise.

Almost all the business entities depend upon share capital and borrowed capital for financing their projects. Borrowed capital may consist of funds raised by issuing debentures, which may be secured or unsecured, or by obtaining financial assistance from financial institution or banks. Section 77 of the Companies Act, 2013 specifies that every company creating a charge shall register the particulars of charge signed by the company and its charge – holder together with the instruments creating. Important points in the Act relating to charge creation is:

Any charge created within or outside India on property or assets or any of the company's undertakings, whether tangible or otherwise, situated in or outside India shall be registered.

Hence, all types of charges are required under the Act to be registered whether created within or outside India.

The Companies Act, 2013 details the procedure for creation, modification and satisfaction of a charge. As a prospected Company Secretary you are expected to advise the management on the subject and ensure compliance to the same. Under this lesson, one understands the basic concept of creation, registration, modification and satisfaction of charges alongwith drafting and issuing search report.

Lesson 8: Distribution of Profits

Dividend is a return on the investment made in the share capital of a company, as distinct from the return on borrowed capital, which is in the form of interest. In commercial usage, the term "Dividend" refers to the share of profits of a company that is distributed amongst its Members. Profit or a portion of profit that can be legally distributed as a dividend to the shareholders is known as Divisible Profit. Considering the small shareholders and their concerns with regard to failure to transfer the dividend to the shareholders the Companies Act, 2013, provides for elaborate mechanism where the shareholders can claim the shares through an authority constituted for the purpose i.e. Investor Education and Protection Fund (IEPF). A company may pay dividend out of the profits of the company for that year arrived at after providing for depreciation or out of the profits of the company for any previous financial year or years arrived at after providing for depreciation and remaining undistributed, or out of both; or out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government; or out of the accumulated profits earned by it in previous years and transferred by the company to the reserves in case of inadequacy or absence of profits in any financial year.

The Act clearly enunciates the procedure for transfer of unpaid dividend to separate account and thereafter after particular time period to the authority. The company has to mandatorily comply with the legal requirement, failure may attract penal provisions, as well as this may also be reflected in the Board's report.

A Company Secretary is also an investor relation officer of the company, he acts as a bridge between the shareholder and company management. This Lesson shall enable the readers to understand the procedures with respect to ascertainment of divisible profits, declaration & payment of dividend , treatment with respect to rights share and bonus shares to be held in abeyance and implement the same while practically operating it.

Lesson 9: Accounts and Auditors

Section 128 of Companies Act, 2013 states that every company need to maintain its registered office, books of accounts and other relevant papers and books for every financial year which states the true and fair view of state of affair of company including its all branches. Private Limited Company, One Person Company and Limited Company including Small Companies are required to maintain proper book of accounts. Further, the Books of Accounts of a Company is the basis on which financial statements of a Company are prepared for company annual return filing. Therefore, maintenance of proper company account is both mandatory and necessary.

According to the Companies Act, 2013, a Company's Book of Accounts is considered to be maintained properly if it satisfies the following two conditions:

- Books which are necessary to give a true and fair view of the state of affairs of the company is kept along with the documents required to explain the transactions.
- Books are kept on accrual basis and according to the double entry system of accounting.

Having an effective audit system is important for a company because it enables it to pursue and attain its various corporate objectives. Business processes need various forms of internal control to facilitate supervision and monitoring, prevent and detect irregular transactions, measure ongoing performance, maintain adequate business records and to promote operational productivity.

Auditing is a means of evaluating the effectiveness of a company's internal controls. Maintaining an effective system of internal controls is vital for achieving a company's business objectives, obtaining reliable financial reporting on its operations, preventing fraud and misappropriation of its assets, and minimizing its cost of capital. Both internal and independent auditors contribute to a company's audit system in different but important ways. Every company shall at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting (AGM) and thereafter till the conclusion of every sixth meeting and the manner and procedure of selection of auditors by the members of the company at such meeting shall be such as prescribed under the Act.

The Lesson details the maintenance of accounts in the company and how the auditors have to be appointed, role of auditors and legal provisions relating to the same including cost audit, secretarial audit and internal audit.

A company has to undertake secretarial audit, cost audit, statutory audit as per the threshold requirement under law. As a company secretary this is an important area and must be well understood by the readers.

Lesson 10 : Compromise, Arrangement and Amalgamations - Concepts

Compromise and Arrangement are form of corporate restructuring which is an inorganic business strategy where one or more aspects of a business are redesigned to improve commercial efficiency, manage competition effectively, drive faster pace of growth, ensure effective utilization of resource, and fulfilment of stakeholders' expectations. It serves different purpose for different companies at different points of time and may take up various forms.

'Compromise' is an amicable agreement between the parties in which they make mutual concessions in order to solve the differences between them. Whereas, 'arrangement' is the process by which the share capital of the company is reorganized either by consolidating or division of the shares or doing both.

~~'Oppression' is that it is an unjust or cruel exercise of authority/ power. Whereas, 'Mismanagement' means conducting affairs in some prejudicial, dishonest manner. A class action allows a number of claimants with a common grievance against a company to file a lawsuit against it.~~

This lesson outlines the concepts of Compromise, Arrangements & Amalgamations ~~along with concept of oppression and mismanagement and class action suits.~~

Lesson 11 : Dormant Company

Companies are generally classified on the basis of their incorporation, number of members, size, basis of control and motive. Additionally, companies can also be classified based on their status. Sometimes, the promoters of a company may feel the need to temporarily close down the company due to various reasons, but they do not want to dissolve it. In such cases, the company may become dormant as against an active company which is carrying on business. Thus, on the basis of its status, companies may be classified into active, dormant, under liquidation, under process of striking off, strike off, dissolved, amalgamated, etc. The 'status' of the company signifies the current state of the company - Whether it is active and operating OR dormant OR it has been struck off and closed.

As a Company Secretary, one must be aware of the procedure of obtaining status of dormant company, active company, the compliances involved for a dormant company etc.

This lesson outlines the legal framework for Dormant Companies, the procedure to obtain the status of a dormant company from active company and *vice-versa*, compliance requirements by dormant companies, prerequisites for obtaining the status of dormant company, etc.

~~Lesson 12: Inspection, Inquiry and Investigation~~

~~Shareholders have been vested with various rights including the right to elect directors. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies and particularly in companies whose shareholders are widely scattered, the shareholders are, by and large, sleeping and passive partners, and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Chapter XIV contains Sections 206 to 229 of the Companies Act, 2013, deals with the provisions relating to Inspection, Inquiry and Investigation of the affairs of company.~~

~~This lesson outlines the powers for inspection alongwith purpose of conducting inspection, kinds of investigations, powers of inspector to conduct investigation into affairs of related companies Protection of employees during Investigation, Seizure of Documents by Inspector, Freezing of Assets of Company on Inquiry and Investigation, Imposition of Restrictions upon Securities, Inspector's Report, Expenses of Investigation, Preparation by a Company Secretary to face Investigation, Establishment of Serious Fraud Investigation Office and Process of Investigation by Serious Fraud Investigation Office.~~

Lesson 13: General Meetings

A company may have many kinds of meetings; general meetings are one among them. In very simple terms, a meeting of general body may be called general meeting. A general meeting may be Annual General Meeting (AGM), Extraordinary General Meeting (EGM) and class meetings. The new Act permits for meeting of Board of directors through video conferencing or audio conferencing. The Lesson discusses the broad parameters of holding such meetings and the restrictions thereat. E-voting at a general meeting has now been practiced and well recognized by the law. The fundamental principles with respect to General Meetings are laid down in the Act. SS-2 facilitates compliance with these principles by endeavouring to provide further clarity where there is ambiguity or establishing benchmark standards to harmonise prevalent diverse practices. SS-2 requires the

Company Secretary (ies) to over-see the vital process of facilitating and recording the decision making process in a company besides maintaining the integrity of the Meetings. Where there is no Company Secretary in the company or in absence of the Company Secretary, any Director or other Key Managerial Personnel (KMP) or any other person authorised by the Board for this purpose may discharge such of the functions of the Company Secretary as given in SS-2.

A Company Secretary plays a critical role in preparation, convening, holding and conducting a meeting. This Lesson gives an overall idea of not only legal framework but also secretarial work involved in conducting a meeting.

Lesson 14: Directors

The directors play a very important role in the day to day functioning of the company. It is the board, who is responsible for the company's overall performance. Only individuals can be appointed as directors of a company. The subscribers to the memorandum who are individuals are deemed to be the first directors of the company. Thereafter the shareholders or in many cases the board of directors appoint the directors. The Act has brought in many new provisions such as appointment of women director, resident director, independent director by certain class of companies. As a Company Secretary you should be in know of the subject.

The Lesson discusses the procedure for appointment, re-appointment and removal of the various types of directors, the rights, and duties of a director.

Lesson 15: Board Composition and Powers of the Board

The Board of director is the ultimate decision – making body and determines the delegation of powers throughout the company; it is considered to be the primary organ of the company. The role of the Board is summarized as:

- Providing entrepreneurial leadership;
- Setting strategy;
- Ensuring the human and financial resources are available to achieve objectives;
- Reviewing management performance;
- Setting up company's values and standards;
- Ensuring robustness of financial controls and risk management.

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.

As per Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement), 2015 the composition of Board of Directors in a listed company shall have a combination of executive and non-executive directors with at least one woman director and not less than fifty per cent of the board of directors shall constitute of non-executive directors and if the chairperson of the board of directors is a non-executive director, then at least one-third of the board of directors shall constitute of independent directors and if the listed entity has an executive chairperson, then at least half of the board of directors shall comprise of independent directors.

This Lesson guides on the constitution of the Board, its powers and restrictions. Board committees are constituted in accordance with Companies Act, 2013 and SEBI (Listing Obligations & Disclosure Requirements) Regulations, 2015.

This Lesson also discusses about Inter corporate loans and investments which play a vital role in the growth of Industries since they result in flow of funds to group companies or other companies in need of funds. The

Companies Act, 2013 (Act) has come up with a change in the concept of 'Loan and Investment by Company'. The new Act provides that inter-corporate investments not to be made through more than two layers of investment companies.

Related party transactions adopted by the companies could be a possible tool for corporate abuse. Transfer of economic resources to the related party at less than arm's length price is necessitated for host of reasons ranging from evasion/avoidance of tax liability to siphon-off the resources. That's why various laws and regulations stipulate the deeper scrutiny and the greater disclosures of such transactions. The Companies Act, 2013 does provide for a framework for transactions in which directors, etc., are interested with a view to avoid situation of conflict of interest. The lesson examines the legal provisions with respect to related party transaction; inter corporate loans, investments, guarantees and security.

Lesson 16: Meetings of Board and its Committees

Under Companies Act, 2013 the Board has to meet at least four times in a year and not more one hundred and twenty days shall intervene between two consecutive Board meetings. Section 173 of the Act deals with Meetings of the Board and Section 174 deals with quorum. A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field. However, the Board of Directors are ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure. The committees have to meet in accordance with the terms of reference of the committee.

A Board can set up committees with particular terms of reference when it needs assistance (for example a New project sub-committee) or when an issue requires more resources and attention (review of effect of legislative changes on organizational programs). They can be set up for a specific purpose or to deal with general issues such as 'development'. They can be established on a short-term or temporary basis, or they can be formed as a permanent body for ongoing work.

As a Company Secretary you need to guide the members on the conduct of affairs of the company and facilitate the convening of meetings and attend Board and Committee meetings and maintain minutes of these meetings.

This Lesson gives the basic idea of holding a meeting of the board or committee, holding virtual board meetings, Secretarial Standards-1 and drafting of notice, agenda and minutes of board and committee meetings.

Lesson 17: Corporate Social Responsibility - Concepts

The concept of Corporate Social responsibility (CSR) has been introduced for the first time in India through Companies Act, 2013. As per rule 2(d) of the CSR Rules as amended "Corporate Social Responsibility" means the activities undertaken by a company in pursuance of its statutory obligation laid down in section 135 of the Act in accordance with the provisions contained in CSR Rules. Every company covered under section 135(1) of the Act is required to constitute a CSR committee of the Board consisting of at least three or more directors with at least one independent director. With the enactment of the Companies Act, 2013, India has become the forerunner to mandate spend on Corporate Social Responsibility (CSR) activities through a statutory provision. India has a tradition of corporate philanthropy, while many corporate houses like TATA, Birlas have been traditionally engaged in doing CSR activities voluntarily, the new CSR provisions has put a greater responsibility on companies in India to set out clear CSR framework.

The Act mandates the spending of atleast 2 % of the net profits towards CSR activities within the defined parameters. The Board has been held responsible to ensure compliance with the provision. Non-compliance of the provision has to be reflected in the Board's report and may not be taken well by the investors.

This Lesson details the framework that the company has to comply with right from the constitution of the

committee, to its role and manner in which a company can carry out its CSR activities, and CSR reporting and impact assessment. As a Company Secretary you have to guide the Board on the subject.

Lesson 18: Annual Report - Concepts

Annual reports are the summarized statements of the financial position and all the material events took place in the business entity in the previous financial year. It is a mandatory requirement for every company whether the company is listed or not. Whereas, the Board's Report is an important means of communication by the Board of Directors of a company with its stakeholders. The Board's Report provides the stakeholders with both financial and non-financial information, including the performance and prospects of the company, relevant changes in the management and capital structure, recommendations as to the distribution of profits, future and on-going programmes of expansion, modernisation and diversification, capitalisation of reserves, further issue of capital and other relevant information.

The "Secretarial Standard on Report of the Board of Directors" (SS-4), formulated by the Secretarial Standards Board (SSB) of the Institute of Company Secretaries of India (ICSI) and issued by the Council of the ICSI, has been effective from 1st October, 2018. Adherence to SS-4 is recommendatory. SS-4 prescribes a set of principles for making disclosures in the Report of the Board of Directors of a company and matters related thereto. SS-4 is in conformity with the provisions of the Companies Act, 2013.

This lesson outlines the concepts of annual reports, board's report, annual return and understanding of Secretarial Standards on report of board of directors.

Lesson 19: Key Managerial Personnel (KMP's) and their Remuneration

The executive management of a company is responsible for the day to day functioning of the company. The Companies Act, 2013 has used the term key managerial personnel to define the executive management. The key managerial personnel are the point of first contact between the company and its stakeholders. While the Board is responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation.

The Companies Act, 2013 has introduced a new concept for appointment of the Key Managerial Personnel at top level of the organizational structure. In the new Act the position of company secretary has been enhanced multifold, from record keeper to key managerial personnel. A present day Company Secretary is expected to do statutory, administrative, managerial and strategic functions.

Sections 203 of the Companies Act, 2013 read with rule 8 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that the every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial personnel i.e. MD or CEO or Manager and in their absence a WTD, CS and CFO.

This Lesson guides on the appointment, procedure for appointment and role to be undertaken as KMP.

CONTENTS

PART I : COMPANY LAW - PRINCIPLES & CONCEPTS

LESSON 1

INTRODUCTION TO COMPANY LAW

Introduction – Jurisprudence of Company Law	2
History and development of the concept of company law in India	2
Concept Paper on Company Law, 2004 & J.J. Irani Report	4
The Companies Act, 2013	4
Reforms brought under the Companies Act, 2013 for Ease of Doing Business	5
Doctrine of *Ultra Vires*	6
Effects of *ultra vires* Transactions	10
Exceptions to the doctrine of *ultra vires*	11
Doctrine of Indoor Management	11
Exceptions to the Doctrine of Indoor Management	13
Doctrine of Constructive Notice	15
Doctrine of *Alter Ego*	16
Doctrine of Lifting Off or Piercing the Corporate Veil	17
Applicability of the Companies Act, 2013 and key concepts	21
Applicability	21
E-Governance and MCA-21	27
Agencies under MCA-21	27
MCA-21	29
Important aspects of MCA-21	30
Organization of ROC Office under MCA	30
Front Office and Back Office	30
MCA Services	32
All about filing and filing of E-Forms	35
Prerequisites for E-Filing On MCA-21	35
Hardware and Software Requirements under e-filing	35

Necessity of Pre-certification of E-Forms 36
Mode of Payment 36
Lesson Round-up 36
Glossary 37
List of Further Readings 38

LESSON 2

LEGAL STATUS AND TYPES OF REGISTERED COMPANIES

What is a Company? 40
Definition of a Company 40
Legal Status of Registered Companies 41
Corporate Personality 42
Company as an Artificial Person 44
Perpetual Succession 45
Separate Property 46
Transferability of Shares 48
Shares are Movable Properties 48
Transferability of Shares of a Private Limited Company 48
Capacity to sue or be sued 49
Company has Nationality and Residence 50
Limited Liability 51
Exceptions to the principle of limited liability 51
Contractual Rights 52
Types of Registered Companies 53
Classification of Companies 55
Private Company 57
Characteristics of Private Limited Company 58
Privileges and Exemptions of Private Company 60
Public Company 62
Characteristics of Public Company 63
Distinction between Private and Public Company 64
Small Company 65
Holding Company or Parent Company 69

Subsidiary Company 72
Associate Company 75
Dormant Company/ Inactive Company 77
Government Company 78
Test Yourself 84
List of Further Readings 85

LESSON 3

MEMORANDUM AND ARTICLES OF ASSOCIATION AND ITS ALTERATION

Memorandum of Association 88
Form of Memorandum of Association 89
Contents of Memorandum 90
Alteration of Memorandum of Association (MoA) 97
A. Alteration of MoA Due To Change In Name Clause 98
Procedure for Alteration in Name Clause of Memorandum: 99
Effect of Change in Name Clause 101
Methods of changing the name 101
Specimen Resolutions 102
B. Alteration of Situation/Registered Office clause in the MoA 103
Change within the local limits of same town 103
Change outside the local limits of any city, town or village 103
Change within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies 103
Change of Registered office from one State to another 104
Steps after obtaining new certificate from ROC 108
Specimen Resolutions 109
C. Alteration of MoA due to change in Object Clause 110
Procedure is to be followed for alteration of objects clause of MOA 111
Specimen Resolutions 113
D. Alteration of Liability Clause 115
Specimen Resolution 115
E. Alteration of Capital Clause in MOA 115
Procedure for altering the Memorandum of Association for increasing the Authorised Capital of the Company 116

Specimen Resolutions 117
Registration of Alteration 118
Articles of Association 119
Registration of Articles 120
Entrenchment Provisions 121
Contents of Articles 122
Distinction between Memorandum and Articles 123
Legal Effect of the Memorandum and Articles 123
Alteration of Articles of Association of a Company 125
Procedure for alteration of AOA 128
Specimen Resolutions 130
Incorporation Contracts and Agreements 132
Pre-incorporation Contracts 133
Specimen Resolution and Format 134
Lesson Round-Up 135
Glossary 135
Test Yourself 136
List of Further Readings 137
Other References (Including Websites/Video Links) 137

LESSON 4

SHARES AND SHARE CAPITAL – CONCEPTS

Part A: Meaning and Types of Share Capital 141
Meaning and Definition of 'Capital' 141
Types of Share Capital 142
Compliance for publication of share capital under Companies Act, 2013 145
Part B: Basic Terms Related To Issue & Allotment of Securities 145
Definition and meaning of Securities 145
Prospectus 146
Share Certificate 149
Maintenance of share certificate forms and related books and documents 151
Case Laws depicting Significance of Share Certificate 151
Legal Effect of Share Certificate 152

Part C: Issue and Allotment of Securities	153
Governing Laws	155
Kinds of issue of shares	155
Share Premium to be transferred to 'Securities Premium Account'	156
Utilisation of Securities premium	156
Concept of Allotment of Securities	157
Private Placement of Shares	160
Equity Shares with Differential Voting Rights	163
Issue and Redemption of Preference Shares	166
Procedure to issue and redemption of Preference Shares	169
Further Issue of Share Capital	170
Right Issue:	171
Employee Stock Option Scheme	173
Issue of Shares on Preferential Basis	176
Bonus Shares	181
Sweat Equity Shares	182
Alteration of Share Capital	187
Buy-Back of Securities	188
Circumstances prohibiting buy-back	193
Why the Company choose Buy Back?	193
Reduction of Share Capital	195
Conditions for reduction of share capital	195
Diminution of Share Capital is not a Reduction of Capital	199
Reduction of Share Capital without sanction of the Tribunal	200
Part E: Transferability of Shares	202
Transfer or Transmission of Securities	202
Transferability of securities	202
Rectification of Register of Members	208
Lost Transfer Deeds	209
Transfer of Shares to Minor	209
Transfer in Violation of Articles	210
Transmission of Securities	211
Forged Transfer	214

Transposition of Name 215
Rights of Transferor 216
Effects of Transfer 217
Legal Framework for Depository Systems 218
Dematerialisation and Rematerialisation of Shares 220
Specimen Resolutions 224
Lesson Round-up 225
List of Further Readings 228
Other References (Including Websites/Video Links) 228

LESSON 5

MEMBERS AND SHAREHOLDERS

The Term - “Members” 230
Ways to acquire membership of the company 231
Differences between Members and Shareholders 232
Who may become a member 233
Minimum Number of Members 235
Cessation of Membership 236
Register of Members 237
Contents of register of members in case company not having share capital 238
Maintaining Register of Members 238
Authentication of entries of register of members 239
Index of Members 240
Foreign Register 242
Maintenance of Foreign Register 242
Closing of Register of Members 243
Preservation of Registers 244
Power of the Central Government to Investigate into the Ownership of Company 244
Declaration by persons not holding beneficial interest in any share 245
Step for declaration of beneficial interest in any shares 246
Significant beneficial owners in a company 247
Declarations to be made by Significant Beneficial Owner 251
Obligations of the Reporting Company 251

Consequences of Non-Reporting under Section 90 (5) 252
Register of Significant Beneficial Owners 253
Rectification of a Register of Members 254
Voting Rights of Members 258
Rights of Dissenting Shareholders 259
Shareholders' Democracy 260
Few businesses which are required to be transacted by shareholders 261
Variation of Shareholder's Rights 262
Shareholders' Agreement 263
Enforceability of the Shareholder's Agreement 263
Veto Power 264
Difference between Veto Power and Casting Vote 265
Veto Rights and 'Control' 265
Assignment of shares in a company 266
Specimen Resolution / Formats 266
Lesson Round-Up 267
Glossary 268
Test Yourself 269
List of Further Readings 270
Other References (Including Websites/Video Links) 270

LESSON 6

DEBT INSTRUMENTS – CONCEPTS

PART A- Borrowing powers of company and debt capital 272
Types of Borrowings 276
Debentures & Bonds 277
Difference between Bonds and Debentures 279
Kinds of Debentures 280
Conversion of Debentures into shares 285
Debenture Redemption Reserve (DRR) 285
Debenture Trustees & Debenture Trust Deed 288
PART B- Overview of Company Deposits 292
Meaning of Eligible Company 295

Terms and Conditions for Acceptance of Deposits from its Members	296
Acceptance of deposits based on time period	297
Acceptance Limits for Deposits	298
Repayment of Deposits	301
Trustee for Depositors	304
Duties of Trustees for Depositors	305
Meeting of Depositors	305
Furnishing of Deposit Receipts to Depositors	306
Maintenance of Liquid Assets and Creation of Deposit Repayment Reserve Account	306
Registers of Deposits	306
General Provisions Regarding Premature Repayment of Deposits	307
Return of Deposits to be Filed with the Registrar	308
Disclosures in the financial statement	308
Specimen Resolution	310
Lesson Round-Up	311
Glossary	312
Test Yourself	312
List of Further Readings	314
Other References (Including Websites/Video Links)	314

LESSON 7

CHARGES

Definition & Meaning of “Charge”	316
Types of Charges	318
Difference between Fixed or Specific Charge and Floating Charge	318
Crystallization of Floating Charge	319
Difference between Mortgage and Charge	321
Difference between Charge and Pledge	322
Registrable Charges	322
Consequences of Non-Registration of Charges	327
Certificate of Registration of Charge & Certificate of Modification of Charge	328
Importance of Registration of Charge and its Certificate	330
Application for Registration of Charge	332

Procedure to be followed for creation or modification of charge	335
Date of Notice of Charge	338
Satisfaction of Charges	339
Recording of satisfaction of charge by Registrar	339
Certificate of registration of satisfaction of charge	340
Procedure for Satisfaction of Charge	341
Register of Charges Maintained in ROC's Office	343
Intimation of appointment of receiver or manager	343
Company's Register of Charges	344
Inspection of Charges	344
Rectification by Central Government in Register of Charges	345
Forms for Charge Management under the Companies Act, 2013	347
Search and Status Report	348
Understanding the provisions relating to charges through judicial precedents	351
Specimen Resolutions	352
Lesson Round-up	355
Glossary	356
Test Yourself	357
List of Further Readings	358
Other References (Including Websites/Video Links)	358

LESSON 8

DISTRIBUTION OF PROFITS

Profit and Ascertainment of Divisible Profit	360
Declaration and Payment of Dividend	360
Interest vs. Dividend	362
Types of Companies and provisions related to payment of dividend	362
Types of Dividend	363
Power to declare Dividend	364
Source of payment of Dividend	366
Transfer of profits to reserve	368
Dividend Distribution Policy	372
Date for determining entitlement to dividend	373

Persons entitled to dividend	373
Dividend on preference shares	374
Dividend on Equity shares with differential rights	375
Dividend in case of Beneficial Owner	375
Waiver of right to receive Dividend	376
Declaration of Dividend	376
Declaration of Dividend to be unconditional	377
Dividend to be deposited in separate bank account	378
Remittance of Dividend to Non-Resident members	378
Rate of Dividend	379
Mode of Payment of Dividend	379
Liability to pay Final Dividend	380
Unpaid Dividend Account	382
The Investor Education and Protection Fund (IEPF)	384
Refund to Claimant from Investor Education and Protection Fund	393
Revocation of Dividend	399
Preservation of Dividend Cheques, Warrants and Dividend Registers	399
Secretarial Standard on Dividend (SS-3)	411
Lesson Round-Up	415
Glossary	416
Test yourself	416
List of Further Readings	418
Other References (Including Websites/Video Links)	418

LESSON 9

ACCOUNTS & AUDITORS

Books of Accounts	420
Important Definitions	420
Requirement of Keeping Books of Accounts	421
Place of Keeping Books of Account	422
Maintenance of Books of Account in Electronic Form	422
Books of Account in Respect of Branch Office	423
Preservation of Books of Accounts	424

Financial Statement	425
Financial statement must give true and fair view	426
Consolidated Financial Statements	427
Manner of Consolidation of Accounts	428
Periodical Financial Statements	428
Re-Opening of accounts on Court's or Tribunal's orders	429
Voluntary Revision of Financial Statements or Board's Report	430
Signing of Financial Statement	430
Right to Inspect	433
Copy of financial statement to be filed with Registrar	433
National Financial Reporting Authority (NFRA)	435
Objectives of NFRA	435
Constitution of NFRA	435
Jurisdiction, Powers of and Imposition of Penalties by NFRA	436
Appeals and Appellate Authority	437
Central Government to Prescribe Accounting Standards	437
Indian Accounting Standards (Ind AS)	438
Appointment of Auditors	440
Manner and Procedure of Selection and Appointment of Auditors	441
Mandatory Rotation of Auditors	442
Rotation of Auditors	443
Re-Appointment of Retiring Auditor	443
Casual vacancy in the office of auditor	443
Powers of Tribunal	446
Removal of Auditor	446
Remuneration of Auditor	448
Eligibility & Qualifications of Auditor	448
Disqualifications of Auditor	449
Auditors – Rights, Duties and Liabilities	451
Audit and Auditor's Report	453
Companies (Auditor's Report) Order, 2020	454
Cost Audit	455
Secretarial Audit	457

Scope of Secretarial Audit 459
Internal Audit 462
Classes of companies requiring Internal Audit 462
Specimen Resolution 464
Lesson Round-Up 465
Glossary 465
List of Further Readings 467
Other References 467

LESSON 10

COMPROMISE, ARRANGEMENT AND AMALGAMATION-CONCEPTS

Introduction 470
Power to Compromise or make Arrangements with Members or Creditors 471
Affidavit by the applicant to disclose certain material facts 471
Notice of the meeting 472
Notice to provide for voting by themselves or through proxy or through postal ballot472
Voting 473
Approval and sanction of the scheme 474
Accounting treatment proposed in the scheme to be in conformity with accounting standards 475
Compromise includes takeover 475
Application to the Tribunal by an aggrieved party 475
Power of the Tribunal to enforce Compromise or Arrangement 478
Merger and Amalgamation of Companies 479
Merger 479
Amalgamation 479
Tribunal's power to call meeting of creditors or members, with respect to merger or amalgamation of companies 480
Merger and Amalgamation of Certain Companies 484
Merger of small companies/holding and subsidiary companies 484
Transferee company to file a copy of scheme approved 485
Application by Central Government to the Tribunal 486
Tribunal's Action to Central Government's application 486
Registrar having jurisdiction over transferee company has to be communicated 487

Effect of registration of the scheme	487
Merger or Amalgamation of a company with a foreign company	488
Power to acquire shares of shareholders dissenting from scheme or contract approved by majority	489
Offer to dissenting shareholders	489
Meaning of dissenting shareholders	489
Acquisition of shares of dissenting shareholders	490
Process of acquisition of shares from dissenting shareholders	490
Purchase of Minority Shareholding	490
Definition of Acquirer and Person acting in concert	490
Power of Central Government to provide for Amalgamation of Companies in public interest	493
Majority Rule and Minority Rights	495
~~Prevention of Oppression and Mismanagement~~	~~498~~
~~Meaning of Oppression~~	~~498~~
~~Application to Tribunal for Relief In Case Of Oppression & Mismanagement~~	~~501~~
~~Right to apply under Section 241~~	~~502~~
~~Power of Tribunal~~	~~503~~
~~Power of Tribunal to issue orders~~	~~503~~
~~Class Action Suits~~	~~507~~
~~Requirement for Consideration of Application~~	~~509~~
~~Effects of Order~~	~~510~~
~~Application of certain provisions to proceedings under Section 241 or Section 245~~	~~510~~
~~Registration Offices and Fees~~	~~510~~
Lesson Round-Up	513
Glossary	514
Test Yourself	514
List of Further Readings	515
Other References	515

LESSON 11

DORMANT COMPANY

Advantages of dormant companies under Companies Act, 2013	519
Compliances for Dormant Company	520
Procedure to obtain the status of a Dormant Company	520

Pre-requisites for obtaining the status of Dormant Company 521
Procedure to obtain the status of active company from Dormant Company 523
Specimen Resolutions 524
Lesson Round-Up 525
Glossary 526
Test Yourself 526
List of Further Readings 527
Other References (Including Websites/Video Links) 527

LESSON 12

INSPECTION, INQUIRY AND INVESTIGATION

Meaning of Inquiry, Inspection and Investigation 531
Powers allotted under the Companies Act, 2013 532
Purpose of Conducting Inspection 533
Power to Call for Information, Inspect Book and Conduct Inquiries 533
Issuance of notice by registrar 533
Duty of the company to furnish information 534
Inspection 534
Inspection ordered by the Registrar by Another Notice 534
Inspection ordered by the Regional Director 535
Inspection ordered by the Central Government 535
Meaning of General or Special Order 535
Inquiry 535
Conduct of Inspection and Inquiry 536
Inspection Report 537
Search and Seizure 537
Application to Special Court for entering places and seizing documents 537
Returning of Seized Books and Papers in 180 days 538
Investigation 538
Kinds of Investigation 538
Investigation into affairs of company in public interest 538
Establishment of Serious Fraud Investigation Office 540
Submission of Report to CG 541

~~Investigation by investigating Officer~~ ~~542~~
~~Offences are Cognizable & Non- Bailable~~ ~~542~~
~~CG may direct SFIO to initiate prosecution~~ ~~543~~
~~Filing of investigation report with SFIO~~ ~~543~~
~~Investigation into the company's affairs on application made by members or other persons~~ ~~548~~
~~Investigation of Ownership of Company~~ ~~549~~
~~Scope of Investigation~~ ~~550~~
~~Power of Inspector~~ ~~550~~
~~Procedure, powers, etc., of inspectors~~ ~~550~~
~~Protection of Employees during Investigation~~ ~~552~~
~~Over-riding effect Section 218(5)~~ ~~553~~
~~Seizure of Documents by Inspector~~ ~~553~~
~~Seizure of Books and Papers~~ ~~553~~
~~Time period for keeping Books and Papers in custody of Inspector~~ ~~554~~
~~Freezing of Assets of Company On Inquiry And Investigation~~ ~~554~~
~~Imposition of Restrictions upon securities~~ ~~554~~
~~Inspector's Report~~ ~~555~~
~~Expenses of Investigation~~ ~~555~~
~~Legal Advisers and bankers not to disclose certain information~~ ~~556~~
~~Information, Inspection, Inquiries and Investigation of Foreign Company~~ ~~556~~
~~Lesson Round-Up~~ ~~557~~
~~List of Further Readings~~ ~~559~~
~~Other References (Including Websites/Video Links)~~ ~~559~~

LESSON 13

GENERAL MEETINGS

Corporate Meetings and Collective Decision making 563
Annual General Meeting 563
Extension of validity period of AGM 565
Day, Time and Place for holding an Annual General Meeting 565
Business to be transacted at Annual General Meeting 566
Convening of a Valid General Meeting 567
Extra-Ordinary General Meeting 568

Class Meetings	571
Meetings of Debenture Holders, Creditors, etc.	571
Adjourned Meeting	571
Procedure for holding Adjourned Meeting	572
Resolution passed at adjourned meetings	573
Types of Resolutions	573
Ordinary and Special Resolutions	573
Resolutions Requiring Special Notice	574
Process of Passing the Resolutions	576
Resolutions and agreements to be filed with the registrar	577
Notice of meeting	578
Length of notice of meeting	578
Shorter notice	580
Contents of Notice	581
Place of meeting	581
Day of meeting	582
Time of meeting	582
Agenda	582
Proxy clause with reasonable prominence	582
Persons Entitled to Receive Notice	584
Notice to Directors, Auditors & other specified persons under Secretarial Standard-2	584
Statement to be Annexed to Notice – Explanatory Statement	586
Quorum for Meetings	588
Chairman of Meetings	590
Proxies	591
Process of Conducting Meeting	595
Voting	600
Procedure of E-Voting	602
Demand for Poll	606
Postal Ballot	607
Rescinding the Resolution	612
Modification to the Resolution	612
Circulation of Members' Resolution	612

Maintenance of Minutes of Meetings	613
Secretarial Standard-2 on General Meetings	614
Preservation of Minutes in case of scheme of Merger and Amalgamation	615
Report on Annual General Meeting	615
Duties of Company Secretaries Before, During and after General Meeting	616
Virtual Meetings	619
Drafting of Notice and Minutes of AGM and EGM	622
Specimen	622
Lesson Round-Up	630
Glossary	631
Test Yourself	631
Other References (Including Websites/Video Links)	633

LESSON 14

DIRECTORS

DIN Requirement	636
Documents Required for Obtaining DIN	638
Procedure for generation of DIN	640
Cancellation/Surrender/Deactivation of DIN	641
Impact of Non Compliance of DIR-3 KYC/DIR-3 KYC Web	642
General Provisions Regarding DIN	642
Types of Directors	644
Independent Directors	647
Remuneration of an Independent Director	651
Term of an Independent Director	651
Payment of Sitting Fee/Commission	653
Appointment / Reappointment, Disqualifications, Vacation Of Office, Retirement, Resignation and Removal of Directors	657
Appointment of directors to be voted individually	658
Appointment of First Director	658
Appointment of Directors by Board	659
Appointment of directors by Tribunal	660
Appointment of Nominee Directors	661

Procedure for Appointment of Directors to be elected by Small Shareholders	661
Appointment of Directors by Members at General Meeting	662
Procedure for re-appointment of the retiring director at the Annual General Meeting	663
Appointment of Independent directors	666
Appointment and removal requirements for IDs in case of listed companies	666
Appointment of independent director on unlisted material subsidiary company	667
Selection of Independent Directors	667
Disqualifications for Appointment of Director	669
Vacation of Office	670
Resignation of Directors	672
Removal of Directors	673
Removal of Director by Shareholders	673
Procedure for Removal of Director	673
Removal of Director by the National Company Law Tribunal	674
Loans to Directors	674
Disclosures by a director of his interest	676
Rule 9 of the Companies (Meetings of Board and its Powers) Rules, 2014	677
Duties of Directors	677
Register of directors and key managerial personnel and their shareholding	677
Members Right to Inspect	678
Specimen Resolution	678
Lesson Round-Up	679
Glossary	680
Test Yourself	680
List of Further Readings	681
Other References (Including Websites/Video Links)	681

LESSON 15

BOARD COMPOSITION AND POWERS OF THE BOARD

Board Composition	684
Board Composition in Listed Entities	686
Number of Directorships	688
Board Committees	690

Functions of Board Committee	691
Powers of the Board to form a Committee	691
Mandatory Board Committees	691
Audit Committee	692
Constitution of Audit Committee	692
Composition of the Audit Committee	692
Disclosure in Board's Report	696
Vigil Mechanism	698
Nomination and Remuneration Committee	699
Stakeholders Relationship Committee	702
Risk Management Committee	704
Powers of Risk Management Committee	705
Corporate Social Responsibility Committee	705
Applicability of CSR Committee	705
Functions of CSR Committee	706
Other Board Committees	707
Powers of Board	707
Delegation of Powers of Board	708
Restriction on Powers of Board	709
Prohibitions and Restrictions Regarding Political Contribution	712
Inter Corporate Loans, Investments Guarantees and Security	713
Loan and Investment by Companies	715
Procedures involved in making loan giving guarantee and providing security	716
Approval from Members	716
Prior Approval of Financial Institution	717
Investments to be held in company's own name	720
Register of Investments not held in Company's own name	721
Related Party Transactions	722
Disclosure in Board's Report	729
Penalties for Non-Compliance	730
Lesson Round-Up	731
Test Yourself	732
Other References (Including Websites/ Video Links)	733

LESSON 16

MEETINGS OF BOARD AND ITS COMMITTEES

Meetings of board and its Committees	737
Frequency, Convening and Proceedings of the Meetings of the Board	737
Aspects to be considered while fixing the Venue:	738
Board Meeting through Video Conferencing:	739
Meetings of the Board	739
Meetings of Committees	740
Preparation of Notices for meetings of Board/Committees of Board	741
Agenda Management	743
Sample of Important Agenda Items for Board Meeting	746
Meeting Management	748
Convening a Meeting	748
Quorum for Board Meetings	749
Meetings of Committees	751
Attendance Registers	751
Leave of Absence	752
Chairman of the meeting of the Board/Committee	753
Minutes	753
Contents of Minutes	754
Types of Resolutions	758
Resolution by Circulation	759
Passing of Resolution by Circulation	759
Procedure for Passing Resolution by Circulation as stated in Secretarial Standards issued by ICSI	760
Meeting of Independent Directors	761
Duties of company secretary before, during and after board /committee meetings	762
Virtual Meetings	763
Need and Scope of Secretarial Standards	769
Secretarial Standards 1	770
Specimen	772
Lesson Round-Up	775
Glossary	776
Test Yourself	776
List of Further Readings	777
Other References (Including Websites/Video Links)	778

LESSON 17

CORPORATE SOCIAL RESPONSIBILITY – CONCEPTS

Meaning of Corporate Social Responsibility	780
CSR under the Companies Act, 2013	782
CSR Committee	788
The functions of CSR Committee	790
Meeting of CSR Committee	790
Functions and Responsibilities of the Board	791
CSR Implementation	791
Identifying appropriate Implementing Agency	793
CSR Policy and Annual Action Plan	793
Annual Action Plan	795
CSR Activities	795
Computation of net profit	798
~~CSR Expenditure~~	~~801~~
~~On-Going Project~~	~~803~~
~~CSR Monitoring~~	803
CSR Reporting	808
~~Impact Assessment for big CSR projects~~	809
Website Disclosure	810
CSR Portal	812
Social Stock Exchange	814
Specimen Resolutions	815
Lesson Round-Up	816
Glossary	816
Test Yourself	818
List of Further Readings	819
Other References (Including Websites/Video Links)	819

LESSON 18

ANNUAL REPORT - CONCEPTS

Introduction	822
Disclosures by Board	822
Annual Report	822

Statement of deviation(s) or variation(s)	830
Documents & Information to shareholders	830
Board's Report	831
Secretarial Standard on Report of the Board of Directors" (SS-4)	832
Disclosures under Section 134(3)	833
Abridged Board Report for OPC and Small Company	841
Voluntary revision of Financial Statements or Board's Report	844
Composition of Audit Committee - Section 177(8)	844
Details of Vigil Mechanism	844
Investor Education and Protection Fund	847
Credit Rating of Securities	848
Approval of the Board's Report	849
Signing of Board's Report	849
Annual Return	853
Objective of filing Annual Return	853
Signing of Annual Return	854
Certification of Annual Return	855
Active Company Tagging Identities and Verification (ACTIVE)	859
Specimen Resolution/Formats	860
Specimen Board's Report	861
Consolidated financial Statements	862
Related Party Transactions	862
Directors' Responsibility Statement	863
Corporate Social Responsibility [CSR]	865
Business Risk Management	865
Managing the Risks of fraud, corruption and unethical business practices	865
Constitution of Audit Committee	866
Energy Conservation, Technology Absorption and Foreign Exchange Earnings and Outgo	866
Lesson Round-Up	867
Glossary	867
Test Yourself	868
List of Further Readings	868
Other References (Including Websites/Video Links)	868

LESSON 19

KEY MANAGERIAL PERSONNEL (KMP'S) AND THEIR REMUNERATION

Various KMP's Positions & Definition thereof under the Companies Act, 2013	870
Appointment of Key Managerial Personnel	871
No Person shall act as Chairman and Managing Director/CFO at the same time	873
Manner of Appointment of KMP	873
Provisions as Specified Under the SEBI (LODR) Regulations, 2015	874
Vacancy of KMP	874
Intimations Regarding appointment of KMP	875
Role of KMP	875
Appointment of Managing Director, Whole-Time Director or Manager	876
Appointment of MD & Manager at the same time is not possible	876
Disqualification of managing Director, Whole-Time Director or Manager	877
Approval for appointment of MD, WTD and Manager -Section 196 (4)	877
Issue of General Notice before making Application to Central Government	879
Procedure for appointment of Managing Director, Whole Time Director & Manager	879
Powers, Duties, and Responsibilities of the Managing Director	881
Chief Executive Officer and Chief Financial Officer	882
Appointment of Company Secretary	884
Takeover Code and Insider Trading	886
Human Resources Management	887
Information Technology	887
Company Secretary as Key Managerial Personnel (KMP)	888
Role of Company Secretary	889
Legal Advisor for Business	890
Link Between Inter and Intra Company Works	890
Duties of a Company Secretary in India	890
Removal of Company Secretary	891
Procedure for Removal/Resignation of Company Secretary	891
Officer who is in default	892
Remuneration of Managerial Personnel	893
Sitting Fees	899
Computation of Net Profit for Calculating Remuneration	900

Consequence of Remuneration in Excess of Prescribed Limit	900
Waiving off Amount Receivable under Sub Section 9	900
Disclosure by Listed Companies	901
Disclosure in Board's Report	901
Specimen Resolutions	907
Lesson Round-Up	909
Glossary	910
Test Yourself	910
List of Further Readings	911
Other References (Including Websites/Video Links)	911
TEST PAPERS	**913**

Introduction to Company Law

Lesson 1

KEY CONCEPTS

■ *Ultra Vires* ■ Indoor Management ■ Constructive Notice ■ Lifting of Corporate Veil ■ MCA-21 ■ Types of Definitions ■ E-Governance

Learning Objectives

To understand:

- Concept and principles of Company Law
- Background and evolution of corporate legislation in India
- Agencies under MCA
- Applicability of Companies Act, 2013 and Key Concepts
- MCA website and its features
- MCA Services
- Pre-requisites for E-Filing on MCA-21

Lesson Outline

- Introduction - Jurisprudence of Company Law
- History and development of Company Law in India
- Meaning and definition of Company
- Nature and characteristics of a Company
- Doctrine of *Ultra Vires* and Indoor Management
- Doctrine of Constructive Notice
- Doctrine of lifting of or piercing the corporate veil
- Important aspects and benefits of MCA-21
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

INTRODUCTION – JURISPRUDENCE OF COMPANY LAW

Company Law in India, is the cherished child of the English parents. Our various Companies Acts have been modelled on the English Acts. Following the enactment of the Joint Stock Companies Act, 1844 in England, the first Companies Act was passed in India in 1850.

The Indian Companies Act, 1866, the Indian Companies Act, 1882, the Companies Act, 1913, and the Companies Act, 1956 was earlier law passed in India. The Companies Act, 2013 received the assent of the President on August 29, 2013 and was notified in the Gazette of India on August 30, 2013. Every Companies Act introduced new concepts. Like, before notifying the Companies Act, 2013 there were no concepts regarding Corporate Social Responsibility, One Person Company and internal/secretarial audit based on threshold limits etc.

HISTORY AND DEVELOPMENT OF THE CONCEPT OF COMPANY LAW IN INDIA

Joint Stock Company Act, 1850

Based on Company Legislation Act, 1844	Registration for companies only in Madras, Calcutta & Bombay	Limitation - only includes Unlimited Liability Company

↓

Joint Stock Company Act, 1857

Includes both Limited & Unlimited liability Company	Limitation - Banking & Insurance Company can only be registered as Unlimited liability Company

↓

Joint Stock Company Act, 1860

Banking and Insurance Company can also be Limited Liability Company

↓

Joint Stock Company Act, 1866

Altogether new law governing incorporation, regulation and winding up of Company

↓

The Companies Act, 1913

Also includes the functioning of commercial organizations, institution of private company apart from company

↓

The Companies Act, 1936

Includes the functions of directors, managing agents & provisions for investigation of any fraudulent activity and guarantying the security & payment of provident fund to its employees

↓

The Companies Act, 1956

Introduced after World War II (1944) & Independence (1947) on the report of HC Bhabha Committee in 1952	It applies to whole of India except Nagaland, J&K and Goa, Daman & Diu subject to some exceptions	Based on social & economic needs of the Company

↓

The Companies Act, 2013

To encourage transparency and high standards of corporate governance

Important Committees recommending changes to the Companies Act

1952 Bhabha Committee	The Government of India appointed a Committee of twelve members representing various interests under the chairmanship of Shri C. H. Bhabha,to go into the entire question of the revision of the Companies Act, 1913.
1957 Sastri Committee	The Government of India appointed a Committee of six members under the chairmanship of Shri A.V. Visvanatha Sastri to overcome such practical force, to remove such drafting defects and obscurities as may have interfered purposes underlying the Act and to consider what changes in the form or structure of the Act, if any.
1978 Sachar Committee	This Committee was constituted by Government under the Chairmanship of Shri Rajindar Sachar to consider and report on what changes are necessary which are required to be made in the form and structure of the Companies Act, 1956, so, as to simplify them and to make them more effective, wherever necessary.
1997 Chandratre Committee	Chandratre Committee was formed under the Chairmanship of Dr. K. R. Chandratre. The main objective of the Group was to re-write the Companies Act, 1956 to facilitate a healthy growth of the Indian corporate sector under a liberalised, fast changing and highly competitive environment.
2000 Eradi Commitee	The Eradi Committee was set up under the chairmanship of Justice V. Balkrishna Eradi consisting of experts to examine the existing law relating to winding up proceedings of companies in order to remodel it in line with the latest developments and innovations in the corporate law and governance.
2002 Joshi Committee	The Committee was constituted under the Chairmanship of Shri R.D. Joshi to examine the remnants of the Companies Bill, 1997.
2003 Naresh Chandra Committee	This Committee was constituted by Government under the Chairmanship of Shri. Naresh Chandra, to Regulate Private Companies and Partnerships.
2005 Irani Committee	The Irani Committee was constituted under the chairmanship of Dr. J. J. Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956.
2005 Vaish Committee	The Government of India appointed a Committee under the Chaimanship of Shri O.P. Vaish to streamline the prosecution mechanism under the Companies Act, 1956 to make it more effective.
Company Law Committee	The government of India has constituted a Company Law Committee for examining and making recommendations to the Government on various provisions and issues to implementation of the Companies Act, 2013 and the Limited Liability Partnership Act, 2008.

CONCEPT PAPER ON COMPANY LAW, 2004 & J.J. IRANI REPORT

Background

A Concept Paper on Company Law drawn up in the legislative format was exposed for public viewing on the electronic media so that all interested parties may not only express their opinions on the concepts involved but may also suggest formulations on various aspects of Company Law.

On August 4, 2004 the Ministry of Company Affairs had published a Concept Paper on Company Law on its website to enable a broad-based examination of various Company Law issues requiring revision. A large number of comments and suggestions were received on the Concept Paper. Later, on December 2, 2004, the Government constituted an Expert Committee on Company Law under the Chairmanship of Dr. J J Irani, the then Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that will be able to address the changes taking place in the national and international scenario, enable the adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever- changing business models. The Committee submitted its report to the Government on 31st May 2005. The report was charting out the road map for a flexible, dynamic and user-friendly new company law.

The Report of the Committee had also sought to bring in multifarious progressive and visionary concepts and endeavored to recommend a significant shift from the "Government Approval Regime" to a "Shareholder Approval and Disclosure Regime". Broad recommendations of the Expert Committee include:

- Private and small companies need to be given flexibilities and freedom of operations and compliance at a low cost
- Companies with higher public interest should be subject to a stricter regime of Corporate Governance
- Government Companies and Public Financial Institutions should be subject to similar parameters with respect to disclosures and Corporate Governance as other companies
- Simplified regulatory regime backed by strengthened disclosure
- To attune the Indian Company Law with the global reforms taking place in the arena

The Companies Act, 2013

The Companies Act, 2013 received the assent of the President on August 29, 2013 and was notified in the Gazette of India on August 30, 2013. It empowers the Central Government to bring into force various sections from such date(s) as may be notified in the Official Gazette.

The Companies Act, stipulates enhanced self-regulations coupled with emphasis on corporate democracy coupled with following attributes:

The Companies Act, 2013 introduced new concepts supporting enhanced disclosure, accountability, better board governance, better facilitation of business and so on. It includes associate company, one person company, small company, dormant company, independent director, women director, resident director, special court, secretarial standards, secretarial audit, class action, registered valuers, rotation of auditors, vigil mechanism, corporate social responsibility, E-voting etc.

Reforms brought under the Companies Act, 2013 for Ease of Doing Business

The enactment of the Companies Act, 2013 allowed India to have a modern legislation for growth and regulation of corporate sector in India. The Act was enacted in light of the changing economic and business environment both domestically and globally to facilitate business-friendly corporate regulations, improve corporate governance norms, enhances accountability on the part of corporates and auditors, raise levels of transparency and protect interests of investors, particularly small investors. The objective of the Companies Act, 2013 is to provide business friendly corporate regulation/ pro-business initiatives; e-Governance Initiatives; good corporate governance and CSR; enhanced disclosure norms; enhanced accountability of management; stricter enforcement of laws; audit accountability; Protection for minority shareholders; Investor protection and Shareholder activism; Robust framework for insolvency regulation; and Institutional structure. Initially, it seems that changes in the Companies Act, 2013 will brought out the significant changes in the manner of doing business in India. It becomes true, when the initial unrest of business community was taken to the Government and to address the practical difficulties faced by the business community upon notification of the various provisions of the Act and Rules made thereunder and the term “Ease of Doing Business” was popularised in India.

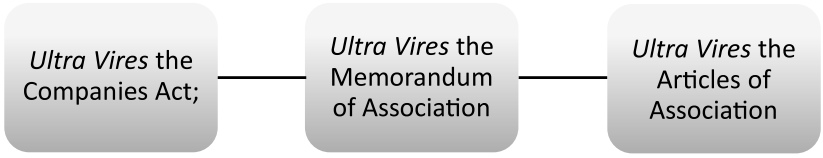
On Ease of Doing Business front, the Government of India has enacted the series of amendments, relaxation, exemptions and simplification in the various Acts, Rules, Regulations etc. covering various business related issues and processes and also extends support to facilitate ease of doing business. In the series the Companies

Act, 2013 has also been amended to extend relief to the business entities governed under the Companies Act, 2013. The amendments were brought through the Companies (Amendment) Act, 2015, the Insolvency and Bankruptcy Code, 2016, the Companies (Amendment) Act, 2017, and the Companies (Amendment) Act, 2019 and the Companies (Amendment) Act, 2020.

DOCTRINE OF *ULTRA VIRES*

Ultra vires is a Latin term made up of two words "ultra" which means beyond and "vires" meaning power or authority. *Ultra vires* acts are any acts that lie beyond the authority of a company to perform.

Any activity done in contrary to or in excess of the scope of activity of the Companies Act, Memorandum of Association or Articles of Association will be *ultra vires*. *Ultra vires* activities can be divided into the following three divisions:



Ultra Vires the Companies Act:

The power of a company is derived from the law governing it. Section 6 of the Companies Act, 2013 expressly provides that the provisions of the Companies Act, 2013 shall prevail notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act.

Any act done contrary to or in excess of the scope of activity of the Companies Act will be *ultra vires* the Companies Act. **Such an act is void and cannot be ratified even by unanimous resolution of all the shareholders**.

For Example; If board members are appointed or removed without following statutory provisions; payment of dividend out of capital or reduced the share capital of the company without complying with the legal formalities.

It also declares a provision contained in the memorandum, articles, agreement or resolution void if it's repugnant to any of the provisions in the Act.

Ultra Vires the Memorandum of Association:

What is Memorandum of Association?

The Memorandum of Association (MOA) is a document listing out the constitution of a company, essentially represents the foundation stone on which the structure of the company is built. It contains clauses detailing the boundaries of the company's activities and its relations with the outside world.

The important attribute of the MOA is considered to be its "objects clause". Section 4(1)(c) of the Companies Act, 2013 requires every company to state in their MOA, the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

The memorandum of association of a company restrict the powers of the company while defining the object of the company. A company cannot do anything, which is beyond the purview of the object clause. **Any act done in contrary to the object clause of the memorandum of association will be *ultra vires* the memorandum of association.**

In the case of a company whatever is not stated in the memorandum as the objects or powers is prohibited by the doctrine of *ultra vires.* As a result, an act which is *ultra vires* is void, and does not bind the company. Neither the company nor the contracting party can sue on it. **Such an act is void and cannot be ratified even by unanimous resolution of all the shareholders.**

Ultra Vires the Articles of Association:

What is Articles of Association:

In terms of Section 5(1) of the Companies Act 2013, the Articles of Association (AOA) of a company shall contain the bye-laws and regulations for the management of the internal affairs of the company. It plays a vital role in governing a company's affairs and also defines the rights of its members inter-se.

If a company acts which are *ultra vires* the Articles of Association but *intra vires* the memorandum of association (i.e. outside the scope of articles but within the powers conferred by the memorandum) will be *ultra vires* the Articles of Association. That is, payment of interest on 'advance calls' at a rate higher than allowed by articles. **These acts are also void, but the company in general meeting may alter the Articles by a special resolution and ratify the unauthorized acts.**

CASE LAW

In *Re. South Durham Brewery Company [(1875) LR 7 HL 653],* the MoA of the company was unclear as to the classes of shares to be issued by it, but the AoA of the company gave power to issue shares of different classes as described therein. The Hon'ble Court held that Articles can be used to explain the ambiguity contained in the memorandum.

".....their Lordships agree that in such cases the two documents must be read together at all events so far as may be necessary to explain any ambiguity appearing in the terms of the memorandum, or to supplement it upon any matter as to which it is silent."

Also, as stated earlier, the company cannot make it valid, even if every member assents to it. The general rule is that an act which is *ultra vires* the company is incapable of ratification. An act which is *intra vires* the company but outside the authority of the directors may be ratified by the company in proper form *[Rajendra Nath Dutta v. Shilendra Nath Mukherjee, (1982) 52 Com Cases 293 (Cal.)].*

The rule is meant to protect shareholders and the creditors of the company. If the act is *ultra vires* (beyond the powers of) the directors only, the shareholders can ratify it. If it is *ultra vires* the Articles of Association, the company can alter its articles in the proper way and thereby such acts can be duly ratified.

CASE LAW

The doctrine of *ultra vires* was first enunciated by the House of Lords in a classic case, *Ashbury Railway Carriage and Iron Co. Ltd. v. Riche, (1878) L.R. 7 H.L. 653.*

The memorandum of the company in the said case defined its objects thus: "The objects for which the company is established are to make and sell, or lend or hire, railway plants to carry on the business of mechanical engineers and general contractors. "

The company entered into a contract with M/s. Riche, a firm of railway contractors to finance the construction of a railway line in Belgium. On subsequent repudiation of this contract by the company on the ground of its being *ultra vires*, Riche brought a case for damages on the ground of breach of contract, as according to him the words "general contractors" in the objects clause gave power to the company to enter into such a contract and, therefore, it was within the powers of the company. More so because the contract was ratified by a majority of shareholders.

The House of Lords held that the contract was *ultra vires* the company and, therefore, null and void. The term "general contractor" was interpreted to indicate as the making generally of such contracts as are connected with the business of mechanical engineers. The Court held that if every shareholder of the company had been in the room and had said, "That is a contract which we desire to make, which we authorize the directors to make", still it would be *ultra vires*. The shareholders cannot ratify such a contract, as the contract was *ultra vires* the objects clause, which by Act of Parliament, they were prohibited from doing.

However, later on, the House of Lords held in other cases that the doctrine of *ultra vires* should be applied reasonably and unless it is expressly prohibited, a company may do an act which is necessary for or incidental to the attainment of its objects. Section 13(1)(d) of the Companies Act, 1956 [Corresponds to section 4(1)(c) of the Companies Act, 2013] provides that the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof be stated in the memorandum. However, even when the matters considered necessary in furtherance of the objects are not stated, they would be allowed by the principle of reasonable construction of the memorandum.

CASE LAW

Justice Shah (afterwards C.J.) in the case *A. Lakshmanaswami Mudaliar v. L.I.C., A.I.R. 1963 S.C. 1185,* upheld the doctrine of *ultra vires*. In this case, the directors of the company were authorized "to make payments towards any charitable or any benevolent object or for any general public or useful object". In accordance with shareholders' resolution the directors paid Rs. 2 lacs to a trust formed for the purpose of promoting technical and business knowledge. The company's business having been taken over by L.I.C., it had no business left of its own.

The Supreme Court held that the payment was *ultra vires* the company. Directors could not spend company's money on any charitable or general objects. They could spend for the promotion of only such charitable objects as would be useful for the attainment of the company's own objects. It is pertinent to add that the powers vested in the Board of directors, e.g., power to borrow money, is not an object of the company. The powers must be exercised to promote the company's objects. Charity is allowed only to the extent to which it is necessary in the reasonable management of the affairs of the company. Justice Shah held: "There must be proximate connection between the gift and the company's business interest". Thus "gifts to foster research relevant to the company's activities" and "payments to widows of ex-employees on the footing that such payments encourage persons to enter the employment of the company" have been upheld as valid and *intra vires*.

In this regard the Act provides for bonafide charitable spending by the company. Section 181 of the Companies Act, 2013 authorizes the Board of directors to contribute to bona fide charitable and other funds. However, prior consent of the company in general meeting shall be required for such contribution, in case any amount the aggregate of which, in any financial year, exceed five percent of its average net profits for the three immediately preceding financial year.

The power of the Board as regards contribution to funds, which do directly relate to business of the company is unrestricted. It should not be inferred from the language of the section that with the consent of the company in general meeting, the board of directors may contribute to charitable funds to an unlimited extent, unless MoA and AoA authorizes such expenditure. If it does not authorize so it will be *ultra vires* the powers of the company.

A bank or any other person lending to a company, for purposes *ultra vires* the memorandum, cannot recover *[National Provincial Bank v. Introductions Ltd., (1969) 1 All. E.R. 887].*

Further, in the case of *Bell Houses Ltd. v. City Wall Properties Limited (1966) 36 Com Cases 779*, the objects clause included a power to "carry on any other trade or business whatsoever which can, in the opinion of the Board of directors, be advantageously carried on by the company." The Court has held the same to be in order.

Loans, Borrowings, Guarantees and *Ultra Vires* Rule

An *ultra vires* borrowing does not create a relationship of a debtor and creditor. In a case, a company had accepted deposits from outsiders which was outside the scope of the Memorandum. When the company was ordered to be wound up, a question was raised whether the depositors were creditors of the company and whether the contributories could be asked to contribute towards payment of deposits. The Court held that the relationship between the company and the depositors was not that of debtor and creditor. But if the lender had lent the amount for discharging lawful expenses, he may recover the amount.

Whether a transaction is *ultra vires* the company can be decided on the basis of the following:

1. if a transaction entered into by a company falls within the objects, it is not *ultra vires* and hence not void;
2. if a transaction is outside the capacity (objects) of the company, it is *ultra vires*;
3. if a transaction is in excess or abuse of the company's powers, it is *ultra vires* and such transaction will be set aside by the shareholders or even ratification by the shareholders would not validate the acts done beyond the authority of the company itself.

Implied Powers

The powers exercisable by a company are to be confined to the objects specified in the memorandum. While the objects are to be specified, the powers exercisable in respect of them may be express or implied and need not be specified.

Every company may necessarily possess certain powers which are implied, such as, a power to appoint and act through agents, and where it is a trading company, a power to borrow and give security for the purposes of its business, and also a power to sell. Such powers are incidental and can be inferred from the powers expressed in the memorandum. *[Oakbank Oil Co. v. Crum (1882) 8 App Cas 65].* The principle underlying the exercise of such powers is that a company, in carrying on the business for which it is constituted, must be able to pursue those things which may be regarded as incidental to or consequential upon that business. [*Egyptian Salt and Soda Co. v. Port Said Salt Association*].

Powers which are not implied

The following powers have been held not to be implied and it is, therefore, prudent to include them expressly in the objects clauses:

1. acquiring any business similar to the company's own business. *[Ernest v. Nicholls, (1857) 6 HLC 40];*

2. entering into an agreement with other persons or companies for carrying on business in partnership or for sharing profit, joint venture or other arrangements. Very clear powers are necessary to justify such transactions [*Re. European Society Arbitration Act (1878) 8 Ch 679];*
3. taking shares in other companies having similar objects. *[Re. Barned's Banking Co., ex parte and The Contract Corporation (1867) 3 Ch. App. 105. Re. William Thomas & Co. Ltd. (1915) 1 Ch 325];*
4. taking shares of other companies where such investment authorizes the doing indirectly that which will not be intra vires if done directly;
5. promoting other companies or helping them financially *[Joint Stock Discount Co. v. Brown, (1869) LR 8 EQ 381];*
6. a power to sell and dispose of the whole of a company's undertaking;
7. a power to use funds for political purposes;
8. a power to give gifts and make donations or contribution for charities not relating to the objects stated in the memorandum;
9. acting as a surety or as a guarantor.

Shareholder's right in respect of *ultra vires* acts

A shareholder can get back the money paid by him to the company under an *ultra vires* allotment of shares. A transferee of shares from him would not have been so allowed. [*Margarate Linz v. Electric Wire Co. of Salestine Ltd. (1948) 18 Com Cases 201, 205 : AIR 1949 PC 51].*

Effects of *ultra vires* Transactions

(i) ***Void ab initio*** – The *ultra vires* acts are null and void ab initio. The company is not bound by these acts. Even the company cannot sue or be sued upon [*Ashbury Railway Carriage and Iron Company v. Riche].*

Ultra vires contracts are *void ab initio* and hence cannot become *intra vires* by reason of estoppel or ratification.

(ii) **Injunction:** The members can get an injunction to restrain a company wherein *ultra vires* act has been or is about to be undertaken *[Attorney General v. Gr. Eastern Rly. Co., (1880) 5 A.C. 473].*

(iii) **Personal liability of Directors:** It is one of the duties of directors to ensure that the corporate capital is used only for the legitimate business of the company and hence if such capital is diverted to purposes alien to the company's memorandum, the directors will be personally liable to replace it. *In Jehangir R. Modi v. Shamji Ladha, [(1866-67) 4 Bom. HCR (1855)],* the Bombay High Court held, "A shareholder can maintain an action against the directors to compel them to restore to the company the funds of the company that have by them been employed in transactions that they have no authority to enter into, without making the company a party to the suit".

In case of deliberate misapplication, criminal action can also be taken for fraud.

However, a distinction must be drawn between transactions which are *ultra vires* the company and the transactions which are *ultra vires* the directors. Where the directors exceed their authority the same may be ratified by passing the resolution in the general body meeting of the shareholders. Provided the company has the capacity to do that transaction as per its memorandum of association.

(iv) Where a company's money has been used *ultra vires* to acquire some property, the company's right over such property is held secure and the company will be the right party to protect the property. This is because, though the property has been acquired for some *ultra vires* object, it represents the money of the company.

(v) *Ultra vires* borrowing does not create the relationship of creditor and debtor *[In Re. Madras Native Permanent Fund Ltd., (1931) 1 Com Cases 256 (Mad.)].*

(vi) ***Ultra vires* torts:** A company will not be liable for torts committed outside its objects.

In order to make the company liable for the torts/crime of its employees, it will have to be proved that:

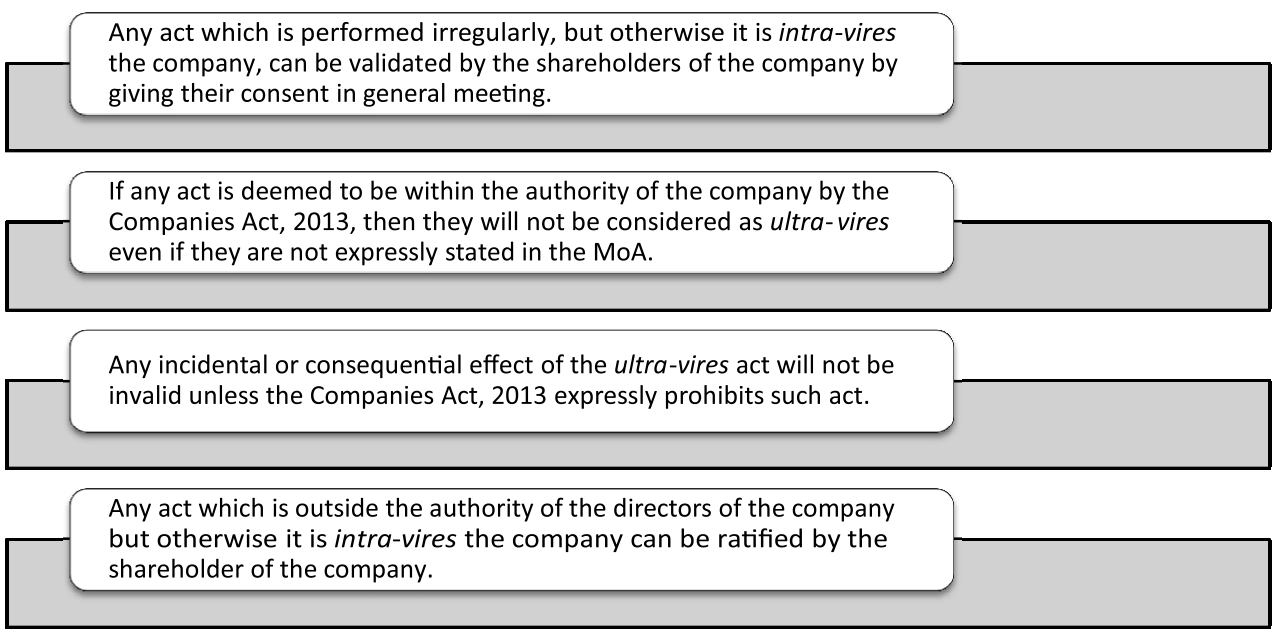
i) the tort was committed in the course of an activity which is in the purview of company's memorandum, and

ii) it was committed by the employee within the course of his employment.

(vii) ***Ultra vires* grants and guarantees:** Directors cannot make an unauthorized grant unless object is to promote prosperity of the company or the grant is incidental to carrying out of the object of the company. *[In Re LEE Behrens & Co., (1932) 2 Comp Cas 588 (Ch. D).]*

A Guarantee for the payment of dividends, which enables the guarantee to bring an action against the company for reimbursement even when there are no profit, is *ultra vires* and void. [In Re Walter's Deed of Guarantee, (1933) 3 Comp Cas 308 (CD)].

Exceptions to the doctrine of *ultra vires*



DOCTRINE OF INDOOR MANAGEMENT

While the doctrine of, 'constructive notice" seeks to protect the company against the outsiders, the principal of 'indoor management' operates to protect the outsiders against the company. This doctrine emphasizes on the concept that an outsider whose actions are in good faith and has entered into a transaction with a company can have a presumption that there are no irregularities internally and all the procedural requirements have been complied with by the company.

The doctrine of indoor management, also known as the Turquand rule is an around one fifty years old concept, which protects outsiders against the actions done by the company.

CASE LAW

In *Royal British Bank v. Turquand,* the directors of a banking company were authorized by the articles to borrow on bonds such sums of money as should from time to time, by resolution of the company in general meeting, be authorized to borrow. The directors gave a bond to Turquand without the authority of any such resolution. It was held that Turquand could sue the company on the strength of the bond, as he was entitled to assume that the necessary resolution had been passed. *Lord Hatherly* observed: "Outsiders are bound to know the external position of the company but are not bound to know its indoor management".

Section 176 of the Companies Act, 2013 provides for the Validity of Acts of Directors - No act done by a person as a director shall be deemed to be invalid, notwithstanding that it was subsequently noticed that his appointment was invalid by reason of any defect or disqualification or had terminated by virtue of any provision contained in this Act or in the Articles of the company:

Provided that nothing in this section shall be deemed to give validity to any act done by the director after his appointment has been noticed by the company to be invalid or have been terminated.

The object of the section is to protect persons dealing with the company - outsiders as well as members by providing that the acts of a person acting as director will be treated as valid although it may afterwards be discovered that his appointment was invalid or that it had terminated under any provision of this Act or the Articles of the company [*Ram Raghubir Lal v. United Refineries (Burma) Ltd., (1932) 2 Com Cases 359; AIR 1931 Rang 139].*

Example of Indoor Management:

Question: *Planet Limited received a cheque from Earth Limited. The Articles of Association of Earth Limited provided that cheques issued by the company need to be signed by two directors and countersigned by the secretary. The directors nor the secretary who signed the cheque was appointed properly and thus the cheque issued was not valid. Planet Limited sued the company for the irregularities in the procedure. Is Planet Limited liable for relief?*

Answer: *Planet Limited is entitled to relief and the company has to pay the amount of the cheque since the appointment of directors is a part of the internal management of the company and a person dealing with the company is not required to enquire about it.*

Relation of company with members and outsiders

The validation of the acts of unqualified directors may apply to circumstances from two different angles:

(1) as between outsiders, strangers and the company as in *Royal British Bank v. Turquand, (1856) 5 E&B 327, British Asbestos Co. Ltd. v. Boyd. (1903) 2 Ch 439 : (1900-3) All ER Rep 323; and Ram Buran Singh v. Mufassil Bank Ltd. AIR 1925 All 206;* and

(2) in relation to the internal affairs of the company as in *Dawson v. African Consolidated Land & Trading Co., (1898) 1 Ch 6 (CA),* where calls made by unqualified directors were held valid. Even if the public documents of the company, and the facts which are apparent, would make it clear that a director was not duly qualified to act, this will not oust the effect of the Section 176 (British Asbestos case) (supra). Similarly in *Boschoek Proprietary Co. Ltd. v. Fuke, (1906) 1 Ch 148*, a resolution of a general meeting convened by de facto directors was upheld.

Forgery and incompetent acts

This section does not apply where the act itself is not in the competence of the Board of directors, e.g. compromising unpaid calls under the guise of forfeiture, the transaction being *ultra vires* and *invalid [Bhagirath Spinning & Wvg. Co. v. Balaji Bhavani Pawar, AIR 1930 Bom. 267].*

Directors not aware of their disqualification

The allotment and forfeiture of shares made by the directors who continued to act even after they were disqualified but were not aware of it, were saved by the Section 176. *[Shiromani Sugar Mills Ltd. v. Debi Prasad, (1950) 20 Com Cases 296: AIR 1950 All 508].* Where this section does not save the situation, the company may in general meeting ratify allotment of shares even if made by de facto directors with mala fide intentions *[Bamford v. Bamford, (1969) 39 Com Cases 838 : (1969) 2 WLR (1107) (CA) and an appeal (1969) : 1All ER 969].*

Where the directors in question were not aware of the fact that by virtue of certain provisions in the articles, they had vacated their office, their acts in passing resolutions for starting certain business transactions were held to be valid *[Seth Mohan Lal v. Grain Chambers Ltd., (1968) 38 Com Cases 543 : AIR 1968 SC 772; Shiromani Sugar Mills Ltd. v. Debi Prasad, (Supra)].*

It is important to remember that the doctrine of "constructive notice", can be invoked by the company and it does not operate against the company. It operates against the person who has failed to inquire but does not operate in his favour. But the doctrine of "indoor management" can be invoked by the person dealing with the company and cannot be invoked by the company.

An outsider is entitled to act on a certified copy of the resolution of the Board of directors delegating the powers of borrowing money to the managing director subject to the limitation mentioned therein *[C.K. Siva Sankara Panicker v. Kerala State Financial Corporation, (1980) 50 Com Cases 817 (Ker.)].*

Exceptions to the Doctrine of Indoor Management

The above noted 'doctrine of indoor management' is, however, subject to certain exceptions. In other words, relief on the ground of 'indoor management' cannot be claimed by an outsider dealing with the company in the following circumstances.

1. **Where the outsider had knowledge of irregularity –** The rule does not protect any person who has actual or even an implied notice of the lack of authority of the person acting on behalf of the company. Thus, a person knowing fully well that the directors do not have the authority to make the transaction but still enters into it, cannot seek protection under the rule of indoor management. In *Howard v. Patent Ivory Co. (38 Ch. D 156),* the articles of a company empowered the directors to borrow upto one thousand pounds only. They could, however, exceed the limit of one thousand pounds with the consent of the company in general meeting. Without such consent having been obtained, they borrowed 3,500 pounds from one of the directors who took debentures. The company refused to pay the amount. Held that, the debentures were good to the extent of one thousand pounds only because the director had notice or was deemed to have the notice of the internal irregularity.

2. **No knowledge of Memorandum and Articles –** Again, the rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them. In *Rama Corporation v. Proved Tin & General Investment Co. (1952) 1All. ER 554,* T was a director in the company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. The Plaintiff relied on the rule of indoor management. Held, they could not because they even did not know that power could be delegated.

3. **Forgery –** The rule of indoor management does not extend to transactions involving forgery or to transactions which are otherwise void or illegal ab initio. In the case of forgery it is not that there is absence of free consent but there is no consent at all. The person whose signatures have been forged is not even aware of the transaction, and the question of his consent being free or otherwise does not arise. Consequently, it is not that the title of the person is defective but there is no title at all. Therefore, howsoever clever the forgery might have been, the personates acquire no rights at all. Thus, where the secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company. The certificate was held to be nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management *[Rouben v. Great Fingal Consolidated (1906) AC 439].*

   Forgery, in the case of a company, can take place in different forms. It may, besides forgery of the signatures of the authorized officials, include the execution of a document towards the personal discharge of an official's liability instead of the liability of the company. Thus, a bill of exchange signed by the manager of a company with his own signature under words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted *[Kreditbank Cassel v. Schenkers Ltd. (1927) 1 KB 826].* The bill in this case was held to be forged because it purported to be a different document from what it was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

4. **Negligence –** The 'doctrine of indoor management', in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make an enquiry, he is estopped from relying on the Rule. In the case of *Underwood v. Benkof Liverpool (1924) 1 KB 775,* a person who was a sole director and principal shareholder of a company deposited into his own account cheques drawn in favour of the company. Held, that, the bank should have made inquiries as to the power of the director. The bank was put upon an enquiry and was accordingly not entitled to rely upon the ostensible authority of director.

   Similarly, in the case of *Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd. AIR 1942 Oudh 417,* an accountant of a company transferred some property of a company in favour of Anand Behari. On an action brought by him for breach of contract, the Court held that the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.

5. Again, the doctrine of indoor management does not apply where the question is in regard to the very existence of an agency. In *Varkey Souriar v. Keraleeya Banking Co. Ltd. (1957) 27 Com Cases 591 (Ker.),* the Hon'ble Kerala High Court held that the 'doctrine of indoor management' cannot apply where the question is not one as to scope of the power exercised by an apparent agent of a company but is with regard to the very existence of the agency.

6. This Doctrine is also not applicable where a pre-condition is required to be fulfilled before company itself can exercise a particular power. In other words, the act done is not merely *ultra vires* the directors/ officers but *ultra vires* the company itself – *Pacific Coast Coal Mines v. Arbuthnot (1917) AC 607.*

   In the end, it is worthwhile to mention that section 6 of the Companies Act, 2013 gives overriding force and effect to the provisions of the Act, notwithstanding anything to the contrary contained in the memorandum or articles of a company or in any agreement executed by it or for that matter in any resolution of the company in general meeting or of its board of directors. A provision contained in the memorandum, articles, agreement or resolution to the extent to which it is repugnant to the provisions of the Act, will be regarded as void.

A corporation, organization or other entity set up to provide a legal shield for the person actually controlling the operation.

Illustration:

Question: *Butterfly Limited receives a share certificate of Flower Limited issued under the seal of the company. The company secretary issues the certificate after affixing the seal and forging the signature of the two directors. Butterfly Limited files a lawsuit claiming that the forging of signatures is a part of the internal management of the company. Is the claim by Butterfly Limited valid and is liable to get relief?*

Answer: *According to the exceptions to the doctrine of indoor management, a transaction involving forgery is null and void. Since the document issued to Butterfly Limited is null and void, the claim made by him is not valid. Thus, he is not entitled to any relief.*

DOCTRINE OF CONSTRUCTIVE NOTICE

In companies law the doctrine of constructive notice is a doctrine where all persons dealing with a company are deemed (or "construed") to have knowledge of the company's Articles of Association and Memorandum of Association.

The Memorandum and Articles, when registered, become public documents and can be inspected by anyone on payment of nominal fee. Therefore, every person who contemplates entering into a contract with a company has the means of ascertaining and is consequently presumed to know, not only the exact powers of the company but also the extent to which these powers have been delegated to the directors, and of any limitations placed upon the exercise of these powers. In other words, every person dealing with the company is deemed to have a "constructive notice" of the contents of its memorandum and articles. In fact, he is regarded not only as having read those documents but also as having understood them according to their proper meaning *[Griffith v. Paget, (1877) Ch. D. 517]*. Consequently, if a person enters into a contract which is beyond the powers of the company, as defined in the memorandum, or outside the limits set on the authority of the directors, he cannot, as a general rule, acquire any rights under the contract against the company *[Mohony v. East Holyfrod Mining Co., (1875) L.R. 7 H.L. 869]*. For example, if the articles provide that a bill of exchange to be effective must be signed by two directors, a person dealing with the company must see that it is so signed; otherwise he cannot claim under it.

A common example of Constructive Notice is when a court is unable to directly reach someone and publishes summons in the public newspaper and it is assumed that everybody has read it.

In another case, the articles required that all documents should be signed by the managing director, secretary and the working director on behalf of the company. A deed of mortgage was executed by the secretary and the working director only and the Court held that no claim would lie under such a deed. The Court said that the mortgagee should have consulted the articles before the deed was executed. Therefore, even though the mortgagee may have acted in good faith and the money borrowed applied for the purpose of the company, the mortgage was nevertheless invalid *[Kotla Venkataswamy v. Rammurthy, AIR 1934 Mad 579]*. The doctrine of indoor management protects third parties who are entitled to an assurance that all the procedural aspects of a transaction are carried out.

Outsiders dealing with incorporated bodies are bound to take notice of limits imposed on the corporation by the memorandum or other documents of constitution. Nevertheless, they are entitled to assume that the directors or other persons exercising authority on behalf of the company are doing so in accordance with the internal regulations as set out in the Memorandum & Articles of Association.

The impact of this doctrine on practical relations is thus stated in HALSBURY: "A company is subject to the rule that, where the conduct of a party charged with a notice shows that he had suspicions of a state of facts the knowledge of which would affect his legal rights, but that he deliberately refrained from making inquiries, he will be treated as having had notice, though he is not entitled to claim for his own advantage," *[Jones v. Smith, (1841) 1 Hare 43]*.

DOCTRINE OF *ALTER EGO*

The term "*Alter Ego*" is a Latin word. Literally translated, it means the "Other I". More idiomatic it can be understood as the identical copy or a person's clone. It is a common tenet that a company is a separate legal entity from its shareholders and directors. This common law principle grants immunity to the shareholders and directors from being held liable for the debts as well as criminal liabilities of the corporation. The doctrine of *alter ego*, however, provides for an exception to this presumption in law. *Alter ego* is the doctrine which prevents the stakeholders of the corporation, i.e., shareholders and directors from taking the refuge of doctrine of separate legal entity. Hence, the Doctrine of *alter ego* is based on lifting of the corporate veil between the directors/ shareholders and the corporation and treating both as one entity.

The doctrine of *alter ego* is based on the assumption that the company as well as the shareholders and the managing directors are the *alter ego*s of each other, i.e., one is the shadow or reflection of the other or can be understood as two sides of the same coin. Hence, the courts can rely on *alter ego* doctrine when they find that there is a very thin line of distinction between the shareholders/ directors and the corporation or a limited liability corporation.

It is used by the courts to ignore the status of shareholders, officers, and directors of a company in reference to their liability in their respective capacity so that they may be held personally liable for their actions when they have acted fraudulently or unjustly.

In *Lennards Carying Co. Ltd. v. Asiatic Petroleum Co. Ltd. [1915] AC 705,* Viscount Haldane propounded the "*alter ego*" theory and distinguished it from vicarious liability. The House of Lords stated that the default of the managing director who is the "directing mind and will" of the company, would be attributed to him and he be held for the wrong doing of the company.

CASE LAW

The Supreme Court of India, in the judgment of *Sunil Bharti Mittal v. Central Bureau of Investigation AIR 2015 SC 923*, clarified the law of "*alter ego*". In the instant case the Special Judge had summoned and proceeded against the Directors of the Company. The Special Judge, had held "On the other hand, the reason for summoning these persons and proceeding against them are specifically ascribed in this para which, prima facie, are:

i. These persons were/are in the control of affairs of the respective companies.

ii. Because of their controlling position, they represent the directing mind and will of each company.

iii. State of mind of these persons is the state of mind of the companies. Thus, they are described as "*alter ego*" of their respective companies.

The Apex Court while overruling the decision of the Special Judge, observed that while the Special Judge had applied the principle of *alter ego*, it had done so in reverse. The criminal mens rea had been attributed to the directors on the assumption that they are the directing minds behind the acts of the Company. The Supreme Court observed that the Special Judge had ignored the fact that such an interpretation of the *alter ego* doctrine would go against the position of law that there is no vicarious liability in criminal law, unless expressly provided in the statute.

DOCTRINE OF LIFTING OF OR PIERCING THE CORPORATE VEIL

The separate personality of a company is a statutory privilege and it must be used for legitimate business purposes only. Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court will break through the corporate shell and apply the principle/doctrine of what is called as "lifting of or piercing the corporate veil". The Court will look behind the corporate entity and take action as though no entity separate from the members existed and make the members or the controlling persons liable for debts and obligations of the company.

The corporate veil is lifted when in defence proceedings, such as for the evasion of tax, an entity relies on its corporate personality as a shield to cover its wrong doings. *[BSN (UK) Ltd. v. Janardan Mohandas Rajan Pillai [1996] 86 Com Cases 371 (Bom)].*

However, the shareholders cannot ask for the lifting of the veil for their purposes. This was held in *Premlata Bhatia v. Union of India (2004) 58 CL 217 (Delhi)* wherein the premises of a shop were allotted on a licence to the individual licencee. She set up a wholly owned private company and transferred the premises to that company without Government consent. She could not remove the illegality by saying that she and her company were virtually the same person.

Statutory Recognition of Lifting of Corporate Veil

The Companies Act, 2013 itself contains some provisions [Sections 7(7), 251(1) and 339] which lift the corporate veil to reach the real forces of action. Section 7(7) deals with punishment for incorporation of company by furnishing false information; Section 251(1) deals with liability for making fraudulent application for removal of name of company from the register of companies and Section 339 deals with liability for fraudulent conduct of business during the course of winding up.

Lifting of Corporate Veil under Judicial Interpretation

Ever since the decision in *Salomon v. Salomon & Co. Ltd.,* (1897) A.C. 22, normally Courts are reluctant or at least very cautious to lift the veil of corporate personality to see the real persons behind it. Nevertheless, Courts have found it necessary to disregard the separate personality of a company in the following situations:

(a) Where the corporate veil has been used for commission of fraud or improper conduct. In such a situation, Courts have lifted the veil and looked at the realities of the situation.

CASE LAW

In Jones v. Lipman, (1962) I. W.L.R. 832

A agreed to sell certain land to B. Pending completion of formalities of the said deal, A sold and transferred the land to a company which he had incorporated with a nominal capital of £100 and of which he and a clerk were the only shareholders and directors. This was done in order to escape a decree for specific performance in a suit brought by B. The Court held that the company was the creature of A and a mask to avoid recognition and that in the eyes of equity A must complete the contract, since he had the full control of the limited company in which the property was vested, and was in a position to cause the contract in question to be fulfilled.

(b) Where a corporate facade is really only an agency instrumentality.

CASE LAW

In Re. R.G. Films Ltd. (1953) 1 All E.R. 615

An American company produced a film in India technically in the name of a British Company, 90% of whose capital was held by the President of the American company which financed the production of the film. Board of Trade refused to register the film as a British film which stated that English company acted merely as the nominee of the American corporation.

(c) Where the conduct conflicts with public policy, courts lifted the corporate veil for protecting the public policy.

CASE LAW

In Connors Bros. v. Connors (1940) 4 All E.R. 179

The principle was applied against the managing director who made use of his position contrary to public policy. In this case the House of Lords determined the character of the company as "enemy" company, since the persons who were de facto in control of its affairs, were residents of Germany, which was at war with England at that time. The alien company was not allowed to proceed with the action, as that would have meant giving money to the enemy, which was considered as monstrous and against "public policy".

(d) *Further, In Daimler Co. Ltd. v. Continental Tyre & Rubber Co.,* (1916) 2 A.C. 307, it was held that a company will be regarded as having enemy character, if the persons having de facto control of its affairs are resident in an enemy country or, wherever they may be, are acting under instructions from or on behalf of the enemy.

(e) Where it was found that the sole purpose for which the company was formed was to evade taxes the Court will ignore the concept of separate entity and make the individuals concerned liable to pay the taxes which they would have paid but for the formation of the company.

CASE LAW

Re. Sir Dinshaw Maneckjee Petit, A.I.R. 1927 Bombay 371

The facts of the case are that the assessee was a wealthy man enjoying large dividend and interest income. He formed four private companies and agreed with each to hold a block of investment as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income in four parts in a bid to reduce his tax liability.

But it was held "the company was formed by the assessee purely and simply as a means of avoiding super- tax and the company was nothing more than the assessee himself. It did no business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over to the assessee as pretended loans". The Court decided to disregard the corporate entity as it was being used for tax evasion.

Vodafone case

One of the landmark case of the Supreme Court, is its decision in the case of *Vodafone International Holdings B.V. v. Union of India & Another [S.L.P. (C)* No. 26529 of 2010]. In judgment, the Supreme Court set aside the Bombay High Court's judgment directing Vodafone International Holdings BV ("Vodafone"), to pay INR 110 billion, as withholding tax in a transaction that took place off-shore.

The facts, as briefly put, are that in May 2007, Vodafone, incorporated in the Netherlands, acquired from Hong Kong based Hutchison Group, the entire share capital of CGP Investments (Holdings) Limited ("CGP"), a company incorporated in the Cayman Islands, which in turn controlled a 67% interest in Hutchison-Essar Limited ("HEL"), Hutchison's Indian mobile business. The Indian income tax authorities contended that capital gains were made by Hutchison in India and that Vodafone was therefore liable to pay withholding tax thereon, amounting to approximately INR 110 billion (the sale price being USD 11.2 billion).

Vodafone challenged the tax demand in the Bombay High Court, which ruled in favour of the income tax authorities, holding that the essence of the transaction was a change in the controlling interest in HEL, which constituted a source of income in India. Vodafone appealed to the Supreme Court, which overruled the High Court and held that the transaction fell outside India's territorial tax jurisdiction and was hence not taxable.

The judgment was not only important in the context of taxation, but also covers other issues of corporate law. One of these are in the context of the principle of the corporate veil, and the circumstances under which it may be lifted, particularly in the context of commercial cross-border transactions and tax avoidance.

The Court recognised the fundamental principle of the corporate veil by noting that, "The approach of both the corporate and tax laws, particularly in the matter of corporate taxation, generally is founded on the abovementioned separate entity principle, i.e., treat a company as a separate person. The Indian Income Tax Act, 1961, in the matter of corporate taxation, is founded on the principle of the independence of companies and other entities subject to income-tax." It observed in the context of parent / subsidiary relationships, that it is generally accepted that the group parent company would give guidance to group subsidiaries, but that by itself would not justify piercing the veil or imply that the subsidiaries are to be deemed residents of the State in which the parent company resides, and that "a subsidiary and its parent are totally distinct tax payers".

Six factors that may be considered to determine whether the transaction is a bogus and whether in a specific case, the corporate veil may be lifted, are: "(i) the concept of participation in investment, (ii) the duration of time during which the Holding Structure exists; (iii) the period of business operations in India; (iv) the generation of taxable revenues in India; (v) the timing of the exit; and (vi) the continuity of business on such exit."

In the final analysis, the Supreme Court decided against lifting the corporate veil in Vodafone, as the tax authorities failed to establish that the transaction was a bogus or tax avoidance scheme.

(f) Avoidance of welfare legislation is as common as avoidance of taxation and the approach in considering problems arising out of such avoidance has necessarily to be the same and, therefore, where it was found that the sole purpose for the formation of the new company was to use it as a device to reduce the amount to be paid by way of bonus to workmen, the Supreme Court upheld the piercing of the veil to look at the real transaction.

CASE LAW

The Workmen Employed in Associated Rubber Industries Limited, Bhavnagar v. The Associated Rubber Industries Ltd., Bhavnagar and another, A.I.R. 1986 SC 1.

The facts of the case were that a new company was created wholly by the principal company with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from shares transferred to it by the principal company i.e. only for the purpose of splitting the profits into two hands and thereby reducing the obligation to pay bonus. The Supreme Court of India held that the new company was formed as a device to reduce the gross profits of the principal company and thereby reduce the amount to be paid by way of bonus to workmen. The amount of dividends received by the new company should, therefore, be taken into account in assessing the gross profit of the principal company.

(g) Another instance of corporate veil arrived at by the Court arose in *Kapila Hingorani v. State of Bihar.*

CASE LAW

Kapila Hingorani v. State of Bihar, 2003 (4) Scale 712

In this case, the petitioner had alleged that the State of Bihar had not paid salaries to its employees in PSUs etc. for long periods resulting in starvation deaths. But the respondent took the stand that most of the undertakings were incorporated under the provisions of the Companies Act, 1956, hence the rights etc. of the shareholders should be governed by the provisions of the Companies Act and the liabilities of the PSUs should not be passed on to the State Government by resorting to the doctrine of lifting the corporate veil. The Court observed that the State may not be liable in relation to the day-to-day functioning of the PSUs but its liability would arise on its failure to perform the constitutional duties and the functions of these undertakings. It is so because, "life means something more than mere ordinal existence. The inhibition against deprivation of life extends to all those limits and faculties by which life is enjoyed".

(h) Where it is found that a company has abused its corporate personality for an unjust and inequitable purpose, the court would not hesitate to lift the corporate veil. Further, the corporate veil could be lifted when acts of a corporation are allegedly opposed to justice, convenience and interests of revenue or workmen or are against public interest.

Thus, in appropriate cases, the Courts disregard the separate corporate personality and look behind the legal person or lift the corporate veil.

Lifting the Corporate Veil of Small Scale Industry

Where small scale industries were given certain exemptions and the company owning an industry was controlled by some group of persons or companies, it was held that it was permissible to lift the veil of the company to see whether it was the subsidiary of another company and, therefore, not entitled to the proposed exemptions *[Inalsa Ltd. v. Union of India, (1996) 87 Com Cases 599 (Delhi)].*

Use of Corporate Veil for Hiding Criminal Activities

Where the defendant used the corporate structure as a device or facade to conceal his criminal activities (evasion of customs and excise duties payable by the company), the Court could lift the corporate veil and treat the assets of the company as the realisable property of the shareholder.

For example, in a case, there was a prima facie case that the defendants controlled the two companies, the companies had been used for the fraudulent evasion of excise duty on a large scale, the defendant regarded the companies as carrying on a family business and that they had benefited from companies' cash in substantial amounts and further no useful purpose would have been served by involving the companies in the criminal proceedings. In all these circumstances it was therefore appropriate to lift the corporate veil and treat the stock in the companies' warehouses and the companies' motor vehicles as realisable property held by the defendants. The Court said that the excise department is not to be criticized for not charging the companies. The more complex commercial activities become, the more vital it is for prosecuting authorities to be selective in whom and what they charge, so that issues can be presented in as clear and short form as possible. In the present case, it seemed that no useful purpose would have been served by initiating criminal proceedings. *[H. and Others, Restraint Order : Realisable Property), Re, (1996) 2 BCLC 500 at 511, 512 (CA)].*

APPLICABILITY OF THE COMPANIES ACT, 2013 AND KEY CONCEPTS

Applicability

According to section 1 of the Companies Act, 2013, the Act extends to whole of India and the provisions of the Act shall apply to the following:-

(a) companies incorporated under this Act or under any previous company law;

(b) 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;

(c) banking companies, except in so far as the said provisions are inconsistent with the provisions of the Banking Regulation Act, 1949;

(d) companies engaged in the generation or supply of electricity, except in so far as the said provisions are inconsistent with the provisions of the Electricity Act, 2003;

(e) any other company governed by any special Act for the time being in force, except in so far as the said provisions are inconsistent with the provisions of such special Act; and

(f) such body corporate, incorporated by any Act for the time being in force, as the Central Government may, by notification, specify in this behalf, subject to such exceptions, modifications or adaptation, as may be specified in the notification.

The Companies Act, 2013 is not applicable to unincorporated companies.

By virtue of section 464 of the Companies Act, 2013 r/w Rule 10 of the Companies (Miscellaneous) Rules, 2014, no association or partnership consisting of more than 50 persons shall be formed for the purpose of carrying on any business that has for its object the acquisition of gain by the association or partnership or by the individual members thereof, unless it is registered as a company under this Act or is formed under any other law for the time being in force. The maximum number of persons which may be prescribed under this section shall not exceed 100.

Section 464 of the Act does not apply to –

(1) In the case of a Hindu undivided family carrying on any business whatever may be the number of its members.

(2) In case of an association or partnership, if it is formed by professionals who are governed by special Acts.

Every member of an association or partnership carrying on business in contravention of sub-section (1) of Section 464 shall be punishable with fine which may extend to one lakh rupees and shall also be personally liable for all liabilities incurred in such business.

Interpretation of Definitions under the Companies Act, 2013

A definition is a statement of the meaning as of a word or phrase.

Usually, every statute has a definitions sections (also called 'interpretation clause') which provides definitions of various words and phrases used in the statute (e.g. Section 2 of the Companies Act, 2013).

Definition:

- *To Define :* The Act of making something definite, distinct or clear.
- *Definition :* An exact statement or description of the nature, scope, or meaning of something (Oxford dictionary)
- *In relation to a Statute :* Definitions given in a statute are those of certain words or expressions used elsewhere in the Statute.
- *Object of using Definitions :* - To avoid frequent repetitions - To aid interpretation of words for that specific statute

Types of Definitions

Restrictive Definitions	***Extensive Definitions***
- Use of the word "mean"	- Use of the word "include"

When in a definition the word "**mean**" is used, it means word is restricted to the scope indicated in the definition section. It means definition is hard and fast definition and no other meaning can be assigned to the expression than is put down in definition.

For Example:

- **"Director"** means a director appointed to the Board of a company

The word "**include**" gives a wider meaning to the words or phrases in the statute. The legislature does not intend to restrict the definition, it makes the definition enumerative but not exhaustive. This is to say, the term defined will retain its ordinary meaning may or may not compromise. The word "includes" by the legislature shows the intention of the legislature that it wanted to give extensive and enlarged meaning to such expression.

For Example:

- **"Body Corporate or Corporation"** includes a company incorporated outside India, but does not include:
  - (i) a co-operative society registered under any law relating to co-operative societies; and
  - (ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf.

'Explanations' in Statutes:

Object and Purpose of explanations:

- To explain/clarify the meaning of words contained in the particular section,

- Part and Parcel of the enactment,
- Does not widen the scope of the word explained.

For eg: "Holding Company", in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Explanation.—For the purposes of this clause, the expression "company" includes any body corporate.

Definitions and Key Concepts under the Companies Act, 2013

Section 2 of the Companies Act, 2013 contains definitions:

- Clause (20) **"Company"** means a company incorporated under this Act or under any previous company law.
- Clause (21) **"Company Limited by Guarantee"** means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.
- Clause (22) **"Company Limited by Shares"** means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.
- Clause (46) **"Holding Company"**, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

  Explanation : For the purpose of this Clause, the expression "Company" includes any Body Corporate.
- Clause (71) **"Public Company"** means a company which –

  (a) is not a private company;

  (b) has a minimum paid-up share capital , as may be prescribed:

  Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.
- Clause (87) **"Subsidiary Company"** or **"Subsidiary"**, in relation to any other company (that is to say the holding company), means a company in which the holding company –

  (i) controls the composition of the Board of Directors; or

  (ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

  Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

  Explanation. — For the purposes of this clause,—

  (a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

  (b) the composition of a company's Board of Directors shall be deemed to be controlled by another company, if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the Directors.

- Clause (62) "**One-person Company"-** The Companies Act, 2013 introduces a new type of entity to the existing list i.e. apart from forming a public or private limited company, the Act enables the formation of a new entity a 'one-person company' (OPC). An OPC means a company with only one person as its member.

- Clause (68) **"Private Company"** means a company having a minimum paid-up share capital as may be prescribed, and which by its articles,—

  (i) restricts the right to transfer its shares;

  (ii) except in case of One Person Company, limits the number of its members to two hundred:

  Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

  Provided further that—

  (a) persons who are in the employment of the company; and

  (b) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased,

  shall not be included in the number of members; and

  (iii) prohibits any invitation to the public to subscribe for any securities of the company.

- Clause (85) **"Small Company"-** Rule 2(1)(t) of the Companies (Specification of definitions Details) Rules, 2014 with effect from September 15, 2022 has amended the definition of Small Company stating that for the purposes of sub-clause (i) and sub-clause (ii) of clause (85) of section 2 of the Act, paid up capital and turnover of the small company shall not exceed rupees four crore and rupees forty crore respectively.

  Thus, the definition of "small company" under Section 2(85) read with Rule 2(1)(t) of the Companies (Specification of definitions Details) Rules, 2014 with effect from September 15, 2022 is given hereunder:

  A small company has been defined as a company, other than a public company.

  (i) paid-up share capital of which does not exceed 4 Crore rupees or such higher amount as may be prescribed which shall not be more than 10 crore rupees; and

  (ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed 40 crore rupees or such higher amount as may be prescribed which shall not be more than 100 crore rupees:

  Provided that nothing in this clause shall apply to –

  (a) a holding company or a subsidiary company;

  (b) a company registered under section 8; or

  (c) a company or body corporate governed by any special Act.

- **Dormant company:** A company formed and registered under this 2013 for a future project or to hold an asset or intellectual property and has no significant accounting transaction such a company or an inactive company may make an application to the Registrar for obtaining the status of a dormant company.(Section 455)

- **Nidhi company:** means a company which has been incorporated as a Nidhi with the object of cultivating the habit of thrift and savings amongst its members, receiving deposits from, and lending to, its members only, for their mutual benefit, and which complies with such rules as are prescribed by the Central Government for regulation of such class of companies. (Section 406).

- Clause (52) **"Listed Company"** means a company which has any of its securities listed on any recognised stock exchange;

  Provided that such class of companies, which have listed or intend to list such class of securities, as may be prescribed in consultation with the Securities and Exchange Board, shall not be considered as listed companies.

  Companies not to be considered as listed companies [Rule 2A of the Companies (Specification of definitions details) Rules, 2014].

  The following classes of companies shall not be considered as listed companies, namely:-

  a) Public companies which have not listed their equity shares on a recognized stock exchange but have listed their –

     (i) non-convertible debt securities issued on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008; or

     (ii) non-convertible redeemable preference shares issued on private placement basis in terms of SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013; or

     (iii) both categories of (i) and (ii) above.

  b) Private companies which have listed their non-convertible debt securities on private placement basis on a recognized stock exchange in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008.

  c) Public companies which have not listed their equity shares on a recognized stock exchange but whose equity shares are listed on a stock exchange in a jurisdiction as specified in section 23(3) of the Companies Act, 2013.

- Clause (45) **"Government Company"** means any company in which not less than fifty-one percent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

- Clause (42) "**Foreign Company**" means any company or body corporate incorporated outside India which,—

  (a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

  (b) conducts any business activity in India in any other manner.

Roles and Responsibilities under the Companies Act, 2013

1. **Officer:** "officer" includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act [section 2(59)].

2. **Key Managerial Personnel:** The term 'key managerial personnel' has been defined in the Act which means :

   (i) the Chief Executive Officer or the Managing Director or the Manager;

   (ii) the Company Secretary;

   (iii) the Whole-Time Director;

   (iv) the Chief Financial Officer;

   (v) such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the Board; and

   (vi) such other officer as may be prescribed [section 2(51)].

   The role and liability have been defined at various places under the Companies Act, 2013.

3. **Promoter:** The term 'promoter' means a person –

   (a) who has been named as such in a prospectus or is identified by the company in the annual return; or

   (b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or

   (c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

   Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity. [section 2(69)].

4. **Independent Director:** The term 'Independent Director' has been defined in the Act, along with several new requirements relating to their appointment, role and responsibilities. "Independent Director" means an independent director referred to in sub-section (6) of section 149 of the Companies Act, 2013. [Section 2(47) & Section 149(6)].

5. **Audit and Auditors**

   a. **Mandatory auditor rotation and joint auditors:** The Act mandates the rotation of auditors after the specified time period. (Section 139).

   b. **Secretarial audit:** The Act mandates Secretarial Audit for the following:

      i. Listed companies;

      ii. every public company having a paid-up share capital of fifty crore rupees or more;

      iii. every public company having a turnover of two hundred fifty crore rupees or more;

      iv. every company having outstanding loans or borrowings from banks or public financial institutions of one hundred crore rupees or more.

      The Secretarial Audit Report is required to be annexed to the Board's Report (Section 204).

   c. **Secretarial Standards:** The Act requires every company to observe secretarial standards specified by the Institute of Company Secretaries of India with respect to general and board meetings [Section 118 (10)].

6. **Class Action Suits-** The Act introduces a new concept of class action suits which can be initiated by members or depositors against the company (Section 245).

E-GOVERNANCE AND MCA-21

With the advent of Information and Communication Technology in all sectors today, Governments across the globe including the Government of India are taking major initiatives to integrate IT in all their processes. Electronic Governance (e-Governance) is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. e-Governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

Earlier the businessmen and professionals had to visit MCA offices to file the statutory forms, to review public documents or to fulfil any compliance in physical mode. It was very hectic and time consuming. People had to stand in long queue which often led to inadvertent missing of filing of statutory e-forms leading to Non-Compliance and levy of fine or imprisonment.

So keeping in tune with the e-Governance initiatives the world over, Ministry of Corporate Affairs (MCA), Government of India, has initiated the MCA-21 project, to enable an easy and secure access to MCA services in a manner that best suits the corporate entities and professionals besides the public.

MCA-21 is an ambitious e-Governance initiative of Government of India that builds on the Government's vision of National e-Governance in the country. As part of the Government's focus on governance norms to meet the expectations arising from globalization, MCA project was launched as a flagship initiative of Ministry of Corporate Affairs (MCA). MCA-21 has resulted in improved procedures for better delivery of services by the MCA. This reform of administration has not only improved efficiency and transparency in the government operations, but has also enabled the Ministry to concentrate more on policy matters. The portal is designed to fully automate all processes related to enforcement and compliance of legal requirements under the Companies Act, 2013, Limited Liability Partnership Act, 2008 & other allied Acts and Rules & Regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law.

MCA21 has been part of Mission Mode projects of the Government of India. Bagging several accolades in past, the project has now reached its 3rd version. MCA21 version-3.0 is a technology-driven forward-looking project, envisioned to strengthen enforcement, promote Ease of Doing Business and enhance user experience. MCA21 version-3.0 rollout has been planned in phases to ensure minimum disruption in regulatory filings.

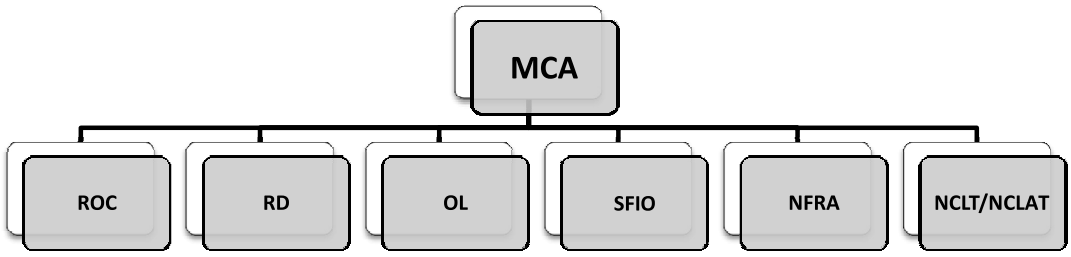
All LLP e-filing and Company forms are available live at MCA V3 portal.

The MCA vide issuing notification dated March 17, 2023 has established the Centre for Processing Accelerated Corporate Exit (C-PACE). The C-PACE be located at the Indian Institute of Corporate Affairs (IICA), Manesar, Gurugram. It is effective from 01st April, 2023. C-PACE is a significant step towards providing ease to companies for closing their business and getting their names removed from the Register of Companies. It caters to make the process of removal of names more streamlined and efficient, saving time and effort for companies.

AGENCIES UNDER MCA-21

The Ministry of Corporate Affairs (MCA) is primarily concerned with administration of the Companies Act 2013, the Limited Liability Partnership Act, 2008 & other allied Acts alongwith rules & regulations framed there-under mainly for regulating the functioning of the corporate sector in accordance with law. Besides, it exercises supervision over the three professional bodies, namely, Institute of Chartered Accountants of India (ICAI), Institute of Company Secretaries of India (ICSI) and the Institute of Cost Accountants of India which are constituted under three separate Acts of the Parliament for proper and orderly growth of the professions concerned.

The Ministry also has the responsibility of carrying out the functions of the Central Government relating to administration of Partnership Act, 1932 and the Societies Registration Act, 1980 etc.



Registrar of Companies (ROC) as defined under Section 2 (75) of the Companies Act, 2013 means a Registrar, an Additional Registrar, a Joint Registrar, a Deputy Registrar or an Assistant Registrar, having the duty of registering companies and discharging various functions under this Act.

Registrars of Companies (ROC) appointed in the various States and Union Territories are vested with the primary duty of registering companies and LLPs floated in the respective states and the Union Territories and ensuring that such companies and LLPs comply with statutory requirements under the Act. These offices function as registry of records, relating to the companies registered with them, which are available for inspection by members of public on payment of the prescribed fee. The Central Government exercises administrative control over these offices through the respective Regional Directors.

Regional Director (RD) is in-charge of the respective region, each region comprising a number of States and Union Territories. They supervise the working of the offices of the Registrars of Companies and the Official Liquidators working in their regions. They also maintain liaison with the respective State Governments and the Central Government in matters relating to the administration of the Companies Act and LLP Act. Certain powers of the Central Government under the Act have been delegated to the Regional Directors.

Official Liquidators (OL) means an Official Liquidator appointed under sub-section (1) of section 359 of the Companies Act, 2013.

As per Section 359 (1) of the Companies Act, 2013, for the purposes of this Act, so far as it relates to the winding up of companies by the Tribunal, the Central Government may appoint as many Official Liquidators, Joint, Deputy or Assistant Official Liquidators as it may consider necessary to discharge the functions of the Official Liquidator.

The liquidators appointed shall be whole-time officers of the Central Government. The salary and other allowances of the Official Liquidator, Joint Official Liquidator, Deputy Official Liquidator and Assistant Official Liquidator shall be paid by the Central Government.

Serious Fraud Investigation Office

As per the Companies Act, 2013, Serious Fraud Investigation Office (SFIO) has been established through the Government of India vide Notification No. S.O.2005(E) dated 21.07.2015. It is a multi-disciplinary organization under the Ministry of Corporate Affairs, consisting of experts in the field of accountancy, forensic auditing, banking, law, information technology, investigation, company law, capital market and taxation, etc. for detecting and prosecuting or recommending for prosecution white-collar crimes/frauds. Investigation into the affairs of a company is assigned to SFIO, where Government is of the opinion that it is necessary to investigate into the affairs of a company –

1. on receipt of a report of the Registrar or inspector under section 208 of the Companies Act, 2013.
2. on intimation of a special resolution passed by a company that its affairs are required to be investigated.
3. In the public interest; or On request from any department of the Central Government or a State Government.

The National Financial Reporting Authority (NFRA) was constituted on 01st October, 2018 by the Government of India under Sub Section (1) of section 132 of the Companies Act, 2013.

As per Sub Section (2) of Section 132 of the Companies Act, 2013, the duties of the NFRA are to:

- Recommend accounting and auditing policies and standards to be adopted by companies for approval by the Central Government;
- Monitor and enforce compliance with accounting standards and auditing standards;
- Oversee the quality of service of the professions associated with ensuring compliance with such standards and suggest measures for improvement in the quality of service;
- Perform such other functions and duties as may be necessary or incidental to the aforesaid functions and duties.

Sub Rule (1) of Rule 4 of the NFRA Rules, 2018, provides that the Authority shall protect the public interest and the interests of investors, creditors and others associated with the companies or bodies corporate governed under Rule 3 by establishing high quality standards of accounting and auditing and exercising effective oversight of accounting functions performed by the companies and bodies corporate and auditing functions performed by auditors.

National Company Law Tribunal/National Company Law Appellate Tribunal (NCLT/NCLAT) - The setting up of the NCLT and NCLAT are part of the efforts to move to a regime of faster resolution of corporate disputes, thus improving the ease of doing business in India. The Ministry of Corporate Affairs (MCA) on 1st June, 2016 notified the Constitution of National Company Law Tribunal (NCLT) & The National Company Law Appellate Tribunal (NCLAT) in exercise of powers conferred under section 408 and 410 of the Companies Act, 2013.

The constitution of NCLT & NCLAT was a step towards improving and easing all the judicial matters relating to the Company law under one roof.

MCA-21

With the advent of Information and Communication Technology in all sectors today, Governments across the globe including the Government of India are taking major initiatives to integrate IT in all their processes. Electronic Governance (e-Governance) is the application of Information Technology to the Government functioning in order to bring about Simple, Moral, Accountable, Responsive and Transparent (SMART) Governance. e-Governance is a highly complex process requiring provision of hardware, software, networking and re-engineering of the procedures for better delivery of services.

So keeping in tune with the e-Governance initiatives the world over, Ministry of Corporate Affairs (MCA), Government of India, has initiated the MCA-21 project, to enable an easy and secure access to MCA services in a manner that best suits the corporate entities and professionals besides the public.

IMPORTANT ASPECTS OF MCA-21

Organization of ROC Office under MCA

The ROC office working from its present address has virtually became the Back Office of the Ministry. Since the number of companies/entities found it difficult to switch over to e-Filing at the initial stage, Facilitation Centers known as Physical Front Offices (PFOs) were set up throughout the Country to provide requisite comfort for e-Filing to such companies.

Front Office and Back Office

Front Office

The major components involved in this comprehensive e-governance project are front office and back office.

Front Office represents the interface of the corporate and public users with the MCA-21 system. This comprises of Virtual Front Office and Registrar's Front Office.

Virtual front office

Virtual front office is one of the various channels available to stakeholders (companies and the professionals) to enable them to do the statutory filing with ROC Offices across the Country. It merely represents a computer facility for filing of digitally signed e-forms by accessing the MCA portal through internet *(www.mca.gov.in)*. It also pre- supposes availability of related facilities to convert documents into PDF format and scanning of documents wherever required.

Registrar's Front Office (RFO)

To facilitate the change over from Physical Document Filing to Digital Document Filing, the Ministry started offices known as the Registrar Front Office. It is one of the various channels available to stakeholders to enable them to do the statutory filing with ROC Offices across the Country. Registrar's Front Offices are managed and operated by the operator RFO has all facilities which are required for online filing like trained manpower, broadband connectivity, scanner, printer and related computer accessories.

Back Office

Back Office represents the offices of Registrar of Companies, Regional Directors and Headquarters and takes care of internal processing of the forms filed by the corporate user as per MCA norms and guidelines. The e-forms are routed dynamically to the concerned authority for processing depending upon the assigned role. All the e-forms along with attachments are stored in the electronic depository, which the staff of MCA can view depending upon the access rights.

Certified Filing Centre (CFC)

In order to provide the Companies to do their e Filing, Professional Institutes (ICSI, ICAI, ICAI-cost), their Regional Councils/Local chapters, individual practicing members and firms of professionals were authorised to create

and set-up the required facilities for facilitating the e Filing process. The Certified Filing Centers, thus set-up by the Professionals are over and above the Registrar's Front Office set-up by the Ministry under the programme. While the services available from the Facilitation Centers set-up by the Ministry are without any charge, the services provided by these Certified Filing Centers entail payment of service charges.

SUBSTANTIAL BENEFITS OF MCA21

➢ Elimination of interface with the offices of ROCs, RDs and the MCA

MCA-21 has been designed virtually to eliminate the physical interface between the companies and the offices of ROCs, RDs and even MCA. It has not only saved time and energy of the company representatives but also enabled them to focus on other creative tasks. Time consuming works of professionals i.e. the tasks of incorporation of new companies, conducting searches of important documents, obtaining certificates of creation, modification and satisfaction of charges, filing of statutory forms and returns etc. have now become very quick and easy.

➢ Effective use of database

With the help of database collected, the vital information has been collected, segregated in such a way that it can be used by various stakeholders for various purposes. It will help in transparency in operations and benefits to players in stock markets as well as easy and prominent exposure of defaulters.

The following websites are created:

Website for Investor Education and Protection Fund: *http://iepf.gov.in*

It would provide information about IEPF and the various activities that have been undertaken/funded by it. It would also provide information relevant for investors, including about various instruments for investment, regulatory system and grievance redressal mechanism.

Awareness to Investors – www.watchoutinvestors.com

It is a national web-based registry covering entities including companies and intermediaries and, wherever available the persons associated with such entities, who have been indicted for an economic default and/or for non-compliance of laws/guidelines and/or who are no longer in the specified activity.

CSR portal-https://www.csr.gov.in/

The National Corporate Social Responsibility Data Portal is an initiative by Ministry of Corporate Affairs, Government of India to establish a platform to disseminate Corporate Social Responsibility related data and information filed by the companies registered with it.

Security Clearance Online Portal: https://esahajmcaservices.nic.in/

Security Clearance is a pre-requisite for granting permission to individuals who are citizens of countries sharing land borders with India and intending to apply for issuance of Director Identification Number (DIN)/appointment of director in new/existing company.

E-Sahaj Seva offers online service for security clearance of applications seeking issuance of Director Identification Number (DIN)/appointment of Director in new/existing company from MCA.

➢ Better supervision and monitoring of compliance

MCA-21 has ensured better supervision and control of the MCA over Companies with regard to compliance with the provisions of the Companies Act. Thus, enforcement of law has become easier and will ultimately benefit the investors, the stakeholders and the concerned Regulatory bodies.

➢ Mutually beneficial system

The focus of the MCA-21 program is on bringing about a fine balance between trade facilitation on one hand and enforcement requirements on the other.

➢ Speed, transparency and efficiency

MCA-21 project aims to bring speed, transparency and efficiency in the delivery of the services rendered by the MCA to all the stakeholders through a set of pre-defined service levels.

➢ Effective due diligence

Banks and Financial Institutions can conduct a thorough scrutiny of the documents filed by the company before advancing loan(s) and other financial assistance to such a company.

➢ Efficient services by professionals

Professionals will be able to offer efficient services to their client companies.

➢ Environment Friendly

MCA-21 has also proved to be environment friendly since paper work involved in filing of forms and documents has been eliminated.

➢ Integration with NSWS

The Ministry of Corporate Affairs vide issuing notification dated October, 2023 has informed that it has integrated with National Single Window System (NSWS) for the incorporation of Companies and LLPs.

MCA SERVICES

The MCA-21 application is designed to fully automate all processes related to the proactive enforcement and compliance of the legal requirements under the Companies Act, 2013 and Limited Liability Partnership Act, 2008. This helps the business community to meet their statutory obligations.

(1) **Register Digital Signature Certificate -** The Information Technology Act, 2000 has provisions for use of Digital Signatures on the documents submitted in electronic form in order to ensure the security and authenticity of the documents filed electronically. This is secure and authentic way to submit a document electronically. As such, all filings done by the companies/LLPs under MCA-21 e-Governance programme are required to be filed using Digital Signatures by the person authorised to sign the documents. An user can register DSC and update particulars of the DSC through the MCA Portal.

(2) **Apply for Director Identification Number (DIN) -** The concept of a Director Identification Number (DIN) was introduced for the first time with the insertion of Sections 266A to 266G of Companies (Amendment) Act, 2006, since then the system has evolved and Companies Act, 2013 also makes a provision for obtaining DIN.

(3) **View Master details of any Company/LLP registered with Registrar of Companies -** A facility has been made available to the general public to view master details of any company/LLP registered with Registrar of Companies. This facility may be availed by clicking “View Company Master Data”. A user can view Master Data of a Company or an LLP, signatory details of a particular company, details of companies and directors under prosecution, details of Companies and LLP’s registered in the last 30 days, master data of directors specifying the name of Companies/LLP’s they are director/partner in, director/designated partner’s details, etc.

(4) **Index of Charges -** A similar facility has also been made available in respect of the 'Register of Charges' for the Companies/LLPs by clicking on to the 'View Index of Charges' and for the viewing the details of the signatories of any company/LLP by clicking on 'View Signatory Details'.

(5) **LLP Services -** A user can check LLP name, find LLPIN (Limited Liability Partnership Identification Number), avail services related to incorporation of an LLP, services related to annual e-Filing for an LLP, services related to change in LLP information and services related to closure of an LLP.

(6) **LLP E-Filing -** to be used if the user wants to avail LLP e-filing services. LLP e-filing services are available in the V3 system**.**

(7) **FO Services -** A user can verify DIN, PAN details of directors, enquire DIN status, find LLPIN, CIN, associate DSC, Track Payment status at NTRP, enquires fees etc.

(8) **Company Services -** A user can check company name, find CIN (Corporate Identity Number), services related to incorporation of a company, avail services related to compliance filing of a company, services related to change in company information, services related to charge management, informational services and services related to closure of a company.

(9) **Company E-filing Services -** A user can have all e-filing services related to all incorporation, DIN, charge, deposit, nidhi services, foreign company services, etc.

(10) **Complaints -** A user can raise service related complaints, track the complaints created, create investor/serious complaint, track the status of complaints created as 'investor/serious complaint', give feedback or suggestions to MCA-21 and raise employee grievances.

(11) **Document Related Services -** A user can get certified copies of forms and documents of a company, view forms and documents online etc.

(12) **Fee and Payment Services -** A user can avail services through Enquire Fees, pay later, link NEFT payment, pay miscellaneous fee, pay stamp duty and track the payment status.

(13) **Public Search of Trademark -** A user can search whether trademark has been registered or applied for a particular name by a company.

(14) **Investor Services -** A user can search amount unclaimed/unpaid amount due to be transferred to the Investor Education and Protection Fund (IEPF), upload investor details, confirm uploaded files.

(15) **Track SRN/Transaction Status -** A user can track the transaction status of the uploaded forms i.e., whether they are approved or pending for approval or required for resubmission or are rejected.

(16) **Independents Director Database Services:** It includes individual and Corporate Registration.

(17) Public Search of Trademark.

(18) Applicable MHA Security clearance.

Besides above mentioned services, to align with global best practices and aided by emerging technologies such as AI, MCA-21 Version 3.0 is envisioned to transform the corporate regulatory environment in India. The key components of MCA-21 are:

- **e-Scrutiny:** MCA is in process of setting up a Central Scrutiny Cell which will scrutinise certain Straight Through Process (STP) forms filed by the corporates on the MCA-21 registry and flag the companies for more in depth scrutiny.
- **e-adjudication:** E-adjudication module, has been conceptualised to manage the increased volume of adjudication proceedings by Registrar of Companies (RoC) and Regional Directors (RD) and will facilitate end to end digitisation of the process of adjudication, for the ease of users. It will provide a platform for conducting online hearings with stakeholders and end to end adjudication electronically.

In exercise of the powers conferred by section 454 read with section 469 of the Companies Act, 2013, the Central Government has notified Companies (Adjudication of Penalties) Amendment Rules, 2024 which has come into force from the 16th day of September, 2024.

A new section 3A after Rule 3 is being inserted in Companies (Adjudication of Penalties) Rules, 2014 in order to enable e-adjudication platform developed by the Central Government.

1. Section 3A states that:

   Adjudication Platform.-

   (1) On the commencement of the Companies (Adjudication of Penalties) Amendment Rules, 2024, all proceedings (including issue of notices, filing replies or documents, evidences, holding of hearing, attendance of witnesses, passing of orders and payment of penalty) of adjudicating officer and Regional Director under these rules shall take place in electronic mode only through the e-adjudication platform developed by the Central Government for this purpose.

   (2) In case the e-mail address of any person to whom a notice or summons is required to be issued under these rules is not available, the adjudicating officer shall send the notice by post at the last intimated address or address available in the records and the officer shall preserve a copy of such notice in the electronic record in the e-adjudication platform referred to in sub-rule (1):

   Provided that in case no address of the person concerned is available, the notice shall be placed on the e-adjudication platform."

2. For the Annexure to the said rules, the Annexure shall be substituted by Form No. ADJ (Memorandum of Appeal)

- **e-Consultation:** To automate and enhance the current process of public consultation on proposed amendments and draft rules etc., e-consultation module of MCA-21 V 3.0 will provide an online platform wherein, proposed amendments/draft legislations will be posted on MCA's website for external users/ comments and suggestions pertaining to the same in a structured digital format. Further, the system will also facilitate AI driven sentiment analysis, consolidation and categorization of stakeholders' inputs and creation of reports on the basis thereof, for reference of MCA.
- **Compliance Management System (CMS):** CMS will assist MCA in identifying non-compliant companies/ LLPs, issuing e-notices to the said defaulting companies/LLPs, generating alerts for internal users of MCA. CMS will serve as a technology platform/solution for conducting rule based compliance checks and undertaking enforcement drives of MCA wherein e-notices will be issued by MCA for effective administration of corporates.
- **MCA Lab:** As part of MCA21 V 3.0, a MCA LAB is being set up, which will consist of corporate law experts. The primary function of MCA Lab will be to evaluate the effectiveness of Compliance Management System, e-consultation module, enforcement module, etc. and suggest enhancements to the same on an on-going basis. The Lab will help MCA in ensuring the correctness of results produced by these key modules in view of the dynamic corporate ecosystem.

Additionally, MCA-21 V 3.0 will have a cognitive chat bot enabled helpdesk, mobile apps, interactive user dashboards, enhanced user experience using UI/UX technologies, and seamless data dissemination through APIs.

Online Inspection of Documents

The documents filed online, once taken on record by ROC Offices are available for public viewing on payment of requisite fees. These documents, which are in domain of public documents, include documents relating to

incorporation, charges, annual returns and balance sheets and change in directors. A certified copy of the documents can also be obtained by any one so interested. For this purpose there is also an option to mention the number of pages in the document for which a certified copy is required as well as the number of copies required.

ALL ABOUT FILING AND FILING OF E-FORMS

E-Forms

An e-form is only a re-engineered conventional form notified and represents a document in electronic format for filing with MCA authorities through the Internet. This may be either a form filed for compliance or information purpose or an application seeking approval from the MCA. Due to technical updates, these forms updates regularly, even though their user interface may not change. User always uses latest e-forms from the MCA Portal.

Filling and filing of forms is an important part of the secretarial function of a Company Secretary. Normally, where Company appoints a Company Secretary, he is designated as the officer responsible for compliance under the Companies Act and other allied legislations. Therefore, for any lapse in complying with the various provisions of the Companies Act or such other legislations, for the compliance of which the Company Secretary has been made responsible, he becomes liable as "officer in default".

Filling and filing of forms, returns and applications under various provisions demand intimate knowledge of substantive as well as procedural law. The Registrar of Companies (RoC) registers the documents filed with them within the prescribed time, if found in order. Often, a large number of documents filed with the RoC are not taken on record due to technical lapses which result in avoidable correspondence and frequent visits to the office of RoC. In order to avoid such errors, every care should be taken to ensure that the forms are properly filled and adequate documents are attached to them before filing.

Company Secretaries, under electronic filing system are required to be familiar with computer, internet, MCA-21 electronic filing system, pdf files and using digital signatures.

PREREQUISITES FOR E-FILING ON MCA-21

Digital Signature certificate (DSC) of either Class 2 and Class 3 signing certificate category issued by a licensed Certifying Authority (CA) needs to be obtained for e-Filing on the MCA Portal.

Digital Signatures are legally admissible in a Court of Law, as provided under the provisions of IT Act, 2000. The Certifying Authorities are authorized to issue a Digital Signature Certificate with a validity of one or two years.

Hardware and Software Requirements under e-filing

The minimum system requirement for e-filing on MCA-21 are as under:

- Computer System/laptop with Windows 2000 or later installed;
- JRE (Java Runtime Environment) -Java version 8 is suggested;
- Internet connection to access the MCA website;
- Internet Explorer 10 or above / Chrome 49 or above /Firefox 45 or above;
- Adobe Acrobat 11 or above version;
- Scanner for scanning paper attachments;

- Printer for printing bank challan or service fee payment receipt;
- Pop-ups from MCA21 Portal must be enabled in your browser.

Necessity of Pre-certification of E-Forms

Introduction of pre-certification by an independent professional in the e-form aimed at reducing the workload of the Registrar of Companies. Once an e-form has been pre-certified by a professional towards its authenticity based on the particulars contained in the books of accounts and records of the company, ROC is entitled to take on record the e-form. Professionals are responsible for submitting/certifying documents (to be signed digitally by them) and system would accept most of these documents online without approval by Registrar of Companies or other officers of the Ministry. If a professional gives a false certificate or omits any material information knowingly, he is liable to punishment under Section 447 and 448 of the Companies Act, 2013 besides disciplinary action by the Institute which issued the Certificate of Practice.

Fees [Rule 12 of the Companies (Registration Offices and Fees) Rules, 2014]

The documents required to be submitted, filed, registered or recorded or any factor information required or authorized to be registered under the Act shall be submitted, filed, registered or recorded on payment of the fee or on payment of the fee or on payment of such additional fee as applicable, as mentioned in Table annexed to Rule 12 of The Companies (Registration Offices and Fees) Rules, 2014.

For the purpose of filing the documents or applications for which no e-form is prescribed under the various rules prescribed under the Act, the document or application shall be filled through Form No.GNL.1 or GNL.2 along with fee as applicable and in case a single form is prescribed for multiple purposes, the fee shall be paid for each of the purpose contained in the single form.

For the purpose of filing information to sub- clause (60) of Section 2 of the Act, such information shall be filed in Form No. GNL.3 along with fee as applicable.

Mode of Payment [Rule 13 of the Companies (Registration Offices and Fees) Rules, 2014]

The fees, charges or other sums payable for filing any application, form, return or any other document in pursuance of the Act or any rule made there under shall be paid by means of credit card; or internet banking; or remittance at the counter of the authorized banks or any other mode as approved by the Central Government.

Lesson Round-up

- The Companies Act, 2013 received the assent of the President on August 29, 2013 and was notified in the Gazette of India on August 30, 2013. It empowers the Central Government to bring into force various sections from such date(s) as may be notified in the Official Gazette.
- Major Developments in the Company Law in India.
- The objective of the Companies Act, 2013 is to provide business friendly corporate regulation/ pro-business initiatives; e-Governance Initiatives; good corporate governance and CSR; enhanced disclosure norms and enhanced accountability of management.
- There are various agencies under the Ministry of Corporate Affairs such as ROC, RD, OL, SFIO, NFRA and NCLT/NCLAT.
- Any activity done in contrary to or in excess of the scope of activity of the Companies Act, Memorandum of Association or Articles of Association will be *ultra vires*.

- Doctrine of "constructive notice" seeks to protect the company against the outsiders, the principal of "indoor management operates" to protect the outsiders against the company.
- Where a fraudulent and dishonest use is made of the legal entity, the individuals concerned will not be allowed to take shelter behind the corporate personality. The Court may break through the corporate shell and apply the principle of what is known as "lifting of or piercing the corporate veil".

Glossary

Jurisprudence : The study of law and the principles on which law is based.

Bill : A bill is proposed legislation under consideration by a legislature. A bill does not become law until it is passed by the legislature. Once a bill has been enacted into law, it is called an act of the legislature, or a statute.

Indoor Management : It operates to protect outsiders against the company. It protects innocent parties who are doing business with the Company and are not in a position to know if some internal rule or procedural requirement has not been complied with.

Rule of Constructive Notice : To protect the company against outsiders. The rule of constructive notice is confined to the external position of the company and, therefore, it follows that there is no notice as to how the company's internal machinery is handled by its officers. It is a presumption in favour of the company which mean that an outsider has a knowledge of the Memorandum and Articles of Association of the company with which he/ she is about to entering into the contract.

E Form : Is a computer program of a paper form.

Incorporation : The formation.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What do you understand by corporate veil and when is it disregarded?
2. The Ministry of Corporate Affairs (MCA) is primarily concerned with administration of the Companies Act 2013, the Limited Liability Partnership Act, 2008 & other allied Acts, in view of the same elucidate the agencies fall under the purview of MCA.
3. Discuss e-Governance and MCA-21.
4. What are the modes of payment under filing of forms under the Companies Act, 2013?
5. Any activity done in contrary to or in excess of the scope of activity of the Companies Act, Memorandum of Association or Articles of Association will be *ultra vires*. Discuss.
6. The Articles of Association of M/s ZXY Limited states that all the company documents needs to be signed by the managing director, Company secretary and the executive director on behalf of the company. A mortgage deed was executed by the secretary and the executive director. Choose the correct answer:

    a) Such mortgage is valid

b) Such mortgage is invalid

c) It can be valid by passing Board Resolution

d) It is valid if the funds are utilized for the purpose of company.

7. M/s SFPL Pvt. Ltd. has issued NCDs for Rs. 20 Crores on private placement basis in terms of SEBI (Issue and Listing of Debt Securities) Regulations, 2008 and got them registered on stock exchange. Suggest the correct option:

a) M/s SFPL Pvt. Ltd. is listed company
b) It will be treated as unlisted company
c) M/s SFPL Pvt. Ltd. is government company
d) None of the above

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- Bare Act- The Companies Act, 2013
- Company Law Procedures by CS K.V. Shanbhogue-Bharat's Publication
- Company Law by Dr. G.K. Kapoor

OTHER REFERENCES (INCLUDING WEBSITES/VIDEO LINKS)

https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks.html

Legal Status and Types of Registered Companies

Lesson 2

KEY CONCEPTS

■ Corporate Personality ■ Perpetual Succession ■ Separate Property ■ Transferability of shares ■ Capacity to sue or be sued ■ Private Company ■ Public Company ■ Small company ■ Holding Company ■ Subsidiary Company ■ Associate Company ■ Government Company ■ Dormant Company

Learning Objectives

To understand:

- Nature and characteristics of a company
- The concepts and legal provisions of various types of companies
- Special provisions and privileges for some classes of companies
- Distinction between different types of companies.
- Advantages and Disadvantages of various types of companies

Lesson Outline

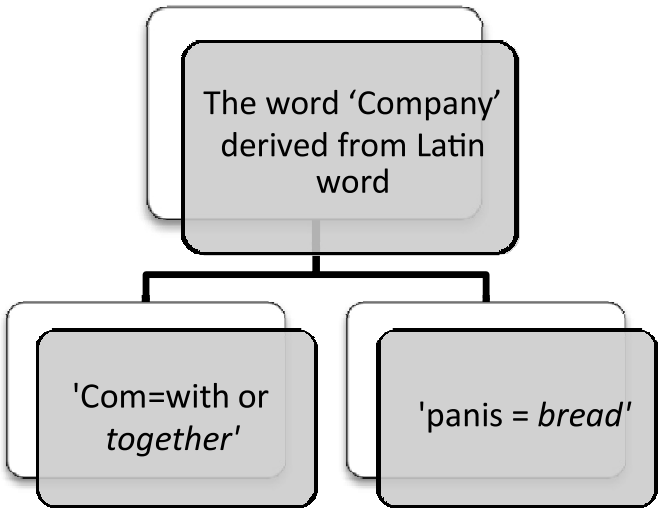
- Meaning and definition of Company
- Nature and characteristics of a Company
- Types of Companies
- Characteristics of Private Company
- Privileges and exemptions of Private Companies
- Public Company
- Characteristics of Public Company
- Meaning of Small Company, Dormant Company, Government Company
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Sections 2,3, 8, 10A, 378A-B, 379-3793, 406 & 455)
- The Companies (Specification of Definitions Details) Rules, 2014

INTRODUCTION

What is a Company?



In the leisurely past, merchants took advantage of festive gatherings, to discuss business matters. Nowadays, the company form of organization has assumed great importance. When they forms their business relations they form a company. In popular parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertaking. A company under law is a corporate body and a legal person having status and personality distinct and separate from the members constituting it.

It is called a body corporate because the persons composing it are made into one body by incorporating it according to the law and clothing it with legal personality. The word 'corporation' is derived from the Latin term 'corpus' which means 'body'. Accordingly, 'corporation' is a legal person created by a process other than natural birth. As a legal person, a corporate is capable of enjoying many rights and incurring many liabilities of a natural person.

An incorporated company owes its existence either to a Special Act of Parliament or to Company Law. Public corporations like Life Insurance Corporation of India, SBI etc., have been brought into existence through special Acts of Parliament, whereas companies like Tata Steel Ltd., Reliance Industries Limited have been formed under the Company law.

Definition of a Company

In terms of the Companies Act, 2013 **a "company" means a company incorporated under this Act or under any previous company law [Section 2(20)].**

In common law, a company is a "legal person" or "legal entity" separate from, and capable of surviving beyond the lives of its members. A company is rather a legal device for the attainment of social and economic end.

It is, therefore, a combined political, social, economic and legal institution. Thus, the term company has been described in many ways. "It is a means of cooperation and organisation in the conduct of an enterprise". It is "an intricate, centralised, economic and administrative structure run by professional managers who hire capital from the investor(s)".

Lord Justice Lindley has defined a 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 profit and loss arising therefrom. The common stock so contributed is denoted in money and is the capital of the company. The persons who contributed in it or form it, or to whom it belongs, are members. The proportion of capital stock to which each member has contributed entitled is his "share". The shares are always transferable although the right to transfer them may be restricted."

Chief Justice Marshall-"A corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence."

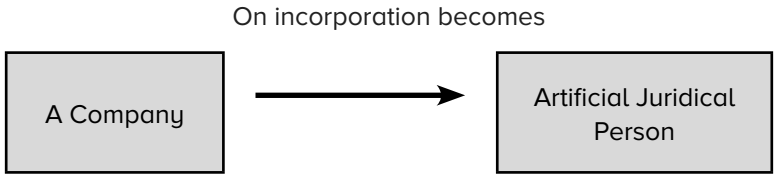
Justice James-"A company is an association of person's united for a common object."

These definitions clearly bring out the meaning of company. A company comes into existence only when it is registered under the Act. When it is registered, it has a legal personality of its own, separate and distinct from its members. An unregistered company has no such separate legal existence. A company is created by law and law alone can dissolve it.

CASE LAW

In Re *G.V. Pratap Reddy Through G.P.A. TSR Research Pvt. Ltd.* vs. *K.V.V.S.N. Associates and others [2016] (SC),* the Supreme Court of India held that, where notice inviting tender by State of Telangana required that bidder must be an individual/company, word company in notice inviting tender could only mean a company as understood under Companies Act and cannot be read to include a firm and, therefore, bid of respondent which was neither an individual nor a company but a firm was rightly rejected by State.

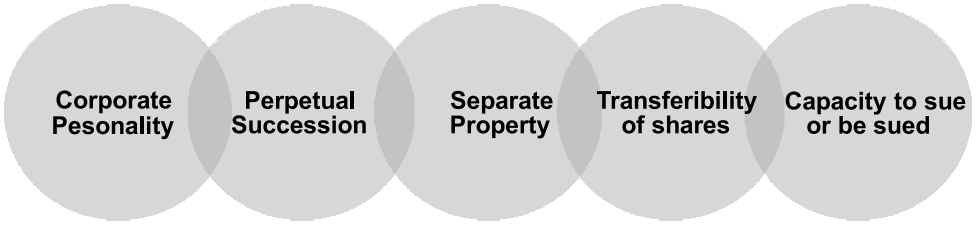
LEGAL STATUS OF REGISTERED COMPANIES



Since a corporate body (i.e. a company) is the creation of law, it is not a human being, it is an artificial juridical person (i.e. created by law) and it is clothed with many rights, obligations, powers and duties prescribed by law. It can, however, do everything what a natural person can do except certain acts which require personal execution. Thus, a company cannot marry or divorce; it cannot vote in an election.

On incorporation, the company acquires a separate legal entity status distinct from and independent of its members. Unlike a partnership, which has no separate existence from its partners, a company has a separate corporate existence. It is different from the members who constitute it.

The most striking characteristics of a company are discussed below:



CORPORATE PERSONALITY

A company incorporated under the Act is vested with a corporate personality.

- It bears its own name and acts thereunder;
- Its assets are separate and distinct from those of its members;
- It is a different 'person' from the members who compose it;
- It can incur debts, borrow money, have a bank account, employ people, enter into contracts and can sue or be sued; and
- It is capable of owning property.

Its shareholders are its notional owners and do not own anything in it except ownership of shares issued and they can be its creditors simultaneously. A shareholder cannot be held liable for the acts of the company even if he holds virtually the entire share capital.

The Indian courts have recognized the principle of separate legal entity of a company. In *T.R Pratt (Bombay) Ltd. v. E.D Sasoon & Co. Ltd. AIR 1936 Bom. 62* it was observed that under the law, an incorporated company is distinct entity, and although all the shares may be practically controlled by one person, in law a company is distinct entity.

The shareholders are not the agents of the company and so they cannot bind it by their acts. The company does not hold its property as an agent or trustee for its members and they cannot sue to enforce its rights, nor can they be sued in respect of its liabilities. Thus, 'incorporation' is the act of forming a legal corporation as a juristic person. A juristic person is in law also conferred with rights and obligations and is dealt in accordance with law. In other words, the entity acts like a natural person but only through a designated person, whose acts are processed within the ambit of law *[Shiromani Gurdwara Prabandhak Committee v. Shri Sam Nath Dass AIR 2000 SCW 139]*.

CASE LAW

The case of Salomon v. Salomon and Co. Ltd., (1897) A.C. 22

The above case has clearly established the principle that once a company has been validly constituted under the Companies Act, it becomes a legal person distinct from its members and for this purpose it is immaterial whether any member holds a large or small proportion of the shares, and whether he holds those shares as beneficially or as a mere trustee.

In the case, Salomon had, for some years, carried on a prosperous business as a leather merchant and boot manufacturer. He formed a limited company consisting of himself, his wife, his daughter and his four sons as the shareholders, all of whom subscribed to 1 share each so that the actual cash paid as capital was £7. Salomon sold his business (which was perfectly solvent at that time), to the Company formed by him for the sum of £38,782. The company's nominal capital was £40,000 in £1 shares. In part payment of the purchase money for the business sold to the company, debentures of the amount of £10,000 secured by a floating charge on the company's assets were issued to Salomon, who also applied for and received an allotment of 20,000 £ 1 fully paid shares. The remaining amount of £8,782 was paid to Salomon in cash. Salomon was the managing director and two of his sons were other directors.

The company soon ran into difficulties and the debenture holders appointed a receiver and the company went into liquidation. The total assets of the company amounted to £6050, its liabilities were £10,000 secured by debentures, £8,000 owing to unsecured trade creditors, who claimed the whole of the company's assets, viz., £6,050, on the ground that, as the company was a mere 'alias' or agent for Salomon, they were entitled to payment of their debts in priority to debentures. They further pleaded that Salomon, as a principal beneficiary, was ultimately responsible for the debts incurred by his agent or trustee on his behalf.

Their Lordships of the House of Lords observed:

> "...the company is a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are managers, and the same hands receive the profits, the company is not, in law, their agent or trustee. The statute enacts nothing as to the extent or degree of interest, which may, be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertakings, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of company."

CASE LAW

The case of Lee v. Lee's Air Farming Ltd. (1961) A.C. 12 (P.C.)

The above case illustrates the application of the principles established in Salomon's case (supra). In this case, a company was formed for the purpose of aerial top-dressing. Lee, a qualified pilot, held all but one of the shares in the company. He voted himself the managing director and got himself appointed by the articles as chief pilot at a salary. He was killed in an air crash while working for the company. His widow claimed compensation for the death of her husband in the course of his employment. The company opposed the claim on the ground that Lee was not a worker as the same person could not be the employer and the employee. The Privy Council held that Lee and his company were distinct legal persons which had entered into contractual relationships under which he became the chief pilot, a servant of the company. In his capacity of managing director he could, on behalf of the company, give himself orders in his other capacity of pilot, and the relationship between himself, as pilot and the company, was that of servant and master. Lee was a separate person from the company he formed and his widow was held entitled to get the compensation. In effect the magic of corporate personality enabled him (Lee) to be the master and servant at the same time and enjoy the advantages of both.

The decision of the Calcutta High Court in *Re. Kondoli Tea Co. Ltd., (1886) ILR 13 Cal. 43,* recognised the principle of separate legal entity even much earlier than the decision in *Salomon v. Salomon & Co. Ltd. case.* Certain persons transferred a Tea Estate to a company and claimed exemptions from ad valorem duty on the ground that since they themselves were also the shareholders in the company, it was nothing but a transfer from them in one name to themselves under another name. While rejecting this Calcutta High Court observed:

> "The company was a separate person, a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons."

CASE LAW

New Horizons Ltd. v. Union of India, (AIR 1994, Delhi 126)

The experience of a shareholder of a company can be regarded as experience of a company. The tender of the company, New Horizons Ltd., for publication of telephone directory was not accepted by the Tender Evaluation Committee on the ground that the company had nothing on record to show that it had the technical experience required to be possessed to qualify for tender. On appeal the rejection of tender was upheld by the Delhi High Court.

The judgment of the Delhi High Court was reversed by the Supreme Court which observed as under:

"Once it is held that NHL (New Horizons Ltd.) is a joint venture, as claimed by it in the tender, the experience of its various constituents namely, TPI (Thomson Press India Ltd.), LMI (Living Media India Ltd.) and WML (World Media Ltd.) as well as IIPL (Integrated Information Pvt. Ltd.) had to be taken into consideration, if the Tender Evaluation Committee had adopted the approach of a prudent business man."

"Seeing through the veil covering the face of NHL, it will be found that as a result of re-organisation in 1992 the company is functioning as a joint venture wherein the Indian group (TPI, LMI and WML) and Mr. Aroon Purie hold 60% shares and the Singapore based company (IIPL) holds 40% shares. Both the groups have contributed towards the resources of the joint venture in the form of machines, equipment and expertise in the field. The company is in the nature of partnership between the Indian group of companies and Singapore based company who have jointly undertaken this commercial enterprise wherein they will contribute to the assets and share the risk. In respect of such a joint venture company, the experience of the company can only mean the experience of the constituents of the joint venture i.e. the Indian group of companies (TPI, LMI and WML) and the Singapore based company (IIPL) [*New Horizons Ltd. and another Union of India (1995) 1 Comp. LJ 100 SC*].

COMPANY AS AN ARTIFICIAL PERSON

What is artificial person?

An artificial person means a juridical person; it has a legal name and has certain rights, protections, privileges, responsibilities, and liabilities in law, similar to those of a natural person.

A Company is an artificial person created by law. It is not a human being but it acts through human beings. It is considered as a legal person who can enter into contracts, possess properties in its own name, sue and can be sued by others etc. It is called an artificial person since it is:

- Invisible;
- Intangible;
- Existing only in the contemplation of law;
- It is capable of enjoying rights and being subject to duties.

CASE LAW

Union Bank of India v. Khader International Construction and Other [(2001) 42 CLA 296 SC]

In this case, the question which arose before the Court was whether a company is entitled to sue as an indigent (poor) person under Order 33, Rule 1 of the Civil Procedure Code, 1908. The aforesaid Order permits persons to file suits under the Code as pauper/indigent persons if they are unable to bear the cost of litigation.

The appellant in this case had objected to the contention of the company which had sought permission to sue as an indigent person. The point of contention was that, the appellant being a public limited company, it was not a 'person' within the purview of Order 33, Rule 1 of the Code and the 'person' referred to only a natural person and not to other juristic persons. The Supreme Court held that the word 'person' mentioned in Order 33, Rule 1 of the Civil Procedure Code, 1908, included any company as association or body of individuals, whether incorporated or not. The Court observed that the word 'person' had to be given its meaning in the context in which it was used and being a benevolent provision, it was to be given an extended meaning. Thus a company may also file a suit as an indigent person.

PERPETUAL SUCCESSION

Meaning:

Perpetual Succession means that the membership of the company may change from time to time, but this does not affect its continuity. An incorporated company never dies, except when it is wound up as per law.

- A company, being a separate legal person is unaffected by death/insolvency / retirement or departure of any member or director;
- It remains the same entity, despite total change in the membership.

According to section 9 of the Companies Act, 2013, from the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having **perpetual succession** with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name.

The membership of an incorporated company may change either because one shareholder has sold/ transferred his shares to another or his shares devolve on his legal representatives on his death or he ceases to be a member under some other provisions of the Companies Act. Thus, perpetual succession denotes the ability of a company to maintain its existence by the succession of new individuals who step into the shoes of those who cease to be members of the company. Professor L.C.B. Gower rightly mentions, *"Members may come and go, but the company can go on forever. During the war all the members of one private company, while in general meeting, were killed by a bomb, but the company survived — not even a hydrogen bomb could have destroyed it".*

CASE LAW

In *Gopalpur Tea Company Ltd. v. Peshok Tea Co. Ltd. and others (1982) 52 Comp Cas 239,* the whole Company was taken over by an Act which purportedly ceased the right to take action against the Company, the Court held that neither the company was extinguished, nor was anyone's right to take action against it. Therefore, until and unless a Company is liquidated legally, a Company will have perpetual succession and its existence will not be affected by the financial status and lives of its shareholders.

Variation in members or their identity does not affect the legal existence and identity of a company. A company is a creation of law and can be dissolved only under law. Even if all the members of the company leave or die, then also company will not come to end and will continue its existence.

Illustration:

M/s ABC Pvt. Ltd. has three directors and all the three directors are also the shareholders of the company. All the directors died in the car accident while going for a meeting. In this case, principle of perpetual succession applies and even if all the directors of M/s ABC Pvt. Ltd. died, the company will continue to have existence and the successors of directors can take over the affairs of the company.

SEPARATE PROPERTY

A company being a legal person and entirely distinct from its members, is capable of owing, enjoying and disposing off property on its own name.

CASE LAW

Mrs. Bacha F. Guzdar v. The Commissioner of Income Tax, Bombay, A.I.R. 1955 S.C. 74

The Supreme Court in this case held that, though the income of a tea company is entitled to be exempted from Income-tax up to 60% being partly agricultural, the same income when received by a shareholder in the form of dividend cannot be regarded as agricultural income for the assessment of income-tax. It was also observed by the Supreme Court that a shareholder does not, as is erroneously believed by some people, become the part owner of the company or its property; he is only given certain rights by law, e.g., to receive notice of or to attend or vote at the meetings of the shareholders. The court refused to identify the shareholders with the company and reiterated the distinct personality of the company.

As a corporate entity, the company is entitled to own and hold property in its own name or to dispose the same. No member can claim ownership of any item of the company's assets. As a company is a legal person it is capable of holding and disposing the property in its name through authorized representative.

Illustration:

Mr. Amit incorporated a company in the name of ABC Public Ltd., the company provides catering services. Mr. Amit decides to purchase a new building and a company van. As an ABC Public Ltd., the company can legally purchase property under the business's information. Mr. Amit do not have to purchase the property under his personal information.

Mr. Amit can begin the property purchase process using his business's name and banking information. On completion of the paperwork, the deed to the property is under the business's name.

CASE LAW

H.C. Shastri v. Dolphin Canpack Pvt. Ltd. (1998)

In this case the shareholder of the company has tried to use the assets of the company for paying off his personal loans. The Delhi High Court held that:

"...As noticed earlier, neither a shareholder nor a Director has any right in the property and assets of the company, which is a separate juristic entity distinct from the shareholders. The shareholder who buys shares does not buy an interest in the property of the company which is a juristic person, entirely distinct from the shareholder. The shareholder as an investor becomes entitled to participate in the profits of the company, and have a say in the management as per law. He can claim the left over assets of the company in case the company is wound up. ...".

CASE LAW

In the case of *R.T. Perumal v. John Deavin And Anr. AIR 1960 Mad 43,* it was stated that no member should claim ownership of any company's property during the association's existence or dissolution. A company cannot even have an insurable interest in the company's property.

CASE LAW

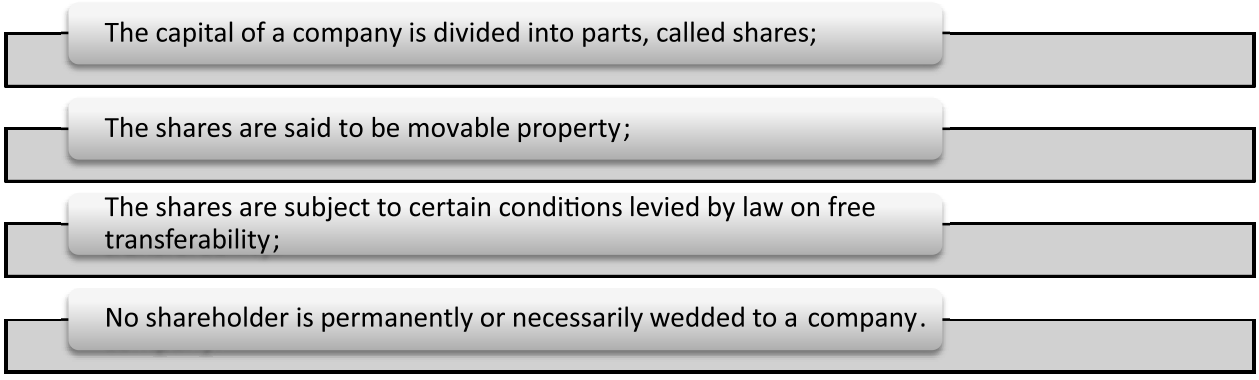
In *Macaura V. Northen Asurance Company Ltd. (1925) AC 619*, it was held that a member does not even have an insurable interest in the property of the company. In this case, Macaura held all except one share of a timber company. He had also advanced substantial amount to the company. He insured the company's timber in his own name. On timber being destroyed by fire, his claim was rejected for want of insurable interest. The court observed: "No shareholder has any right to any item of property owned by the company or he has no legal or equitable interest herein."

CASE LAW

In Re Chiranjilal Chuadhari Vs. Union of India (1951) 21 Comp. Cas. 33 (SC)

In this case, the Supreme Court of India stated that a company has a fundamental right to own property and in event of infringement of such right, the company can bring an action and not the its shareholder. It was observed that, it is settled law that in order to redress a wrong done to the company, the action should prima facie be brought by the company itself. Although the shareholders of the company, may in a sense, be interested to observe that the company of which he is a shareholder is not deprived of its property, he cannot be heard as a complainant in his own name and on his own behalf for the infringement of the fundamental right to property of the company.

TRANSFERABILITY OF SHARES



Shares are Movable Properties

Section 44 of the Companies Act, 2013 enunciates the principle by providing that the shares held by the members are movable property and can be transferred from one person to another in the manner provided by the articles. If the articles do not provide anything for the transfer of shares and the Regulations contained in Table "F" in Schedule I to the Companies Act, 2013, are also expressly excluded, the transfer of shares will be governed by the general law relating to transfer of movable property.

A member may sell his shares in the open market and realise the money invested by him. This provides liquidity to a member (as he can freely sell his shares) and ensures stability to the company (as the member is not withdrawing his money from the company). The Stock Exchanges provide adequate facilities for the sale and purchase of shares of listed entities.

In the listed companies, the shares are transferable through Electronic mode i.e. through Depository Participants in dematerialised form instead of physical transfers.

Transferability of Shares of a Private Limited Company

However there are restrictions with respect to transferability of shares of a Private Limited Company. Even if share of a Private Limited Company is in demat form, restrictions by the Articles of the company shall apply.

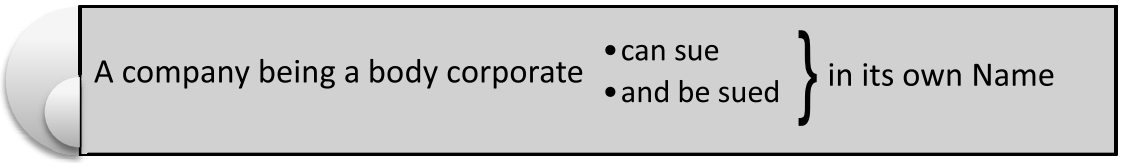
The concept of free transferability of shares in a public and private company is discussed in the case of *Western Maharashtra Development Corporation Ltd. Vs. Bajaj Auto Ltd 2010 154 com cases 593 Bom*. In the case, the court held that the Company Act makes a clear distinction regarding the transferability of shares relating to private and public companies. By its definition, a 'private company' is a company, which restricts the right to transfer its shares. In the case of a public company, the Act provides that the shares or debentures and any interest of the company are freely transferable.

Test Yourself

Question. In case of any shareholders' agreement amongst the shareholders with specific restriction like right of first refusal or pre-emptive right given to any shareholders, whether such restrictions are enforceable or not if the same are not part of the articles of association?.

Answer. As as per the decision of Supreme Court in *V.B. Rangaraj v. V.B Gopalakrishnan and other AIR 1992 SC 453*, it was held that the clause of shareholders agreement shall be enforceable provided the same are main part of the article of association.

CAPACITY TO SUE OR BE SUED



To sue, means to institute legal proceedings against (a person) or to bring a suit in a court of law. All legal proceedings against the company are to be instituted in its name. Similarly, the company may bring an action against anyone in its own name. A company's right to sue arises when some loss is caused to the company, i.e. to the property or the personality of the company. Hence, the company is entitled to sue for damages in libel or slander as the case may be *[Floating Services Ltd. v. MV San Fransceco Dipaloa (2004) 52 SCL 762 (Guj)*]. A company, as a person distinct from its members, may even sue one of its own members.

A company has a right to seek damages where a defamatory material published about it, affects its business. Where video cassettes were prepared by the workmen of a company showing, their struggle against the company's management, it was held to be not actionable unless shown that the contents of the cassette would be defamatory. The court did not restrain the exhibition of the cassette. *[TVS Employees Federation v. TVS and Sons Ltd., (1996) 87 Com Cases 37].* The company is not liable for contempt committed by its officer. *[Lalit Surajmal Kanodia v. Office Tiger Database Systems India (P) Ltd., (2006) 129 Com Cases 192 Mad].*

CASE LAW

In *Rajendra Nath Dutta Vs. Shibendra Nath Mukherjee (1982) 52 Comp. Cas. 293 (Cal.)*

In the above mentioned case, it was held that for any wrong done, the company must sue or be sued in its own name. It was observed that as the company is a distinct legal personality, distinct from its shareholders and/or directors, the company if aggrieved by some wrong done to it by any person, it must sue or contrarily be sued in the name of the company itself. In the referred case, a lease deed was executed by the director of the company without seal of the company. Subsequently, a suit was filed by the directors and not the company to avoid lease on ground that a new term had been fraudulently included in the lease deed by the defendants. It was held that a director of the Board of Directors or a managing director could not file a suit, unless it was by the company, in order to avoid the any deed which admittedly was executed by one of the directors and admittedly also the company received the rent. The case as made out in the pliant was not made by the company but some of the directors of the company and the company was not even a plaintiff. It the company was aggrieved, it was the company which was to file the suit and not the directors. Therefore, the suit was not maintainable in the eyes of court.

Illustration:

Suppose there is a company Antriksh Limited. Antriksh Limited can file a defamation case against a defamatory article that was published against it. It can also file police complaints for various offences. It can basically undertake all sorts of litigations through an Authorized Representative.

It is pertinent to note that an Authorized Representative of a Company can be changed during the course of the litigation and doing so would not hamper the pending case before the Courts / Authorities.

COMPANY IS NOT A CITIZEN

The company, though a legal person, is not a citizen under the Citizenship Act, 1955 or the Constitution of India.

The reason as to why a company cannot be treated as a citizen is that, citizenship is available to individuals or natural persons only and not to juristic persons.

In *State Trading Corporation of India Ltd. v. C.T.O., A.I.R. 1963 S.C.* 1811, the Supreme Court held that the State Trading Corporation though a legal person, was not a citizen and can act only through natural persons. Nevertheless, it is to be noted that certain fundamental rights enshrined in the Constitution for protection of "person", e.g., right to equality (Article 14) etc. are also available to company. Section 2(f) of Citizenship Act, 1955 expressly excludes a company or association or body of individuals from citizenship.

CASE LAW

In R.C. Cooper v. Union of India, AIR 1970 SC 564

In this case, the Supreme Court held that where the legislative measures directly touch the company of which the petitioner is a shareholder, he can petition on behalf of the company, if by the impugned action, his rights are also infringed. In that case, the court entertained the petition under Article 32 of the Constitution at the instance of a director as shareholder of a company and granted relief. It is, therefore, to be noted that an individual's right is not lost by reason of the fact that he is a shareholder of the company.

Company has Nationality and Residence

CASE LAW

Bennet Coleman Co. v. Union of India, AIR 1973 SC 106

In this case, the Supreme Court stated that:

"It is now clear that the Fundamental Rights of shareholders as citizens are not lost when they associate to form a company. When their Fundamental Rights as shareholders are impaired by State action, their rights as shareholders are protected. The reason is that the shareholders' rights are equally and necessarily affected if the rights of the company are affected."

Company has Nationality and Residence

Though it is established through judicial decisions that a company cannot be a citizen, yet it has nationality, domicile and residence. In *Gasque v. Inland Revenue Commissioners,* (1940) 2 K.B. 88, Macnaghten. J. held that a limited company is capable of having a domicile and its domicile is the place of its registration and that domicile clings to it throughout its existence. He observed in this case:

"It was suggested that a body corporate has no domicile. It is quite true that a body corporate cannot have a domicile in the same sense as an individual. But by analogy with a natural person the attributes of residence, domicile and nationality can be given to a body corporate."

CASE LAW

In Tulika v. Parry and Co., (1903) I.L.R. 27 Mad. 315, Kelly C.B. observed

"A joint stock company resides where its place of incorporation is, where the meetings of the whole company or those who represent it are held and where its governing body meets in bodily presence for the purposes of the company and exercises the powers conferred upon it by statute and by the Articles of Association."

LIMITED LIABILITY

"The privilege of limited liability for business debts is one of the principal advantages of doing business under the corporate form of organisation." The company, being a separate person, is the owner of its assets and bound by its liabilities.

The liability of a member as shareholder, extends to the contribution to the capital of the company up to the nominal value of the shares held and not paid by him.

Members, even as a whole, are neither the owners of the company's undertakings, nor liable for its debts. In other words, a shareholder is liable to pay the balance, if any, due on the shares held by him, when called upon to pay and nothing more, even if the liabilities of the company far exceed its assets. This means that the liability of a member is limited.

For example, if A holds shares of the total nominal value of 1,000 and has already paid Rs.500/- (or 50% of the value) as part payment at the time of allotment, he cannot be called upon to pay more than Rs. 500/-, the amount remaining unpaid on his shares. If he holds fully-paid shares, he has no further liability to pay even if the company is declared insolvent. In the case of a company limited by guarantee, the liability of members is limited to a specified amount of the guarantee mentioned in the memorandum.

Buckley, J. *in Re. London and Globe Finance Corporation, (1903) 1 Ch.D. 728 at 731*, has observed: "The statutes relating to limited liability have probably done more than any legislation of the last fifty years to further the commercial prosperity of the country. They have, to the advantage of the investor as well as of the public, allowed and encouraged aggregation of small sums into large capitals which have been employed in undertakings of "great public utility largely increasing the wealth of the country".

Exceptions to the principle of limited liability

- *Members are severally liable in certain cases*- The following are the prerequisites for attracting the provisions of Section 3A:-

  1. The number of members of the Company is reduced to below seven in case of public company or below two in case of private company;
  2. The company carries on business for more than six months with such less number of members;
  3. The members are cognizant of fact that the company is carrying business with such less number of members.

  In such case the remaining members so continuing in the company shall be liable for the payment of whole debts of the company contracted during that time.

- When the company is incorporated as an Unlimited Company under Section 3(2)(c) of the Act.

- Where a company has been got incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members of such company shall be unlimited. [Section 7(7)(b)]
- Further under section 339(1), where in the course of winding up it appears that any business of the company has been carried on with an intent to defraud creditors of the company or any other persons or for any fraudulent purpose, the Tribunal may declare the persons who were knowingly parties to the carrying on of the business in the manner aforesaid as personally liable, without limitation of liability, for all or any of the debts/liabilities of the company.[Section 339]
- Under Section 35(3), where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person who was a director at the time of issue of the prospectus or has been named as a director in the prospectus or every person who has authorised the issue of prospectus or every promoter or a person referred to as an expert in the prospectus shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.
- As per section 75(1), where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified or such further time as may be allowed by the Tribunal and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to other liabilities, also be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors.
- Section 224(5) states that where the report made by an inspector states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property, or cash, and also for holding such director, key managerial personnel, officer or other person liable personally without any limitation of liability.

CONTRACTUAL RIGHTS

What are contractual rights?

They refer to a guaranteed set of rights given to all the parties (two or more) when they enter into a valid contact. Contract rights usually involve business matters. Some common types of contractual rights are:

- Right to purchase a product or service;
- Right to sell a product or service, etc.

A company, being a legal entity different from its members, can enter into contracts for the conduct of the business in its own name. A shareholder cannot enforce a contract made by his company; he is neither a party to the contract, nor be entitled to the benefit derived from it, as a company is not a trustee for its shareholders. Likewise, a shareholder cannot be sued on contracts made by his company. The distinction between a company

and its members is not confined to the rules of privity but permeates the whole law of contract. Thus, if a director fails to disclose a breach of his duties towards his company, and in consequence a shareholder is induced to enter into a contract with the director on behalf of the company which he would not have entered into had there been disclosure, the shareholder cannot rescind the contract.

Similarly, a member of a company cannot sue in respect of torts committed against the company, nor can he be sued for torts committed by the company. Therefore, the company as a legal person can take action to enforce its legal rights or be sued for breach of its legal duties. Its rights and duties are distinct from those of its constituent members.

Disadvantages of Registered Companies

We have discussed the various features of registered companies, now let us discuss certain disadvantages of incorporated companies:

- **Formality and Expense:** Registration of a company involves a lot of statutory formalities and the consequent expense. The affairs and working of a company have to be conducted strictly in accordance with the applicable legal provisions, non-compliance of which entails penal consequence.

  Other forms of business organization are comparatively relieved from various legal compulsions and formalities**.**

- **Privacy Loss:** Another form of disadvantage of a company of loss of privacy. Various returns, resolutions and documents are to be uploaded and filed with the Registrar of Companies. The office of Registrar of Companies is a public office and accessible to public on payment of prescribed fees for inspection of any document filed by company to Registrar.

- **Diversified Control:** The members of the company cannot have as effective control over the workings of company as in sole proprietorship and partnership business models. Normally, the shareholders of the company are very in high in numbers and its acts through the representatives of he shareholders in the name of-the Directors/ KMPs.

- **Public Accountability:** The Company cannot work in contravention to public interest, because as and when the public interest will come in conflict with corporate working, intervention by regulatory authorities will be triggered.

- **Fraud Possibilities:** The company operates through control of economic resources in a few hands, there is a possibility that the other people who have contributed funds to the company either as shareholder or debenture holder or creditor or lender, those few hands may defraud by diverting funds of the company to their private channels. By the time it comes to notice of regulatory authorities the damage is already done.

TYPES OF REGISTERED COMPANIES

A company is nothing but a group of persons who have come together or who have contributed money for some common purpose and who have incorporated themselves as a separate legal entity in the form of a company for that purpose.

Under Halsbury's Laws of England, the term " Company" has been defined as a collection of many individuals united into one body under special denomination, having perpetual succession under an artificial form and vested by the policies of law with the capacity of acting in several respect as an individual, particularly for taking and granting of property, for contracting obligation and for suing and being sued, for enjoying privileges and immunities in common and exercising a variety of political rights, more or less extensive, according to the design of its institution or the powers upon it, either at the time of its creation or at any subsequent period of its existence.

In India, the two common types of companies which may be registered are:

Private Company	Public Company

A company's liability may be limited by shares, in which case the liability of the company's members is limited to the amount of the shares held by them, or it may be limited by guarantee, in which case the liability is limited to a predetermined amount to which the company's members have agreed to contribute if the company is dissolved with outstanding liabilities.

Section 3 of the Companies Act, 2013 read with the Companies (Incorporation) Rules, 2014, states that:

(1) A company may be formed for any lawful purpose by–

(a) seven or more persons, where the company to be formed is a public company;

(b) two or more persons, where the company to be formed is a private company; or

(c) one person, where the company to be formed is a One Person Company that is to say, a private limited company, by subscribing their names or his name to a memorandum and complying with the requirements of the act in respect of registration.

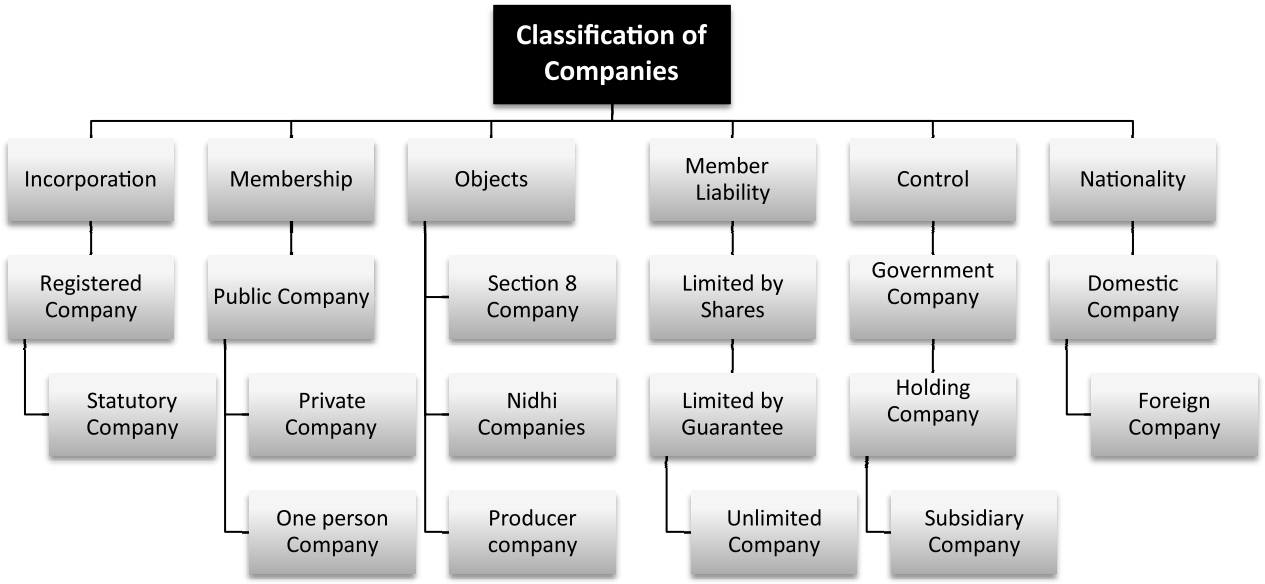
(2) A company formed under sub-section (1) may be either–

(a) a company limited by shares; or

(b) a company limited by guarantee; or

(c) an unlimited company.

CLASSIFICATION OF COMPANIES



*(**Cross Reference:** For more details on classification of companies the students are also advised to read Lesson 1 of "Setting up of Business, Industrial and Labor Laws")*

Some of the basic forms of classification of companies are mentioned as below:

(i) Classification on the basis of Incorporation: Companies may be incorporated under the following categories:

(a) Registered Companies: The companies which are incorporated under the Companies Act, 2013 or under any previous company law and registered with the Registrar of Companies, fall under this category.

(b) Statutory Companies: These are constituted by a Special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them.

For examples: Life Insurance Corporation of India.

(ii) Classification on the basis of Liability: Under this category there are three types of companies: -

(a) Companies limited by shares: A company that has the liability of its members limited by the liability clause in the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed as a company limited by shares. Section 2(22) of the Companies Act, 2013 provides that "Company limited by shares" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

For example, a shareholder who has paid Rs.75 on a share of face value Rupees 100 can be called upon to pay the balance of Rupees.25 only. Companies limited by shares are by far the most common and it may be either public or private.

(b) Companies limited by guarantee: Section 2(21) of the Companies Act, 2013 provides that a company that has the liability of its members limited to such amount as the members may respectively undertake, by the memorandum, to contribute to the assets of the company in the event of its being wound-up, is known as a company limited by guarantee. The members of a guarantee company are, in effect, placed in the position of guarantors of the company's debts up to the agreed amount. The members is liable to the company and to any other person.

(c) Unlimited Companies: In this type of company, the liability of members of the company is unlimited, Section 2(92) of the Companies Act, 2013 provides that unlimited company means a company not having any limit on the liability of its members, such companies may or may not have share capital. They may be either a public company or a private company. The members is liable to the company and to any other person.

(iii) Other Forms of Companies

(a) Section 8 Company/Non Profit Oriented Company: A company whose sole objective is to promote commerce, art, science, sports education, research, social welfare, religion, charity, protection of environment or any other useful purpose and not having any profit motive will be termed as a not for profit company. Such a company must apply its profits or other incomes in promoting its objects.

(b) Government Companies: As per section 2(45) of the Companies Act, 2013 the "Government Company" means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Explanation- For the purposes of this clause, the "paid up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued.

(c) Holding and Subsidiary Companies: As per section 2(46) of the Companies Act, 2013, the "holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies and the expression "company" includes any body corporate.

As per section 2(87) of the Companies Act, 2013 "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company –

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation. - For the purposes of this clause, –

(i) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(ii) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(iii) the expression "company" includes any body corporate;

(iv) "layer" in relation to a holding company means its subsidiary or subsidiaries.

As per section 2(11) of the Companies Act, 2013, the "body corporate" or "corporation" includes a company incorporated outside India, but does not include –

(i) a co-operative society registered under any law relating to co-operative societies; and

(ii) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf.

(d) Associate Companies/ Joint Venture Company: As per section 2(6) of the Companies Act, 2013 the "associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation. - For the purpose of this clause, –

(i) the expression "significant influence" means control of at least twenty per cent. of total voting power, or control of or participation in business decisions under an agreement;

(ii) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

(e) Dormant Companies covered under Section 455 of the Companies Act, 2013 and includes a company which is formed and registered under the Act for a future project or to hold an asset or intellectual property and which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

(f) Small Company: The MCA for the Ease of doing Business has revised the definition of Small companies by increasing their threshold limits for paid up capital from "not exceeding Rs. 2 Crore" to "not exceeding Rs. 4 Crore" and turnover from "not exceeding Rs. 20 Crore" to "not exceeding Rs. 40 Crore". Thus, the definition of small company under Section 2(85) read with Rule 2(1)(t) of the Companies (Specification of definitions Details) Rules, 2014 with effect from September 15, 2022 is hereunder: "Small company" means a company, other than a public company, —

(i) paid-up share capital of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to— (A) a holding company or a subsidiary company; (B) a company registered under Section 8; or (C) a company or body corporate governed by any special Act.

(g) Domestic Company: A domestic company is a company that conducts its affairs in its home country. It should be registered under the provisions of the Companies Act, 2013 or earlier law applicable in India. The domestic company shall have registered office in India. As per Section 2(22A) of the Income-tax Act, 1961, Domestic Company means an Indian Company, or any other Company which, in respect of its income liable to tax under this Act, has made the prescribed arrangements for the declaration and payment, within India, of the dividends (including dividends on preference shares) payable out of such income.

PRIVATE COMPANY

As per Section 2(68) of the Companies Act, 2013, "private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles:–

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that -

(a) persons who are in the employment of the company; and

(b) persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company.

The aforesaid definition of private limited company specifies the restrictions, limitations and prohibitions, which must be expressly provided in the articles of association of a private limited company.

As per proviso to Section 14 (1) of the Act, if a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, such company shall, as from the date of such alteration, cease to be a private company.

The words 'Private Limited' must be added at the end of its name by a private limited company.

As per section 3(1), a private company may be formed for any lawful purpose by two or more persons, by subscribing their names to a memorandum and complying with the requirements of this Act in respect of registration.

Section 149(1) further lays down that a private company shall have a minimum number of two directors. The only two members may also be the two directors of the private company.

Some examples of Private Limited Companies in India:

Life Style International Private Limited

Life Style International Pvt Ltd was founded in the year 1999 and is headquartered in Bengaluru, Karnataka. The company retails clothing and accessories online. It is a part of the Dubai-based retail and hospitality conglomerate Landmark Group and comprises Lifestyle stores (Large format Departmental stores), Home Centre (Home Improvement stores), and Max (Value fashion chain) along with International fashion apparel brands.

Malabar Gold Private Limited

Malabar Gold and Diamonds is a BIS-certified Indian jewelry group headquartered in Kozhikode, Kerala, India. The company operates as jewellery stores.

Characteristics of Private Limited Company

- **Limit on Members:**

  To start a company, minimum number of 2 members is required and a maximum number of 200 members as per the provisions of the Companies Act, 2013.

  The company which is incorporated as private limited company is required compulsorily restrict through its Article of Association, the number of members to two hundred, taking a joint holders as single member and also not counting the present or formal employees who are members of the company.

However, with reference to the past employees of the company, for the benefits of exemption being available to the company, such employees must have been members while they were in employment of continue as members after ceasing to be in employment of the company. Therefore, it may be interpreted that the exemption cannot be claimed by first being enrolled as the members and then inducted as employee.

Further if a director is also employed by the company in any other capacity such as works Manages, Sales Manager or as the Company Secretary, he may be treated as employee of the company notwithstanding his directorship. He will not then be counted towards the maximum numbers of members.

Can number of Debenture Holders exceed the limit of 200?

It may be noted that it is only the number of members that is limited to two hundred. Private Company may route for and issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures cannot be made.

- **Limited Liability structure:**

  The liability of each member or shareholders is limited. It means that if a company faces loss under any circumstances then its shareholders are not liable to sell their own assets for payment. Thus, the personal, individual assets of the shareholders are not at risk.

Exception to limited liability Section 3A provides that if the number of members of a private company is reduced below two, and the business is carried on for more than six months, while the number of members is so reduced, every person who is a member of the company during this period and is cognisant of this fact, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefore.

- **Perpetual succession:**

  The Company keeps on existing in the eyes of law even in the case of death, insolvency, the bankruptcy of any of its members. This leads to perpetual succession of the company. The life of the company keeps on existing forever.

- **Index of members:**

  An index of the names entered in the respective registers of members and the index shall, in respect of each folio, contain sufficient indication to enable the entries relating to that folio in the register to be readily found. The maintenance of index of members is not necessary in case the number of members of the company is less than fifty. Which is a privilege to a private company wherein number of members is less than fifty.

- **A number of directors:**

  When it comes to directors, a private company needs to have minimum two directors. With the existence of 2 directors, a private company can come into existence and can start with its operations.

- **Paid up capital:**

  There is no minimum capital requirement in case of private limited companies.

- **Prospectus:**

  Prospectus is a detailed statement of the company affairs which is issued by a company for its public. However, in the case of private limited company, the act prohibits any invitation to the public to subscribe

for any securities of the company. There is no such need to issue a prospectus because in this type of companies, public is not invited to subscribe for the shares of the company.

- **Commencement of Business:**

  A company incorporated after the commencement of the Companies (Amendment) Act, 2019 (w.e.f. 02/11/2018)and having a share capital cannot commence any business or exercise any borrowing powers unless –

  (a) A declaration is filed by a director within a period of one hundred and eighty days of the date of incorporation of the company, with the Registrar that every subscriber to the memorandum has paid the value of the shares agreed to be taken by him on the date of making of such declaration; and

  (b) The company has filed with the Registrar a verification of its registered office.

- **Name:**

  It is mandatory for all the private companies to use the word "private limited" after its name.

Privileges and Exemptions of Private Company

The Companies Act, 2013, confers certain privileges on private companies which are not subsidiaries of public companies. Such companies are also exempted from complying with quite a few provisions of the Act. The basic rationale behind this is that since private limited companies are restrained from inviting capital and deposits from the public, not much public interest is involved in their affairs as compared to public limited companies. Private limited companies lose the privileges and exemptions the moment they cease to be private companies.

- **Easy to Form:** Under the Companies Act, 2013, a private limited company is relatively easier to form than a public limited company. A mere two persons can form a private company as opposed to the requirement of seven or more persons for a Public limited company. There is no requirement of minimum paid up share capital even for a private limited company.
- **Provisions for Alteration of Articles of the Company:** Articles of Association of Private Limited Company may contain provisions for Entrenchment to the effect that specified provisions may be altered only if conditions or procedures as that are more restrictive than those applicable in case of special resolution are met or complies with.

  Entrenchment clause in Article of a private company leads to give additional legal safeguard by placing the clause in a very strong position, that cannot be changed easily or addition of provision which makes certain amendments either more difficult or cumbersome by way of procedure, checks and safeguards. All the members of the Private Company is required to agree to the Entrenchment clause in the Articles.
- **Lesser Compliance for Issue of Shares:** A Private Company, while issuing further capital, is not required to make a prospectus or submit a statement in lieu of this prospectus to the Registrar of companies. A prospectus and Registrar's permission is requisite for a public company which can make public offers to larger number of potential investors. Since a private company does not have the capability of making a public offer, it is exempted from this requirement.

  Rule 9A of Companies (Prospectus and Allotment of Securities) Rules, 2014 pertaining to Dematerialization of Shares requires every unlisted public company to Issue the securities only in dematerialized form; and to facilitate dematerialization of all its existing securities. However, such compliance is not required for Private Company.

- **Closure of Register of Members or Debenture Holders or Other Security Holders:** Section 91 read with Rule 10 of the Companies (Management and Administration) Rules, 2014, provides that a company closing the register of members or the register of debenture holders shall give at least seven days previous notice and in such manner, as may be specified by Securities and Exchange Board of India, if such company is a listed company or intends to get its securities listed, by advertisement at least once in 2 newspapers, once in a vernacular newspaper in the principal vernacular language of the district and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company.

  This requirement is not applicable to a private company provided that the notice has been served on all members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders.

- **Lesser Compliances related to Directors of Private Companies:** A Private Company has the privilege of having as less as two directors as opposed to the requirement of three directors for a Public Company. Further, at every annual general meeting of a public company, one-third of such of the directors for the time being as are liable to retire by rotation. However, directors of Private Companies are not liable to retire by rotation.

- **Appointment of Woman Director:** Second proviso to section 149(1) provides that every listed company and every other public company having (a) paid–up share capital of one hundred crore rupees or more; or (b) turnover of three hundred crore rupees or more are mandated to have at least one woman director. Private Companies are exempted from appointing such women director.

- **Appointment of Independent Director:** Section 149(4) provides that every listed public company shall have at least one-third of the total number of directors as independent directors; and The Central Government has prescribed the Public Companies having paid up share capital of ten crore rupees or more; or turnover of one hundred crore rupees or more; or, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees to have at least two directors as independent directors in the Board of Directors of the Company. However, Private Companies are exempted from appointing such Independent Directors.

- **Disqualifications for Appointment of Director:** A private company may by its AOA provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2) of Section 164.

- **Vacation of office of Director:** Private companies may by its AOA, provide any other ground for the vacation of the office of a director in addition to those specified in Section 167.

- **Key Managerial Personnel:** Appointment of Managing Director, Chief Executive Officer (CEO), Manager, Wholetime Director, Chief Finance Officer (CFO) as per Section 203 is not applicable. However, all Private Companies having a paid up share capital of Rs. 10 crores or more is required to appoint a Whole Time Company Secretary.

- **Overall Maximum Managerial Remuneration:** The total managerial remuneration payable by a public company, to its directors, in respect of any financial year shall not exceed eleven percent of the net profits. However, such restriction is not applicable on Private Company and is allowed to pay the justifiable managerial resolution as per the Articles of Association and authorized resolutions.

- **Report on Annual General Meeting:** Section 121 provides that Private companies are not required to file report on annual general meeting through E Form MGT-15 unlike Listed Companies.

- **Audit Committee and Nomination and Remuneration Committee:** Section 177 and 178 provides that every listed public company or Public Companies having paid up share capital of ten crore rupees or more; or turnover of one hundred crore rupees or more; or have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees is required to constitute an Audit Committee and Nomination and Remuneration Committee. However, Private Companies are exempted from constituting such committees.
- **Vigil Mechanism:** Vigil mechanism is applicable to a Private Company only if it has borrowed money from banks and public financial institutions in excess of fifty crore rupees.
- **Internal Audit:** Section 138 provides that only private companies having: turnover of two hundred crore rupees or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year shall be required to appoint an internal auditor.
- **Corporate Social Responsibility Committee:** Section 135 read with CSR Rules provides that a private company having only two directors on its Board is required to constitute its CSR Committee with two such directors only.

The Private Companies are economy boosters therefore, the Ministry of Corporate Affairs time to time considers the relaxation to the provisions applicable to private companies, wherever the situation requires, in order to provide hassle free compliance access to the promoters and professionals.

PUBLIC COMPANY

By virtue of Section 2(71), a public company means a company which:

(a) is not a private company;

(b) has a minimum paid-up share capital, as may be prescribed;

(c) subsidiary of a public company shall be deemed to be public company.

As per section 3(1)(a), a public company may be said to be an association consisting of not less than 7 members, which is registered under the Act. In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The securities of a public company may be quoted on a Stock Exchange. The number of members is not limited to two hundred.

The concept of free transferability of shares in public and private companies is very succinctly discussed in the case of *Western Maharashtra Development Corpn. Ltd. v. Bajaj Auto Ltd. [2010] 154 Com Cases 593 (Bom).* It was held that the Companies Act, makes a clear distinction in regard to the transferability of shares relating to private and public companies.

By definition, a "private company" is a company which restricts the right to transfer its shares. In the case of a public company, the Act provides that the shares or debentures and any interest therein, of a company, shall be freely transferable.

The provision contained in the law for the free transferability of shares in a public company is founded on the principle that members of the public must have the freedom to purchase and, every shareholder should have the freedom to transfer. The incorporation of a company in the public, as distinguished from the private, realm leads to specific consequences and the imposition of obligations envisaged in law. Those who promote and manage public companies assume those obligations. Corresponding to those obligations there are some rights, which the law recognizes as inherent in the members of the public who subscribe to shares of the company.

Some examples of Public Limited Companies In India:

- Bharat Heavy Electricals Ltd. (BHEL)
- Bharat Petroleum Corporation Ltd. (BPCL)
- Coal India Ltd.
- Steel Authority of India Ltd.
- Oil and Natural gas Corporation Ltd. (ONGC)

CHARACTERISTICS OF PUBLIC COMPANY

- **Board of Directors:** The Board of the Public company comprises of a minimum number of three directors and a maximum of 15. The company may appoint more than 15 directors after passing a special resolution. They act as the representatives of the shareholders in the management of the company. Public limited companies are headed by a board of directors and Key Managerial Personnel of the Company. Composition of the board of directors is set out in the company's articles of association and the applicable rules and regulations.
- **Limited Liability:** Shareholder liability for the losses of the company is limited to their share contribution only. This is what makes it a separate legal entity from its shareholders. The business can be sued on its own and not involve its shareholders. The company does not belong to any person since one person can own only a part of it.

  Exception to limited liability

  Section 3A provides that if the number of members of a public company is reduced below seven and the business is carried on for more than six months, while the number of members is so reduced, every person who is a member of the company during this period and is cognizant of this fact, shall be severally liable for the payment of the whole debts of the company contracted during that time, and may be severally sued therefore.

- **Number of Members:** A public limited company have a minimum number of seven shareholders or members and no maximum limit of members. It can have as many shareholders as its share capital can accommodate.
- **Transferable shares:** Shares of a public limited company are bought and sold by the shareholders, however, in case of listed company the shares are traded on a stock exchange where the shares of the company are listed. They are freely transferable between its members and people trading in the stock exchange.
- **Life Span:** A public limited company is not affected by death of one of its shareholders, but the shares are transferred to the next kin or legal heir of such deceased shareholder and the company continues to run its business as usual. In the case of a director's death, the Board is empowered to fill the resulting casual vacancy that may be filled by Board of Directors at Board meeting which shall be subsequently approved by members in the immediate next general meeting.
- **Financial Privacy:** Public limited companies are strictly regulated and are required by law to publish their complete financial statements annually. This ensures that they reveal their true financial position to their owners and to potential investors so that they can determine the true worth of its shares.

- **Capital:** Public limited companies enjoy an increased ability to raise capital since they can issue shares to the public through the stock market. They can also raise additional capital by issuing debentures and bonds through the same market from the public. Debentures and bonds are in the form of secured or unsecured debts issued to a company on the strength of its integrity and financial performance by the general public or its members etc.

Distinction between Private and Public Company

Following are the main points of distinction between a private company and a public company:

1. **Minimum Number of Members:**

   In case of a private company, the minimum number of persons to form a company are two, while it is seven in the case of public company. (Section 3)

2. **Maximum number of Members:**

   In case of private company the maximum number must not cross the limit of two hundred whereas there is no such restriction n the maximum number of members in the case of a public company.

3. **Transferability of Shares:**

   As per section 44 of the Companies, Act, 2013, the shares of any members in a company shall be movable property and transferable in the manner provided by the Article of Association of the company. In a private company, by its very definition, Article of Association of a private company have to contain restrictions on transferability of shares.

4. **Prospectus:**

   A private company cannot issue a prospectus, while a public company may, through prospectus; invite the general public to subscribe for its securities.{Section 2(68)}

5. **Minimum numbers of Directors:**

   A private company must have a least two directors on Board, whereas a public company must have at least three director on Board.(Section 149)

6. **Retirement of Directors:**

   Directors of a private company are not required to retire by rotation, but in case of a public company at least 2/3rd of the directors must be such whose period of office is subject to retirement by rotation. (Section 152)

7. **Quorum for General Meetings:**

   Unless the Articles of Association of the company provide for a larger number, in case of public company the quorum for general meeting shall be:

   i. five members personally present if the number of members as on the date of meeting is not more than one thousand;

   ii. fifteen members personally present if the number of members as on the date of meeting is more than one thousand but up to five thousand;

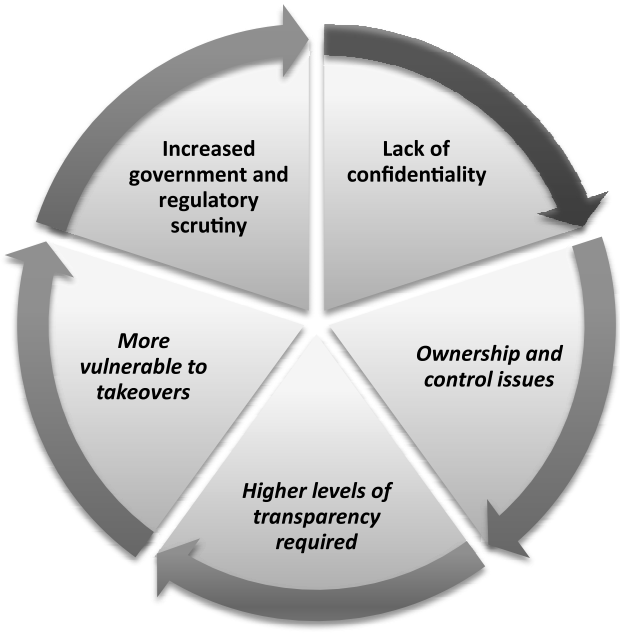
   iii. thirty members personally present if the number of members as on the date of the meeting exceeds five thousand.

   In case of a private company, unless Articles of Association provide for a higher number, two members personally present, hall be quorum for a meeting of the company.

ADVANTAGES OF A PUBLIC COMPANY

- Raising capital through public issue of shares
- Prestigious profile and confidence
- Growth and expansion opportunities
- Widening the shareholder base and spreading risk
- Transferability of shares

DISADVANTAGES OF PUBLIC COMPANIES



SMALL COMPANY

Meaning and Explanation under Companies Act, 2013

For the first time in India, the concept of Small Company was introduced in the Companies Act, 2013. This is a new step towards the de-regulation of entities through providing some exemptions, privileges and liberation with lesser compliances burden on the entities which are smaller in size and operations.

Ministry of Corporate Affairs (MCA), time to time amending the definition of Small Company to provide many advantages to Corporates. This move of MCA is expected to lighten the compliance burden of small companies in India. The move is motivated to get more companies under the 'small' category and benefit them in terms of the compliance requirements. As due to this move, many Companies will get exemptions of so many compliances of Companies Act, 2013. This move would benefit Start-ups in India. Therefore, we can state that the decision to amend the definition of small company is a pragmatic and growth-oriented step of the government.

New Definition of a Small Company

The MCA for the Ease of doing Business has revised the definition of Small companies by increasing their threshold limits for paid up capital from "not exceeding Rs. 2 Crore" to "not exceeding Rs. 4 Crore" and turnover from "not exceeding Rs. 20 Crore" to "not exceeding Rs. 40 Crore".

Thus, the definition of small company under Section 2(85) read with Rule 2(1)(t) of the Companies (Specification of definitions Details) Rules, 2014 with effect from September 15, 2022 is hereunder:

"Small company" means a company, other than a public company, —

(i) paid-up share capital of which does not exceed four crores rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees.

Provided that nothing in this clause shall apply to—

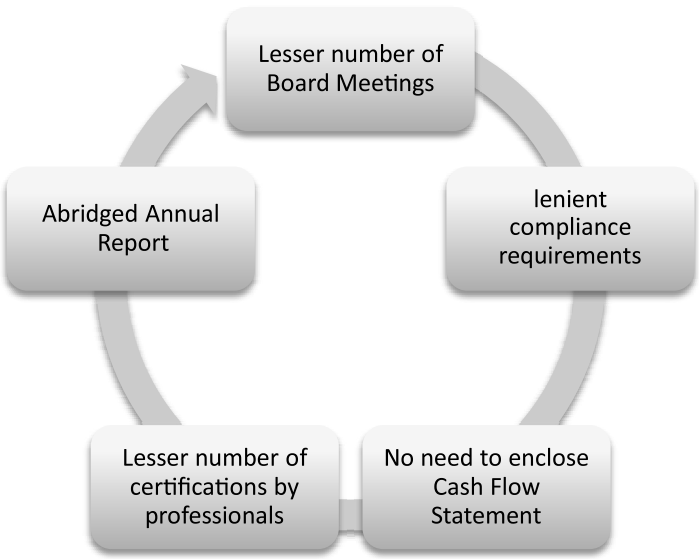
(A) a holding company or a subsidiary company;

(B) a company registered under Section 8; or

(C) a company or body corporate governed by any special Act.

Advantages of a Small Company

A private limited company that can be classified as a small company enjoys a number of benefits under the Companies Act, 2013 and lesser compliance formalities. Some of the advantages enjoyed are:



1. **Filing of annual return:** The annual return of a private limited company classified as a small company, can be signed by a Company Secretary, or where there is no company secretary, by a Director of that company.

2. **Board's Report:** As per Section 134(3A) of the Companies Act, 2013, the Central Government has prescribed an abridged form of Board's report for a small company. Rule 8A of the Companies (Accounts) Rules, 2014 has been notified for small companies which includes the following disclosures:

   (a) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;

   (b) number of meetings of the Board;

   (c) Directors' Responsibility Statement as referred to in sub-section (5) of section 134;

   (d) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;

   (e) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report;

   (f) the state of the company's affairs;

   (g) the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the Form AOC-2;

   (h) the financial summary or highlights;

   (i) material changes from the date of closure of the financial year in the nature of business and their effect on the financial position of the company;

   (j) the details of directors who were appointed or have resigned during the year;

   (k) the details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future.

   As per Notification Dated 13th June, 2017, in case of small company Section 143(3)(i) shall not apply which says that the Auditor's Report shall state whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

3. **Board Meeting:** It is sufficient for a small company to conduct only two Board Meetings in a calendar year, one in every half calendar year with a gap of not less than 90 days between these two meetings.

4. **Cash Flow Statement:** A private limited company classified as a small company need not prepare cash flow statement as a part of the financial statements.

5. **Rotation of Auditors:**

   (a) Private limited company classified as a small company are not required to rotate their statutory Auditors.

   (b) Private limited company not classified as a small company must rotate their Auditors every 5 or 10 years as per the provisions of the Act, if these companies falls within the prescribed category such as their paid up share capital is more than Rs.50 Crores more or these are having public borrowings from financial institutions, banks or public deposits of Rs. 50 Crores or more.

Further, as per the definition of a small company, holding and subsidiary companies are specifically excluded from the concept of small company.

Thus, even though both the holding company and subsidiary company may fulfil the capital or turnover requirement of a small company, they will still fall outside the purview of small company and accordingly, the benefits which are available to a small company cannot be applied to a company which is holding or subsidiary company.

In other words, a holding or a subsidiary company can never enjoy the privileges of a small company even though they may fulfil the capital or turnover requirement of a small company.

Similarly, a company may be classified as a small company in a particular year but may become ineligible in the next year and may become eligible again in the subsequent year.

The privileges/exemptions available to a small company are same as that available to a one person company, but not all privileges available to a one person company are available to a small company.

So also, a company registered under Section 8 of the Companies Act, 2013 is also specifically excluded from the definition of small company. Hence, any company registered under Section 8 of the Companies Act, 2013 would not be small company though it may be a private company.

Further, Section 233 of the Companies Act, 2013 was notified with effect from December 15, 2016 and the Companies (Compromises, Arrangements and Amalgamations) Rules came into effect from the said date. Section 233 deals with fast track mergers. Two or more small companies are permitted to undertake fast track merger under section 233 of the Act. Such merger would require approval of Registrar of Companies having jurisdiction over the company, the Official liquidator, members holding at least 90% of total number of shares and majority of creditors representing 9/10th in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose, or otherwise approved in writing.

Rule 25 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, has allowed scheme of merger or amalgamation under section 233 of the Companies Act, 2013 (fast track mergers through relatively simpler procedure) between any of the following class of companies, namely:-

(i) two or more start-up companies; or

(ii) one or more start-up company with one or more small company.

6. **Reduced Penalties for non-compliance:** If penalty is payable for non-compliance of any of the provisions of this Act by a small company or by any of its officer in default, or any other person in respect of such company, then such company, its officer in default or any other person, as the case may be, shall be liable to a penalty which shall not be more than one-half of the penalty specified in such provisions subject to a maximum of two lakh rupees in case of a company and one lakh rupees in case of an officer who is in default or any other person, as the case may be. This provision has overriding effect on any other contradictory provisions of the Act.

7. **E-forms Certifications:** As per the provisions of the Act, there is no necessity of certification of the eforms of a Small Company from Professional (CA/CS/CMA).

Examples of Small Company:

1. **Local Auto Repairs companies**
2. **Food Services in form of small eateries**

HOLDING COMPANY OR PARENT COMPANY

As per the Company law, a company controlled by another company is called a subsidiary company and the controlling company is called a holding company. Thus "control" is used as the benchmark in Company Law to determine holding company's status. The control can be through control of management or through ownership of shares.

Holding Company

Key Features:

Maintains control

Capital raising flexibility

Business diversity

Division of tax burden

By definition, a holding company is a company organized with the intention of acquiring equity ownership in other companies. Holding companies are popular in India, mainly in two forms –

(1) Corporate groups running multiple and varied businesses; and

(2) Private equity funds looking to create platforms to consolidate multiple assets within specific sectors or verticals, in which there are not the companies of the required size and scale.

This structure lends several advantages to either the corporate group or the investor.

Firstly, a holding company can gain control over its subsidiaries without investing the entire equity requirement.

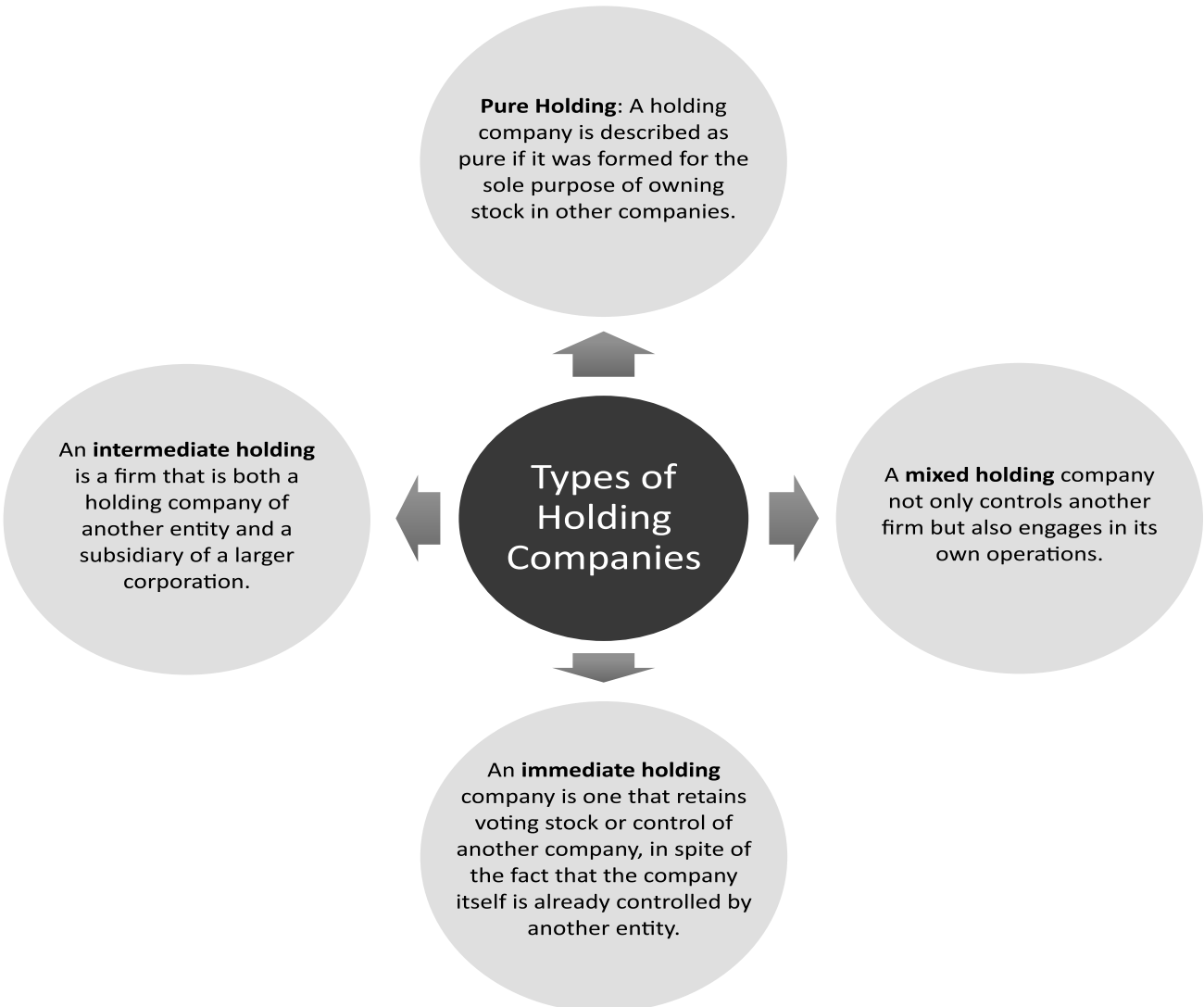
Examples of a Holding Company:

- Alphabet Inc.
- Sony Corporation
- JP Morgan Chase & Co.
- Johnson & Johnson

An example of a well-known holding company is Berkshire Hathaway, which owns assets in various public and private companies, including Dairy Queen, Clayton Homes, Duracell, GEICO, Fruit of the Loom, RC Wiley Home Furnishings and Marmon Group.

Thus, a holding company allows for structural leverage due to its ability to control the business of its subsidiaries by holding majority (just over 50% shareholding), but at the same time allowing for fresh external investment for the balance stake.

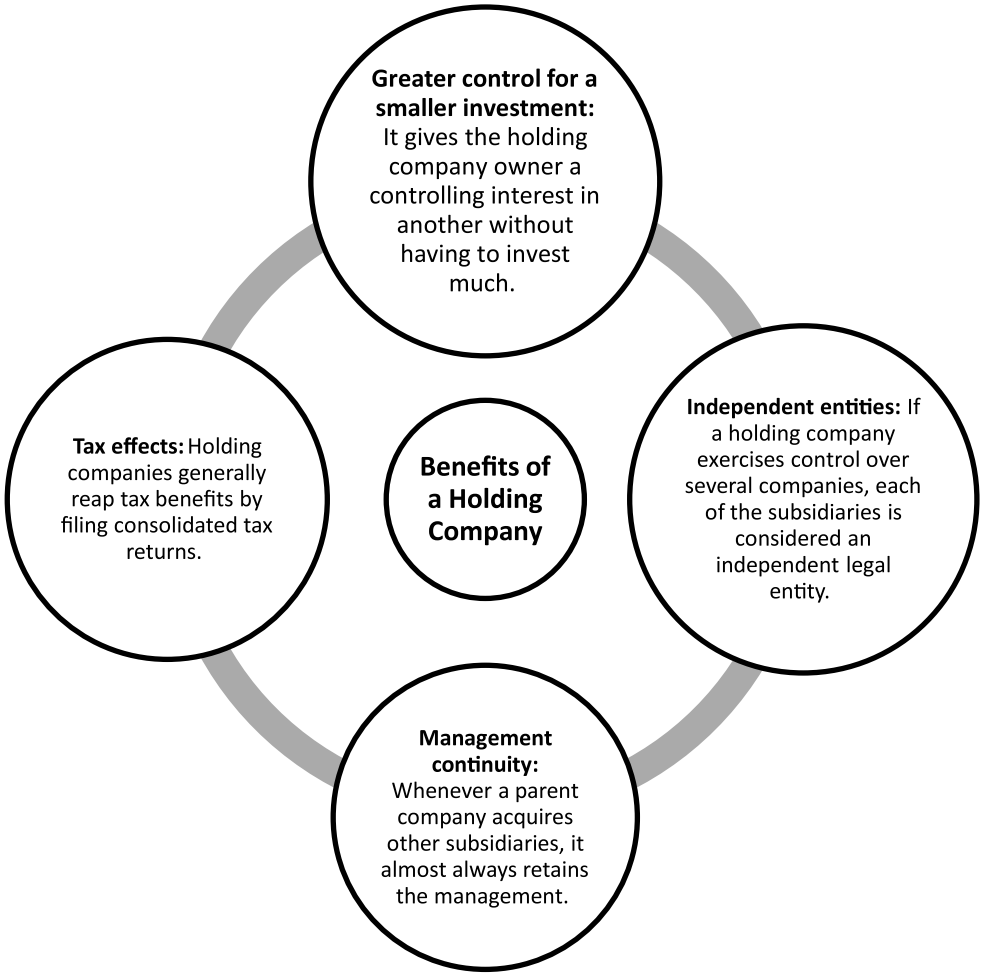
Secondly, it can assist in raising capital based on the consolidated financial strength of its subsidiaries, which otherwise could be difficult for each individual subsidiary company. Flexibility to reorganize and structure finances is also available for individual businesses. Another key advantage of a holding company structure is that while it allows investment in multiple businesses under one parent company, it also ring-fences each business from the risks of the other, by preventing the business performance of one business from affecting the performance and valuation of another. For investors, this offers the option to gain an exposure to any preferred business along with the flexibility to structure the investment (as debt, equity etc.) to meet their investment objectives.



Clause (46) of section 2 of the Companies Act, 2013 states as under:

A "holding company" in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Explanation: For the purpose of this clause, the expression "Company" includes anybody corporate.



Provisions in the Companies Act, 2013 relating to holding company: The summarized provisions relating to financial statements as contained in Section 129 and the Companies (Accounts) Rules, 2014 are given below:

Financial Statements of Holding Company:

The Consolidated Financial Statement of holding company is required to disclose prescribed details about subsidiary companies, associate companies and joint ventures.

If Holding Company has more than one subsidiary:

If a Company has one or more subsidiaries, associate companies and joint ventures, it shall, prepare a consolidated financial statement of the company and of all the subsidiaries, associate companies and joint venture in the same form and manner as that of its own.

Separate financial statement of Holding Company:

This Statement is in addition to the separate financial statement of the holding company. The consolidated financial statement shall also be placed before the annual general meeting of the holding company along with the laying of its own financial statement.

Disclosure in balance Sheet of Holding Company:

Balance sheet of holding company shall specifically disclose investments in the subsidiaries.

Disclosure in Profit and Loss account of Holding Company:

Profit and Loss account of Holding company shall disclose:

(a) Dividends from subsidiary Companies

(b) Provisions for losses of subsidiary Companies

Every Company having a subsidiary or subsidiaries has to submit consolidated financial statements in addition to its own 'financial statements' to Registrar of Companies within 30 days from the date of Annual General Meeting along with the prescribed fees. {Sub section (1) of section 137}.

In case the company has a website:

The Company is required to place separate audited accounts in respect of each of its subsidiary on its website, if any, and provide a copy of separate audited financial statements in respect of each of its subsidiary, to any shareholder of the Company, who asks for it [4th proviso to sub section (1) of section 136].

DISADVANTAGES OF HOLDING COMPANIES:

- **Over capitalization:** Since capital of holding company and its subsidiaries companies may be pooled together, it may result in over capitalization. Shareholders would get not get a fair return on their invested capital.
- **Exploitation of subsidiaries:** The subsidiaries companies might face challenging situation where they are compelled to buy goods from the holding at high prices and vice versa.
- **Manipulation:** Information about subsidiaries may be used for personal gains. For example information of the financial performance of subsidiary companies may be misused to indulge in speculative activities.
- **Concentration of economic power**: There is concentration of economic power in the hands of those who manage the holding company.
- **Monopoly:** Holding companies, by absorbing more and more subsidiaries companies, may also create conglomerates and a monopolistic market if they may own multiple companies in the same industry.

SUBSIDIARY COMPANY

As per Section 2(87), a "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company –

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Explanation*: – For the purposes of this clause –*

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries.

Illustration:

Where the composition of the Board of Directors of a company (including body corporate), say S Ltd., is controlled by another company (holding company), say H Ltd., either directly (on its own) or together with its one or more subsidiaries, then such company (or body corporate) [S Ltd.] is said to be subsidiary of the other company, H Ltd. Such control can also be through any subsidiary of the holding company, H Ltd. The composition of a company's Board of Directors shall be deemed to be controlled by another company, even if the same is not actually so controlled, if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors .

The term 'control' is defined under section 2(27) as under:

'Control' shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

Illustration:

Where more than one-half of the total voting power of a company (including body corporate), Z Ltd., is controlled by another company (holding company), Y Ltd., either directly (on its own) or together with its one or more subsidiaries, then such company (or body corporate), Z Ltd., is said to be subsidiary of the other company, Y Ltd. Such control can be through any one or more subsidiary / subsidiaries of the holding company.

CASE LAW

In Re *Oriental Industrial Investments Corporation Ltd vs. Union of India (1981) 51 Comp. Cas 487 Delhi*

Control over the composition of a subsidiary company's Board of Directors can arise from provisions in subsidiary's memorandum or articles or from a contract with subsidiary empowering holding company to appoint directors to subsidiary's Board.

Further, the proviso to section provided as under:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed. The said proviso got notified with effect from 20th September, 2017 by issue of the Companies (Restriction on Number of Layers) Rules, 2017. Under Rule 2 of the said Rules, no company, other than a company belonging to a class specified in sub-rule (2) of the said Rules shall have more than two layers of subsidiaries.

The following classes of companies are exempt from restriction on number of layers:

- A banking company;

- A non-banking financial company which is registered with the Reserve Bank of India and considered as systematically important non-banking financial company by the Reserve Bank of India;
- An insurance company being a company which carries on the business of insurance; and
- A Government company.

The first proviso to Rule 2 of the Companies (Restriction on Number of Layers) Rules, 2017 provides exemption to a Company from acquiring a company incorporated in a country outside India with subsidiaries beyond two layers as per the laws of such country.

The obvious intent of this carve-out is that Indian law cannot extend its sweep beyond the territorial jurisdiction, and when it comes to propagation of subsidiaries in offshore jurisdictions, India will have to rely on the regulations in the relevant country. In case of off-shore subsidiaries, it is quite a commonplace practice to have multiple layers of subsidiaries based on the need of specific countries to have a business incorporated in the country of jurisdiction, while at the same time, to direct the FDI into that country from a location of choice.

What Is a Wholly Owned Subsidiary Company?

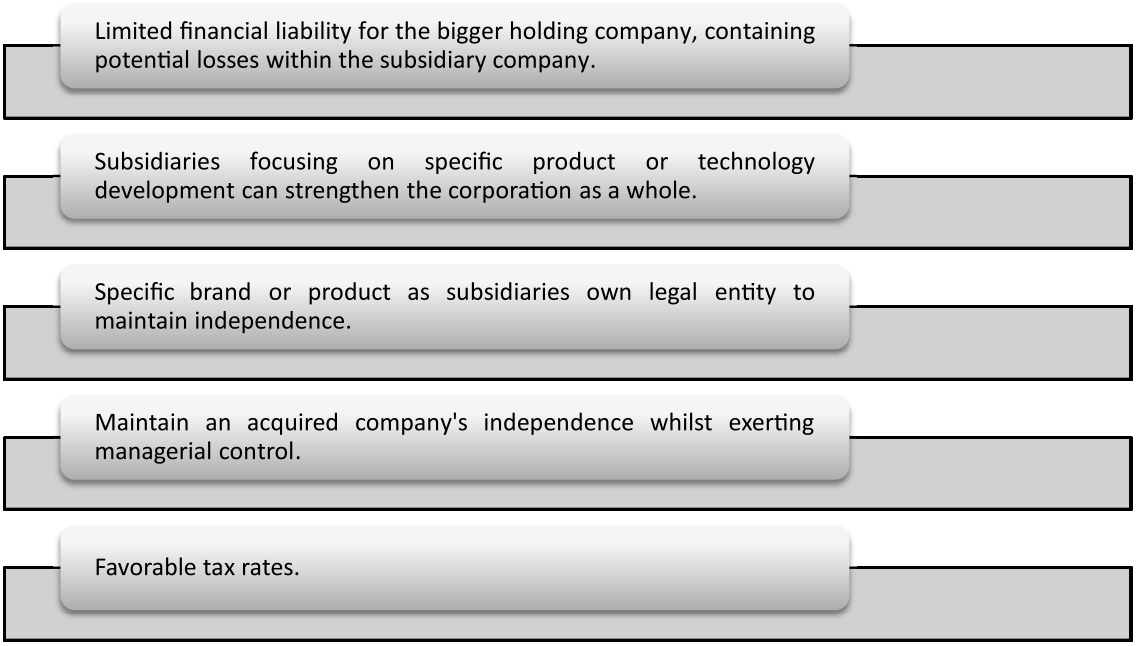
A wholly owned subsidiary company is a company that is incorporated under the provisions of the Companies Act, 2013 and in which holds hundred percent share capital of such company. In other words, a wholly owned subsidiary company can be defined as an entity whose entire share capital is held by another Indian or foreign company.

Example:

Starbucks company Japan is a wholly-owned subsidiary of the Starbucks group.

Reliance Industrial Investment and Holdings Limited (RIIHL), is a wholly owned susbidiary of the Reliance Group of Company.

BENEFITS OF A SUBSIDIARY COMPANY INCLUDE:



The cap on layers of subsidiaries useful to keep a check on usage of multiple layers of holding-subsidiary structures for siphoning off /routing of funds and will enable regulators/ authorities to identify the ultimate beneficiaries of complex corporate structures.

ASSOCIATE COMPANY

Under section 2(6) of the Companies Act, 2013, "associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Below is the explanation for the purpose of this clause –

(a) the expression "significant influence" means control of at least twenty per cent of total voting power, or control of or participation in business decisions under an agreement;

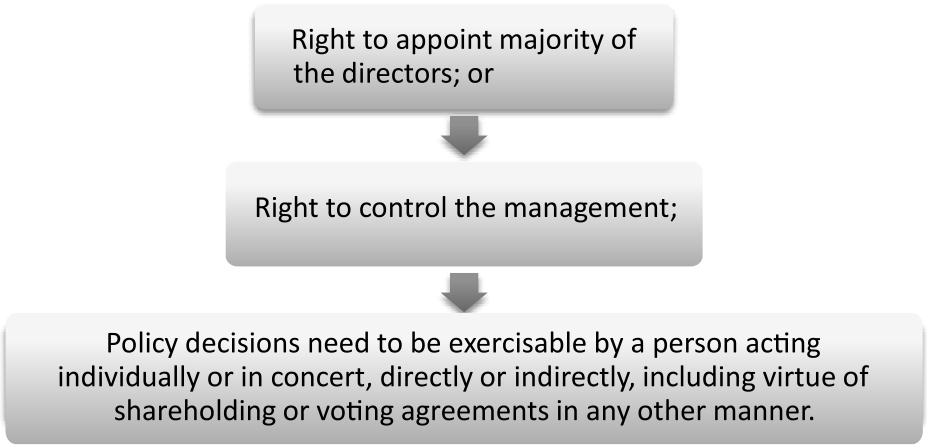
(b) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

For the purpose of "significant Influence", the following conditions need to be fulfilled:

(i) Control of at least 20% of total voting power but less than 50% of Share Capital by another company.

(ii) Control of business decisions under an agreement.

Section 2(27) of Companies Act, 2013 defines 'control'. It includes –



The second condition, namely, "control of business decisions under an agreement" has been the subject of controversy and debate. It may be noted that if this condition is satisfied, then a company will be an associate company, even if there is no control of even 20% of total voting power. The clause is applicable even when the control of business decision is under an oral agreement or a written agreement.

Additional compliances/restrictions under the Companies Act:

If a company has an Associate Company- section 2(76)

It will be considered as Related Party. Section 188 (Related Party Transaction) as per the Companies Act, 2013 will be applicable where the transactions prescribed in section 188(1) of the Companies Act, 2013 are being entered by the company with its Associate Company.

Section 129

Consolidated Financial Statements shall also include financial statements of Associate Company.

Section 149(6)

Following persons cannot be appointed as independent director in a company if they are:

1. A promoter or related to promoters or Director of an Associate Company.
2. Has/had or any of his relatives has or had pecuniary relationship with Associate Company.
3. Holding or any of their relative(s) held the position of key managerial personnel or has been employee of an Associate Company.

Section 192

If directors of an Associate Company want to do any Non-Cash transactions with the company, then they need to pass Ordinary resolution. This section provides for the manner in respect of regulation of arrangements with respect to acquisition of assets for consideration other than cash. Such arrangements shall require prior approval by a resolution in general meeting and if the director or connected person is a director of its holding company, approval is required to be obtained by passing a resolution in general meeting of the holding company.

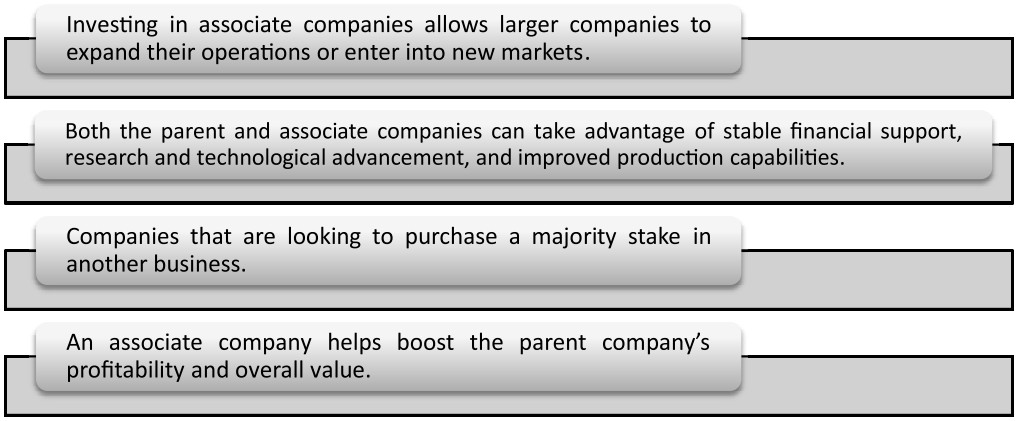
Illustration:

There is a company ABC Limited and below are the list of shareholders:

List of shareholders:

S. No.	*Name of Shareholder*	*% of shares Held*
1	Y Limited	21
2	Z Limited	18
3	X Limited	17
Y limited is the associate company of ABC Limited, because it is holding 21% shares of ABC Limited.		

Advantages of Associate Company:



Difference between Associate and Subsidiary Company

Associate Company	*Subsidiary Company*
The parent company holds a minimum of 20% but less than 50% of the total voting power.	Parent company holds more than 50% of the total voting power.
The parent company has significant influence, that is, the power to participate in the financial and operating decisions of the Associate company.	The Parent company has controlling power over the financial and operating decisions of the subsidiary company.
There may be presence of certain number of common promoters/directors.	The parent company controls the management of the subsidiary company.

DORMANT COMPANY/ INACTIVE COMPANY

The definition of an Inactive Company can be found in the explanation to Section 455(1) of the Companies Act, 2013. It reads as under:

(i) "inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.

Why Obtain Dormant Status?

The section provides that where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

Thus, the words "dormant company" and "inactive company" are synonymous. However, a company has to obtain a status as "dormant company" and hence, such companies are not incorporated as such.

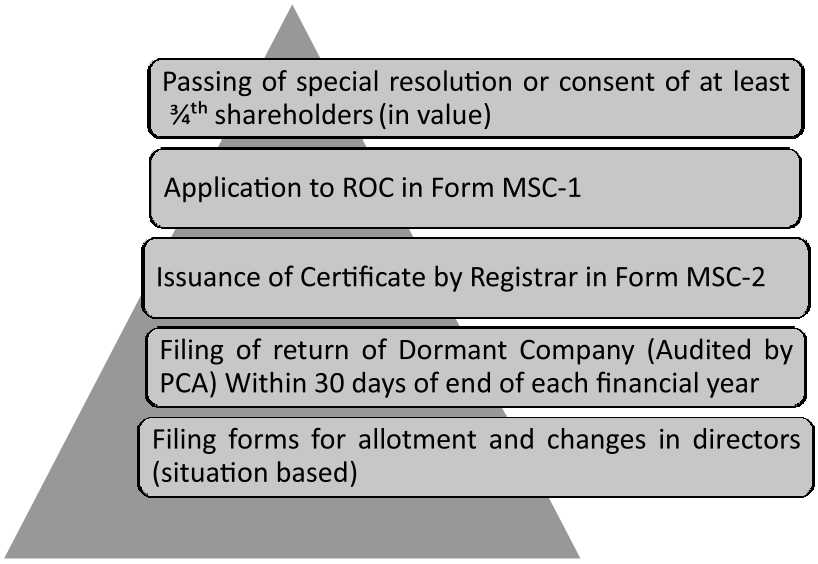
Procedural aspects relating to dormant company / inactive company:

To obtain the status of dormant company, an application is to be filed in Form MSC-1 with the Registrar. After considering the same, the Registrar shall issue a certificate in Form MSC-2 allowing the status of a Dormant Company.

A company shall be eligible to apply for dormant status only after following the conditions mentioned under Rule 3 of the Companies (Miscellaneous) Rules, 2014.

As per Rule 7 of the Companies (Miscellaneous) Rules, 2014, a dormant company shall file a "Return of Dormant Company" annually indicating financial position duly audited by a chartered accountant in practice in Form MSC-3 within 30 days from the end of each financial year. The company shall continue to file returns of allotment and change in directors within the time specified in the Act, whenever the company allots any security to any person or there is any change in the directors of the company.

Compliance Process for Dormant Company:



GOVERNMENT COMPANY

Section 2(45) of the Companies Act, 2013 contains the definition of Government Company. According to the said sub section, "Government company" means any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

This is explained for the purposes of this clause, that the "paid up share capital" shall be construed as "total voting power", where shares with differential voting rights have been issued.

Government Companies are subject to all provisions of the Act unless specified otherwise (i.e., by way of exemptions granted by the Central Government). A Government Company may be formed as a Private Limited Company or Public Limited Company.

Government Companies enjoyed many exemptions and reliefs under the Companies Act, 1956. The introduction of Companies Act, 2013 proved a challenge to them. Many of the provisions of the Companies Act, 2013 were posing difficulty in their practical application, like those relating to appointment of independent directors, seeking deposit from directors seeking appointment at general meetings etc.

The Ministry of Corporate Affairs notified total/partial exemptions to Government companies from compliance with certain sections of the Companies Act, 2013 vide notification No. G.S.R. 463(E) dated 5th June, 2015.

Summary of the exemptions is given below:

Name:

The name of all Government Companies shall end with the word "Limited", be it Public or a Private Company. The word "STATE" is allowed in name.

Transfer of Shares:

Provisions of Sub Section 1 of Section 56 (Transfer of Shares) are not applicable on Government Company in respect of Securities held by nominees of the Government. The requirement of execution of an instrument of transfer (SH-4) and delivering the same to the company has also been done away with in case of transfer of securities held between nominees of the Government.

Transfer of Bonds:

As per Second proviso of Section 56(1), in case of transfer of Bonds issued by a Government Company, Instrument of transfer is not required to be executed and delivered to the Company provided an intimation regarding the transfer supported by the details of the transferee and the relevant bond certificate and in case where it is not in existence then the letter of allotment is delivered to the Company.

Declaration in respect of beneficial interest in any share and investigation of beneficial ownership of shares in some cases (sections 89 and 90).

Both the sections are not applicable to Government Companies.

Declaration of dividends out of accumulated profits of previous year:

The second proviso to sub-section (1) of section 123 do not apply to the company in which the entire paid up share capital is held by the Central Government, or by any Stale Government or Governments or by the Central Government and one or more State Governments.

Deposit of dividend in a scheduled bank within five days from the date of declaration:

Sub-section (4) of section 123 shall not apply to the company in which the entire paid up share capital is held by the Central Government, or by any Stale Government or Governments or by the Central Government and one or more State Governments or by one or more Government Company.

Exemption from Accounting Standard 17 relating to Segment Reporting:

Section 129 shall not apply to the extent of application of Accounting Standard 17 (Segment Reporting) to the companies engaged in defence production.

Exemption from certain disclosure requirements in Board's Report:

Board's Report of Government Company need not include the disclosure requirement contained in section 134(3)(e) of the Act and Section 134(3)(p) of the Act where the directors are evaluated by Ministry of or Department of Central Government which is administratively in charge of the company or as the case may be the State Government as per its own evaluation methodology.

The requirement of disclosing the Company's nomination and remuneration policy etc in the Board's Report has been relaxed for Government Company.

Appointment of more than 15 Directors:

As per the exemption in respect of Section 149(1) (b) and first proviso to Section 149(1), a Government Company can have more than 15 directors. Such a company is now no longer required to pass a special resolution for appointing more than 15 directors.

Place of Annual General Meeting:

Every Annual General Meeting shall be called during business hours, on any day that is not a National Holiday and shall be held either at the registered office of the Company or at some other place as the Central Government may approve in this behalf.

Independent Director

With respect to provision in section 149(6)(a) of the Act, the "Board" will be substituted by "Department of Central Government which is administratively in charge of the company or as the case may be the State Government" and Section 149(6)(c) will not apply to Government Company.

The provisions of sub-paragraph (2) and (7) of paragraph II, paragraph IV, paragraph V, clauses (a) and (b) of subparagraph (3) of paragraph VII and paragraph VIII of Schedule IV of Companies Act, 2013 shall not apply in the case of a Government company as defined under clause (45) of section 2 of the Companies Act, 2013, if the requirements in respect of matters specified in these paragraphs are specified by the concerned Ministries or Departments of the Central Government or as the case may be, the State Government and such requirements are complied with by the Government companies.

Appointment of Director (sub-section 5 of section 152)

The requirement of seeking consent from a Director to hold office of director and filing the same within 30 days of appointment to ROC is relaxed where appointment of such Director is done by the Central Government or State Government as the case may be.

Retirement of directors by rotation and filing of vacancy (sub-section (6) and (7) of section 152)

These sub-sections are not applicable to:

(a) a Government company, which is not a listed company, in which not less than fifty-one per cent of paid up share capital is held- by- the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;

(b) a subsidiary of a Government company, referred to in (a) above.

Right of persons other than retiring directors to stand for directorship (Section 160)

The section is not applicable to –

(i) A Government Company, in which the entire paid up share capital is held by the Central government, or by any State Government(s) or by the Central Government and one or more State Governments;

(ii) A subsidiary of a government Company referred to in (i) above, in which the entire paid up share capital is held by that Government Company.

Appointment of directors to be voted individually (section 162) and option to adopt principle of proportional representation for appointment of directors (section 163).

These sections are not applicable to -

(i) A Government Company, in which the entire paid up share capital is held by the Central government, or by any State Government(s) or by the Central Government and one or more State Governments;

(ii) A subsidiary of a government Company referred to in (i) above, in which the entire paid up share capital is held by that Government Company.

Disqualification of directors {sub-section (2) of section 164}

Disqualifications for appointment as Director – Director of a Company which has not filed financial statements/ annual returns for continuous 3 years not repaid deposits or interest thereon, etc shall not apply to Government Company.

Register of Directors, KMP and their shareholding & its inspection: (sections 170 and 171)

Section 170 (Maintenance of Register of Directors and KMPs and their shareholding) and 171 (Members right to inspect – Register of directors and KMP and their shareholding) shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government, or by the State Government or Governments or by the Central Government and one or more State Governments.

For Section 177 Audit committee to recommend for appointment, remuneration and terms of appointment of the Auditors of the Company. in case of Government Cos., the clause to be read as Audit Committee to recommend for remuneration of the Auditors of the Company.

For Nomination and Remuneration committee and Stakeholders Relationship Committee, changes effected vide notification relating to sub-sections (2) (3) and (4) of section 178 related to role and terms of reference of Nomination & Remuneration Committee -- to identify persons to be appointed as directors and senior management, Independence of Director, etc. Shall not apply to Government company except with regard to appointment of 'senior management' and other employees.

Loan to Director (Section 185)

The restrictions contained in Section 185 regarding loans to director shall not apply to Government company in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security under the section (except giving of any loan as a part of the conditions of service extended by the company to all its employees).

Loan and Investment by Company (Section 186)

The requirement of seeking member's approval by means of a Special Resolution for making loan/investments or giving guarantee/security in excess of the threshold limits specified in Section 186 has been relaxed for Government Companies.

Related Party Transaction (Section 188)

Exemptions to Government Companies under Section 188 of the Companies Act, 2013 vide notification no: G.S.R. 151(E), dated 02nd March, 2020.

First and Second proviso to sub-section (1) of section 188 shall not apply to –

(a) a Government company in respect of contracts or arrangements entered into by it with any other Government company, or with Central Government or any State Government or any combination thereof;

(b) a Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before entering into such contract or arrangement.

Before this amendment the contracts or arrangements with any other Government Company is only exempted, with this amendment the exemption is also extended to the contracts or arrangements with the Central Government or any State Government or any combination thereof.

Appointment of Managerial Personnel (Section 196)

The following provisions of Section 196(2), (4) and (5) shall not apply to Government Companies:

- Requirement of Appointment/Re-appointment of MD/WTD/Manager for a term not exceeding 5 years at a time.
- Requirement of seeking approval of Board and Members at a meeting for appointment of Managerial Personnel and also of Central Government where such appointment/ remuneration of Managerial Personnel is not in accordance with provisions of Schedule V.
- Requirement that notice convening the Board or General Meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including, interest, of a Director or Directors, in such appointment, if any.
- Requirement of filing return of appointment of Managerial Personnel within 60 days with the ROC in Form MR-1.

- Provision that where an appointment of a Managing Director, Whole Time Director or Manager is not approved by the Company at a General Meeting, any act done by him before such approval shall not be deemed to be invalid.

Appointment of Key Managerial Personnel (Section 203)

The provisions of sub-sections (1), (2), (3) and (4) of this section shall not be apply to a Managing Director or Chief Executive Officer or Manager and in their absence, a Whole-Time Director of the Government Company.

All the provisions of Section 203, attracting the penal provision contained in sub-section (5) will not apply to a Managing Director or Chief Executive Officer or Manager and in their absence, a Whole-Time Director of the Government Company.

All the provisions of Section 203 will continue to apply to CFO and CS of Government Companies as only these persons will be mandatorily required to be appointed as whole time KMP in case of select class of companies prescribed in the Act.

Provisions relating to Auditor

Appointment of First Auditor in a Government Company	***Appointment of Auditor for Subsequent Financial year***	***Appointment in case of casual vacancy***
In the case of Government Company, the First Auditor shall be appointed by the Comptroller and Auditor General of India (C & AG) within 60 (Sixty) days from the date of registration of the Company. If CAG fails to appoint first Auditor within 60 days, then the Board of Directors of the Company shall appoint the Auditor within the next 30 days and in the case of failure of the Board to appoint such auditor within the next thirty days, it shall inform the members of the company who shall appoint such auditor within the sixty days at an extraordinary general meeting, The First Auditor holds office till the conclusion of the First Annual General Meeting.	The appointment of Auditor in a Government Company in every subsequent financial year shall be made by C & AG within period of 180 days from the commencement of the financial year. The Auditor shall hold office upto the conclusion of the Annual General Meeting.	Where a casual vacancy arises in the office of the Auditor in a Government Company it is required to be filled by the Comptroller and Auditor-General of India within thirty days: Provided that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next thirty days.

Auditor Report in a Government Company [sub-section (5) of section 143]

In case of Government Company, the Controller and Auditor General of India shall appoint the auditor under subsection (5) or sub-section (7) of Section 139 and direct such Auditor the manner in which the Accounts of the Company are required to be audited. Accordingly, the Auditor shall submit a copy of the report to the C&AG which shall include the directions, if any, issued by the C&AG, the action taken thereon and its impact on the accounts and financial statement of the Company.

Supplementary Audit Ordered by C & AG [sub section (6) of section 143]

The C & AG shall, with in 60 (Sixty) days of the receipt of the Audit Report, have a right to –

(a) Conduct a supplementary audit of the Company's accounts by himself or by such person or persons as he may authorize and for the purpose of such audit require information or additional information to be furnished to any person or persons, so authorized, on such matters, by such person or persons and in such form as the C&AG may direct.

(b) Comment upon the Audit Report or supplement such Audit Report.

The Company shall send copy of any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report to every person entitled to copies of audited financial statements under sub section (1) of section 136 and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Annual Report of Government Company (Section 394)

In terms of Section 394, where the Central Government is a member of a Government company, the Central Government shall cause an annual report on the working and affairs of that company to be—

(a) prepared within three months of its annual general meeting before which the comments given by the Comptroller and Auditor-General of India and the audit report is placed under the proviso to sub-section (6) of section 143; and

(b) as soon as may be after such preparation, laid before both Houses of Parliament together with a copy of the audit report and comments upon or supplement to the audit report, made by the Comptroller and Auditor General of India.

Where in addition to the Central Government, any State Government is also a member of a Government company, that State Government shall cause a copy of the annual report prepared under sub-section (1) to be laid before the House or both Houses of the State Legislature together with a copy of the audit report and the comments upon or supplement to the audit report referred above.

LESSON ROUND-UP

- The word 'company' is derived from the Latin word (Com = with or together; panis = bread), and it originally referred to an association of persons who took their meals together.
- When a company is incorporated under law, it is vested with a corporate personality distinct from individuals who are its members.
- A company as an entity has several distinct features which together make it a unique organization.
- The main characteristics of a company are corporate personality, limited liability, perpetual succession, separate property, transferability of shares, capacity to sue and be sued & contractual rights, etc.
- A private company is a company incorporated under section 2(68) of the Companies Act, 2013.
- The MCA for the Ease of doing Business has revised the definition of Small companies by increasing their threshold limits for paid up capital from "not exceeding Rs. 2 Crore" to "not exceeding Rs. 4 Crore" and turnover from "not exceeding Rs. 20 Crore" to "not exceeding Rs. 40 Crore".
- Control is used as the benchmark in company law to determine holding company's status.
- Sub section (45) of Section 2 of the Companies Act, 2013 contains the definition of Government Company.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Answer the following:
   (a) Three persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?
   (b) The members of a private limited company consist of 'A' and 'B' who are also its directors. On 4th August, 2019 'A' left India for a foreign business tour and on 28th August, 2019 he died abroad. On 1st September, 2019 'B' purchased on credit of Rs. 10,000 worth of goods from 'C' on behalf of the company. 'C' now proposes to make 'B' personally liable for the payment of the debt. Is 'B' liable?
   (a) "Members of a Limited Company may nevertheless have unlimited liability." Comment.
2. M/s Rajshekhar Private Limited wants to make application to Registrar for getting the status of inactive company. Can it apply for the same?
   a) No, being a private company it cannot apply for inactive status.
   b) It can apply for inactive company only if it has not filed its financial statements for period of three years consecutively.
   c) It can apply for status of inactive company if it has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.
   d) It can apply for status of inactive company if it has not been carrying on any business or operation, or has not made any significant accounting transaction during the last three financial years, or has not filed financial statements and annual returns during the last four financial years.
3. Jalsa Pvt Ltd was incorporated on 15th June 2000, thereafter due to working capital requirements the company has taken Loan from Kuber Bank. In which form the company needs to attach Consent of the lender if any loan is outstanding with for the purpose of Application to ROC for obtaining the status of dormant company ?
   a) Form MSC-1;
   b) Form MSC-2;
   c) Form MSC-3;
   d) Form MSC -4
4. State the consequences in each of the following cases giving reasons for your answers:
   (a) A Private Company has 210 members in total of which ten are the employees of the company. Five of these employees leave the employment of the company.
   (b) A private firm has 20 partners, including a private company which is having 30 shareholders.
5. "The fundamental attribute of corporate personality is that the company is a legal entity distinct from the members." Elucidate the above statement.

6. Write short notes on:
   (a) Perpetual succession
   (b) Transferability of shares
   (c) Limited liability of shareholders
   (d) Corporate personality.
7. Examine the following and say whether they are correct or wrong:
   (a) A company being an artificial person cannot own property and cannot sue or be sued.
   (b) Members are the owners of the company's undertaking.
   (c) The term "body corporate" connotes a wider meaning than the term "Company".
   (d) Every member of an illegal association shall be personally liable for all liabilities incurred in carrying on the business.
   (e) A company is a juristic legal person.
8. Comment on the following statements :

   A company is an artificial juristic person. It does not have citizenship, residence and domicile

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- Bare Act- The Companies Act, 2013.
- Company Law Procedures by Dr. Sanjeev Gupta-Bharat's Publication.

OTHER REFERENCES (INCLUDING WEBSITES/VIDEO LINKS)

https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks.html

Memorandum and Articles of Association and its Alteration

Lesson 3

KEY CONCEPTS

■ Memorandum ■ Articles ■ Incorporation contracts ■ Alteration ■ Name Clause ■ Registered Office Clause ■ Object Clause ■ Liability Clause ■ Capital Clause

Learning Objectives

To understand:

- The concept of Memorandum of Association and Articles of Association
- Their purpose, contents and registration
- Incorporation contracts
- Scope and procedural aspects of alteration of various clauses contained in MoA & AoA of the company
- The legal effect of these documents

Lesson Outline

- Memorandum of Association (MoA)
- Forms of Memorandum of Association
- Contents of Memorandum of Association
- Articles of Association (AoA)
- Contents of Articles of Association
- Distinction between Memorandum and Articles
- Alteration in Memorandum and Article of Association
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 [Section 2(56), 2(5), 4, 5, 7 13 and 14]
- The Companies (Incorporation) Rules, 2014
- The SEBI (LODR) Regulations, 2015

MEMORANDUM OF ASSOCIATION

Introduction

A company is formed and registered when a number of people come together for achieving a specific purpose. This specific purpose is usually commercial in nature. Companies are generally formed to earn profit from business activities. To register a company, an application form has to be filed with the Registrar of Companies (ROC). This application form is required to be submitted with a certain number of specified documents. One of the fundamental documents that are required to be submitted with the application form for incorporation of company is the Memorandum of Association (MoA).

What is Memorandum of Association?

- Memorandum of Association is a legal document which describes the purpose for which the company is formed and therefore identified the possible scope of its operations beyond which its action cannot go. It defines as well as confines the powers of the company. If anything is done beyond these powers that will be *ultra vires* (beyond the powers) of the company and so void.
- The first step in the formation of a company is to prepare a document called the memorandum of association. In fact, memorandum is one of the most essential pre-requisites for incorporating any form of company under the Companies Act, 2013 (hereinafter referred to as 'Act').

"The Memorandum of Association", as observed by Palmer, "is a document of great importance in relation to the proposed company".

The requirement of memorandum is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose:

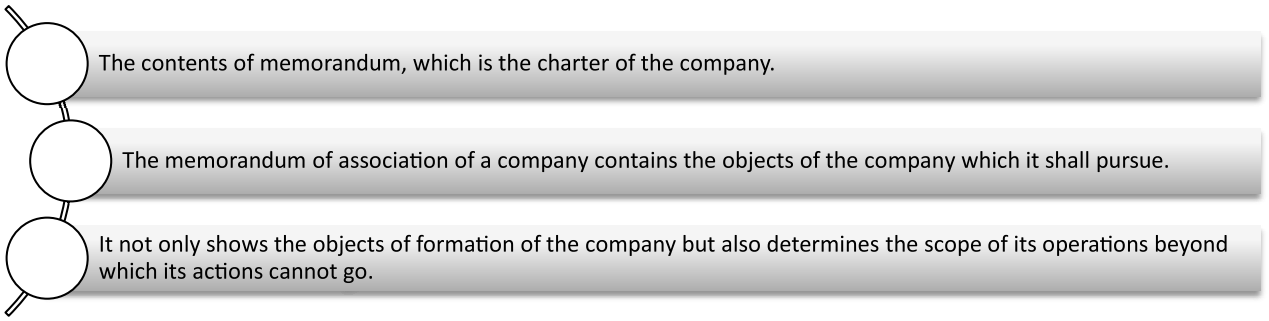
- by seven or more persons, where the company to be formed is a public company;
- two or more persons, where the company to be formed is a private company; or
- one person, where the company to be formed is a One Person Company

by subscribing their names or his name to a **memorandum** and complying with the requirements of this Act in respect of its registration.

Definition and provisions pertaining to Memorandum under the Companies Act, 2013:

According to Section 2(56) of the Act "memorandum" means the memorandum of association of a company as originally framed and altered, from time to time, in pursuance of any previous company law or this Act.

Section 4 of the Act specifies in clear terms:



CASE LAWS

In the celebrated case of *Ashbury Railway Carriage & Iron Co. Ltd. v. Riche, (1875) L.R. 7 H.L. 653*, Lord Cairn observed: "The memorandum of association of a company is its charter and defines the limitations of the powers of the company. It contains the both which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and powers which by law are given to the corporation, and it states negatively, if it is necessary to state, that nothing shall be done beyond that ambit" *[Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd. (1931) A.C. 677].*

In Re Attorney General Vs. Great Eastern Railway (1880) 5 AC 473, It was held that the court will consider ancillary/incidental objectives along with main objects of the company.

Memorandum enables shareholders, creditors and all those who have business terms with company to know what its powers are and what is the range of its activities. An intending shareholder can find out the purposes for which his money is going to be used by the company and what type of risk he is taking by investing the company. In same manner, anyone dealing with the company, viz. supplier of goods, will know whether the transaction he intends to make with the company is within the objects of the company and not *ultra vires* its objects.

Question: Do all the companies require MoA?

Answer: *Yes,* it is mandatory for every company to have a MoA as it defines the scope of its operations. The entire structure of the company is detailed in the MoA. It is to be submitted to the Registrar of Companies. It is a public document, and any person can view the MoA of the company by paying the required fees to the Ministry of Corporate Affairs (MCA).

FORM OF MEMORANDUM OF ASSOCIATION

Section 4(6) of the Act provides that the memorandum of association should be in any one of the Forms specified in Tables A, B, C, D or E of Schedule I to the Act, as may be applicable in relation to the type of company proposed to be incorporated or in a Form as near thereto as the circumstances admit.

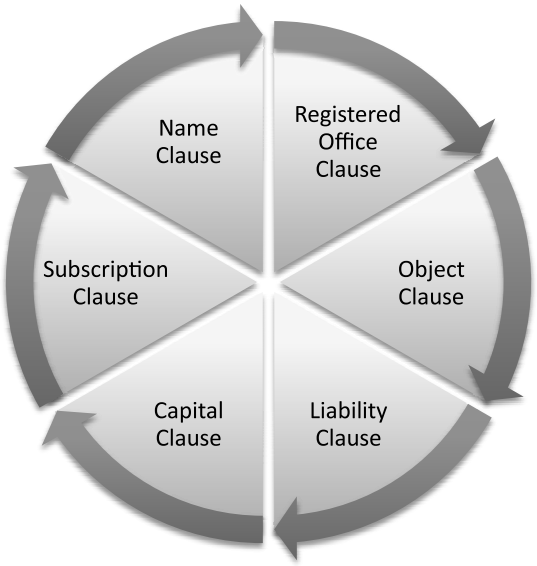
Tables	*Company*
Table A	Companies limited by shares
Table B	Companies limited by guarantee not having a share capital
Table C	Companies limited by guarantee having a share capital
Table D	Unlimited companies not having a share capital
Table E	Unlimited companies having a share capital

A company shall adopt any of the model Forms of the memorandum of association mentioned above, as may be applicable to it.

The memorandum should be printed, numbered and divided into paragraphs. It should also be signed by the subscribers of the company.

CONTENTS OF MEMORANDUM [SECTION 4 READ WITH SCHEDULE I]

Memorandum of Association (MoA) consists of the following clauses:



As per Section 4(1), the memorandum of a limited company must state the following:

(a) the name of the company with "Limited" as its last word in the case of a public company; and "Private Limited" as its last words in the case of a private company; (Name Clause)

This shall not apply in case of companies registered under section 8.

Similarly, in case of government companies the name of the company need not be ended with the words "Limited" or "Private Limited". This is as per the exemptions to Government Companies under Section 462 of Companies Act, 2013 vide notification dated June 5, 2015;

(b) the State in which the registered office of the company is to be situated (Situation Clause);

(c) the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof (Objects Clause);

(d) the liability of members of the company, whether limited or unlimited, and also state (Liability Clause),–

(i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and

(ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute –

(A) to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and

(B) to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

(e) in the case of a company having a share capital (Capital Clause), – the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount;

(Subscription Clause):

(i) the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share; and

(ii) the number of shares each subscriber to the memorandum intends to take, indicated opposite his name;

(f) in the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.

According to section 4(7), any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

The above clauses are compulsory and are designated as “conditions” prescribed by the Act, on the basis of which a company is incorporated.

It is to be noted that the Companies Act, 2013 shall override the provisions in the Memorandum and Articles of a company, if the latter contains anything contrary to the provisions in the Act (Section 6).

1. Name Clause:

This clause defines the name of the company. The name of the company should not be identical or resemble too nearly to any existing company. Also, if it is a private company, then it should have the word ‘Private Limited’ at the end. And in case of public company, then it should add the word “Limited” at the end of its name.

Example:

a) ABC Private Limited in case of the private company;

b) ABC Limited for a public company.

A company being a legal entity must have a name of its own to establish its separate identity. The name of the company is a symbol of its independent corporate existence. The first clause in the memorandum of association of the company states the name by which a company is to be known. The company may adopt any suitable name provided it is not undesirable.

According to section 4(2), the name stated in the memorandum shall not –

(a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or

(b) be such that its use by the company –

  (i) will constitute an offence under any law for the time being in force; or

  (ii) is undesirable in the opinion of the Central Government.

Section 4(3) of the Act provides that without prejudice to the provisions of section 4(2), a company shall not be registered with a name which contains –

(a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or

(b) such word or expression, as prescribed in rule 8 of the Companies (Incorporation) Rules, 2014, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

As per section 4(4), a person may make an application for reservation of name by using web service SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32), and for change of name by using web service RUN (Reserve Unique Name), in prescribed manner and accompanied by prescribed fee to the Registrar for the reservation of a name set out in the application as –

(a) the name of the proposed company; or

(b) the name to which the company proposes to change its name.

Section 4(5)(i) lays down that upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of twenty days from the date of approval or such other period as may be prescribed.

Section 4(5)(ii) states that where after reservation of name under clause (i), it is found that name was applied by furnishing wrong or incorrect information, then,—

(a) if the company has not been incorporated, the reserved name shall be cancelled and the person making application under sub-section (4) shall be liable to a penalty which may extend to one lakh rupees;

(b) if the company has been incorporated, the Registrar may, after giving the company an opportunity of being heard—

  (i) either direct the company to change its name within a period of three months, after passing an ordinary resolution;

  (ii) take action for striking off the name of the company from the register of companies; or

  (iii) make a petition for winding up of the company.

Provided that in case of an application for reservation of name or for change of its name by an existing company, the Registrar may reserve the name for a period of sixty days from the date of approval.

The object is to prevent the use of a name which is likely to mislead the public. For example, a company is not allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950, or suggestive of any connection with Government or of State patronage where there is none.

CASE LAWS

The Registrar must make preliminary enquiries to ensure that the name allowed by him is not misleading or intended to deceive with reference to the Objects Clause of the memorandum *[Methodist Church v. Union of India, (1985) 57 Com Cases 443 (Bombay)]*.

The Registrar is not, however, required to carry out any elaborate investigation at the time of registration of the company. Unless the purpose of the company appears to be unlawful ex-facie or is transparently illegal or prohibited by any statute, it cannot be regarded as an unlawful association *[T.V. Krishna v. Andhra Prabha (P) Ltd., (1960) 30 Com Cases 437 (AP)]*.

In the case of *Atlas Cycles (Haryana) Ltd. v. Atlas Products Pvt. Ltd [146 (2008) DLT 274 (DB)],* use of the brand name as corporate name was settled. Both the plaintiff and the defendant companies belong to the same family. The Appellant-plaintiff was the proprietor of the trade mark in the name "Atlas". The Respondent- defendant company containing the name "Atlas" in its corporate name started dealing in bicycles. The plaintiff objected to the use of the name "Atlas" by the defendant company. The Defendants were restrained from using the word 'Atlas' in their corporate/trade name in respect of bicycles and bicycle parts.

Where a company is directed to change the name, the court cannot directly tell the Registrar to effect the change in the name of the company. The Court can only direct the company to do so. The company cannot simply file the Court order regarding the change, but it will have to follow the prescribed procedure. [*Halifax Plc v. Halifax Repossessions Ltd. (2004) 2 BCLC 455 (CA)*].

A person cannot be permitted to name a company even after his personal name if that name resembles the name of an existing company. [K.G. Khosla Compressors Ltd. v. Khosla Extractions Ltd., (1986) 1 Comp LJ 211: AIR 1986 Del 181]

In Re Vardhaman Crop Nutrients (P.) Ltd. Vs. Union of India High Court of Punjab and Haryana LPA No. 101 of 2015 (O&M).

Brand name 'Vardhaman' was already registered trade mark of respondent-company Vardhaman Fertilizers and Seeds (P.) Ltd. and both appellant (Vardhaman Crop Nutrients Private Limited) and respondent companies were doing same business, the respondent-company filed an application under section 22 seeking direction to the appellant-company to change/delete the brand name 'Vardhaman', the registered Trade Mark of the respondent-company, as the same was undesirable and causing great loss of business, reputation and goodwill of its company, and the appellant-company, on merits it was held that appeal was dismissed and the appellant company was granted three months' time from the date of receipt of certified copy of order, to change its name to some other name, after deleting the word "VARDHAMAN" from its existing name.

2. Situation Clause:

This clause connotes the name of the State in which the registered office of the company is situated. This helps to determine the jurisdiction of the Registrar of Companies (RoC). The company is required to inform the location of the registered office to the Registrar of Companies within 30 days from the date of incorporation of the company and all time thereafter, the company must have a registered office to which all communications and notices may be sent.

Example:

Registered office of Reliance Capital Limited is "Trade World, B-Wing, 7th Floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel, Mumbai Mumbai City MH 400013."

Source: Master data of Company

Publication of Name and Address of the Company:

According to Section 12(3) of the Act, every company is required to display its name and address in legible letters in conspicuous position and in all its business letters, bill heads, letter papers. Accordingly, the company shall –

(a) paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed therefor are not those of the language or of one of the languages in general use in that locality, also in the characters of that language or of one of those languages;

(b) have its name engraved in legible characters on its seal, if any;

(c) get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications; and

(d) have its name printed on negotiable instruments such as hundies, promissory notes, bills of exchange and such other document as may be prescribed.

Every company which has a website, shall disclose/publish its name, address of its registered office, the Corporate Identity Number, Telephone number, fax number if any, email and the name of the person who may be contacted in case of any queries or grievances on the landing/home page of the said website. The Central Government may as and when required, notify the other document on which the name of the company shall be printed.

However, where a company has changed its name or names during the last two years, it shall paint or affix or print, as the case may be, along with its name, the former name or names so changed during the last two years.

Further, in case of One Person Company, the words ''One Person Company'' shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.

Ministry of Corporate Affairs (MCA) has clarified that display of its name in English in addition to the display in the local language will be a sufficient compliance with the requirements of the section.

CASE LAW

The words 'outside of every office' do not mean outside the premises in which the office is situated *[Dr. H.L. Batliwalla Sons & Company Ltd. v. Emperor (1941) 11 Com Cases 154 : AIR 1941 (Bom.) 97].* Where office is situated within a compound, the display outside the office room, though inside the building, is sufficient.

3. Object Clause:

Under section 4(1)(c) of the Act, all companies must state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. It defines the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.

It indicates the purpose for which the company has been set up and its actual capability, besides its sphere of activities. It states affirmatively the ambit and extent of powers of the company and, stated negatively, that nothing should be done beyond that ambit and that no attempt shall be made to use the company for any other purpose than that which is specified. The purpose of the objects clause is to enable the persons dealing with the company to know its permitted range of activities. The acts beyond this ambit are *ultra vires* and hence void. Even the entire body of shareholders cannot ratify such acts.

Although express powers are necessary, a company may do anything which is incidental to and consequential upon the powers specified, and the act will not be *ultra vires [Attorney General v. G.E. Rly. Co., (1880) 5 A.C. 473].* Thus, a trading company has an implied power to borrow money, draw and accept bills of exchange in the ordinary form, but a railway company cannot issue bills although it may borrow money.

CASE LAWS

The memorandum of association of a company is its charter defining the objects of its existence and operations. As pointed out in *Cotman v. Brougham 1918 AC 514*, its purpose is 'to enable the shareholders, creditors and those dealing with the company to know what is the permitted range of the enterprise. The objects clause or clauses in the memorandum are to be so construed as to confer on the company all powers reasonably required to the attainment of the objects.' "A memorandum of association like any other document must be read fairly and its importance derived from a reasonable interpretation of the language which it employs" *[Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd. AC 677: (1931) 1 Com Cases 285: AIR 1931 PC 182; 62 MLJ 163; Deuchar v. Gas, Light and Coke Co., (1925) AC 691)].* The natural and ordinary meaning of the language used in several clauses should be taken into consideration for determining whether a particular transaction does or does not fall within the objects stated in the memorandum *[Bell Houses Ltd. v. City Wall Properties Ltd. (1966) 36 Com Cases 779: (1966) 2 All ER 674 (CA)].*

It is *ultra vires* for a company to act beyond the limits of its memorandum. Any attempted departure will be invalid and cannot be validated even if assented to by all the shareholders of the company. *Ultra vires* means an act or transaction of a company, which though it may not be illegal, is beyond the company's powers by reason of not being within the objects of the memorandum of association. The memorandum is, so to speak, the limit beyond which a company cannot travel. *[Ashbury Railway Carriage and Iron Company v. Riche, (1875) LR 7 HL 653].* An act beyond the objects mentioned in the memorandum is *ultra vires* and void and cannot be ratified *[Dr. Lakshmanaswami Mudaliar A. v. LIC (1963) Comp LJ 248: 1963 33 Com Cases 420: AIR 1963 SC 1185].* Where no connection or nexus exists between the exercise of a power and the attainment of an object, exercise of power will be *ultra vires [Radha Cinema & Co. v. Chitralipi Films, 1974 Tax LR 2180 (Cal)].*

4. Liability Clause:

It states the liability of the members of the company. In case of an unlimited company, the liability of the members is unlimited whereas in case of a company limited by shares, the liability of the members is restricted by the amount unpaid on their share. For a company limited by guarantee, the liability of the members is restricted by the amount each member has agreed to contribute at the time of incorporation.

Section 4 sub-section 1(d) of the Act, states that the liability of members of the company is to be specifically mentioned in the MoA. It is provided that the liability of member may either be limited or unlimited.

5. Capital Clause:

This clause specifies the maximum capital that a company can raise which is also called the authorized/ nominal capital of the company. This also explains the division of such capital amount into the number of shares of a fixed amount each.

The capital is variously described as "nominal", "authorized" or "registered".

The amount of nominal capital is determined having regard to the present as well as future requirements of the company with reference to its objects. The usual way to state the capital in the memorandum is:

"The capital of the company is 10,00,000 rupees divided into 1,00,000 equity shares of 10 rupees each".

This amount lays down the maximum limit beyond which the company cannot issue shares without altering the memorandum as provided by Section 61 of the Companies Act, 2013.

If there are both equity and preference shares, then the division of the capital is to be shown under these two heads. A company is not authorized to issue capital beyond its authorized/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorized capital, the amount received on excess number of shares should be returned.

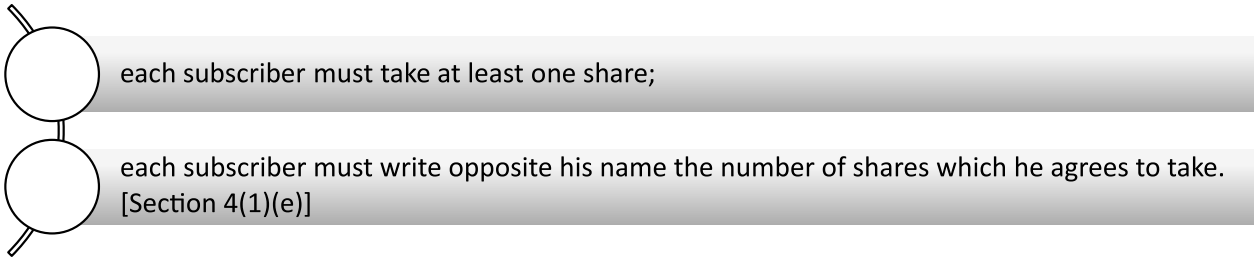
Out of the issued capital, the total amount actually subscribed or agreed to be subscribed is known as subscribed capital, and this subscribed capital again may be wholly paid or partly paid, in which latter case the balance would be payable on future calls when made. The amount actually paid by the shareholders is called the paid- up capital.

6. Subscription Clause:

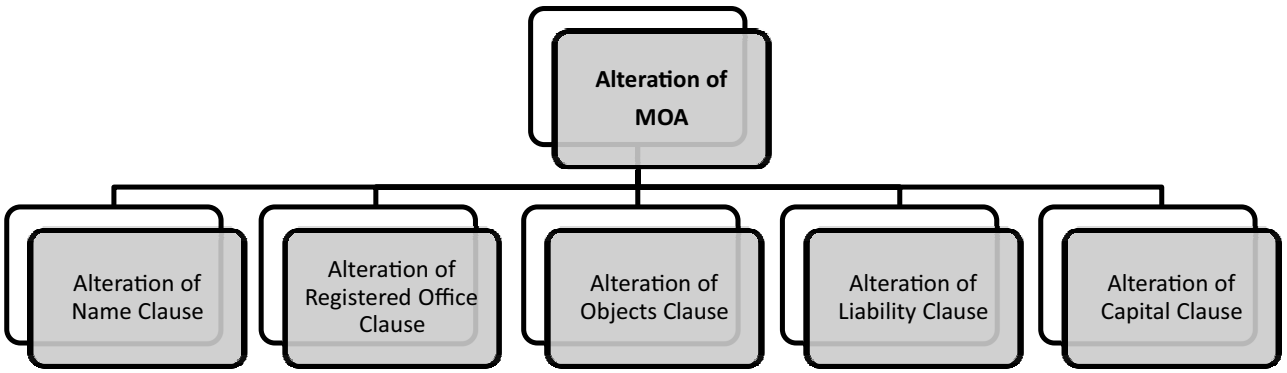
The Subscription Clause defines who are signing the memorandum of company. Each subscriber must state the number of shares he is subscribing to. The subscribers have to sign the memorandum in the presence of two witnesses. Each subscriber must subscribe to at least one share.

The subscribers to the memorandum declare: "We, the several persons whose names and addresses are subscribed below, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names". Then follow the names, addresses, description, occupations of the subscribers, and the number of shares each subscriber has agreed to take and their signatures attested by a witness.

The statutory requirements regarding subscription of memorandum are that:



ALTERATION OF MEMORANDUM OF ASSOCIATION (MOA)



Applicable section for alteration of MoA:

Section 13(1) of the Act provides that save as provided in section 61 (Dealing with power of limited company to alter its share capital), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. The memorandum of association of a company may be altered in the following respects:

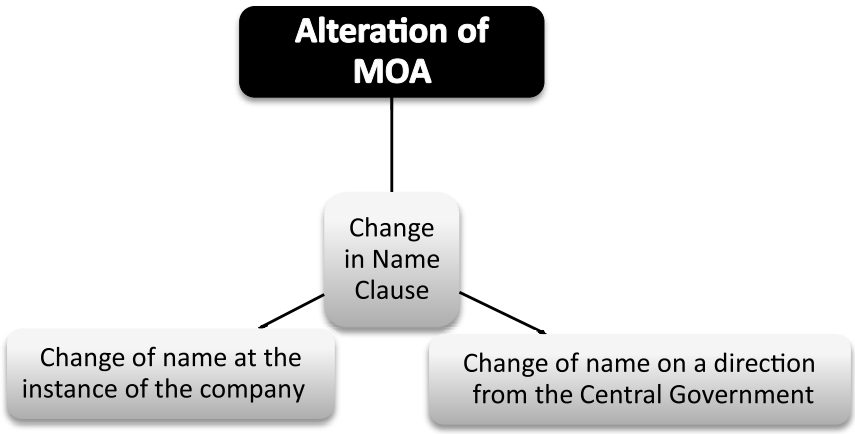
1. Alteration in the Name clause;
2. Alteration in the Registered Office Clause;
3. Alteration in the Object clause;
4. Alteration in the Capital clause;
5. Alteration in the Liability Clause.

The provisions or conditions of the memorandum of association relating to the name clause, registered office clause, the objects clause, limited liability clause, capital clause, subscriber's share clause as provided in Section 4 of the Companies Act, 2013 or any other specific provisions contained therein, can be altered by following the prescribed procedure laid down in the Act. Strict compliance of the prescribed procedure is demanded by law. Failure to comply with the express provisions made under the Act for the purpose of alteration of the provisions or conditions contained in the memorandum will be deemed as a nullity.

- Section 13(6) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1).
- Section 13(10) provides that no alteration made under this section shall have any effect until it has been registered in accordance with the provisions of the said section.
- Further, any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void. [Section 13 (11)].

The procedure for the alteration of the compulsory clauses or conditions of the memorandum is discussed in detail in the following paragraphs.

A. ALTERATION OF MOA DUE TO CHANGE IN NAME CLAUSE [SECTION 13 (2) AND (3)]



- The name of the company can be altered by a special resolution and with the approval of the Central Government in writing. Approval of the Central Government is not required, in case where the change in the name of the company relates to the addition/deletion of the word 'Private' to the name of the company consequent to the conversion of a company into a public company and vice versa [Section 13 (2)].
- If through inadvertence or otherwise, a company on its first registration or on its registration by a new name has been registered with a name which, in the opinion of the Central Government, is identical with or too closely resemble the name of an existing company, it may direct the company to change its name and the company shal change its name or new name, within a period of three months from the issue of such direction by passing an ordinary resolution and by obtain the approval of the Central Government in writing. (Section 16)
- When any change in the name of a company is made under section 13(2), the Registrar shall enter the new name in the register of companies in place of the old name and issue a fresh certificate of incorporation with the new name and such change in the name shall be complete and effective only on the issue of such a certificate [Section 13(3)].

According to Rule 29 of the Companies (Incorporation) Rules, 2014, the change of name shall not be allowed to a company which has not filed annual returns or financial statements due for filing with the Registrar or which has failed to pay or repay matured deposits or debentures or interest thereon.

Provided that the change of name shall be allowed upon filing necessary documents or payment or repayment of matured deposits or debentures or interest thereon as the case may be.

An application shall be filed in Form No. INC-24 along with the fee for change in the name of the company and a new certificate of incorporation in Form No. INC-25 shall be issued to the company consequent upon change of name.

CASE LAW

In Re cGMP Pharmaplan (Pvt) Ltd. Vs. Regional Director, Ministry of Corporate Affairs (2011) 105 SCL 675

NNE Pharmaplan Ltd. filed a representation before the office of Regional Director of MCA under section 16 (the then section 22) seeking a direction that the petitioner company incorporated on later date with the name cGMP Pharmaplan (Pvt) Ltd, it should change its name. Regional Director of the MCA concluded that the use of name by petitioner of the word 'pharmaplan" in its name would have a misleading effect in the minds of general public and it was fit case for issue of direction under section 16 {the then section 22(i)(b)} and directed petitioner to delete the word 'pharmaplan" from its existing name and change its name to some other name. The Hon'ble Delhi High Court held that since the names of both the companies structurally and phonetically too nearly resembled each other, Regional Director of MCA was right in directing the petitioner to change it name.

Procedure for Alteration in Name Clause of Memorandum:

1. Calling of Board Meeting

(a) Issue notice in accordance with the provisions of section 173(3) of the Companies Act, 2013, for convening a meeting of the Board of Directors to consider the reason for changing name of the company and get its approval for change in name of the Company.

(b) Pass a Board resolution authorizing the Company Secretary/ Director to make the required application to the Registrar of Companies.

2. Seeking name availability for proposed new name from the ROC

As per section 4(4) of the Act read with Rule-9 of Companies (Incorporation) Rules, 2014, application for the reservation/availability of name shall be in RUN along with prescribed fee of Rs. 1,000/- .

In selection of a Company name, it should be in accordance with name guidelines given in Rule-8 of Companies (Incorporation) Rules, 2014.

As per rule 9 of the Companies (Incorporation) Rules, 2014, an application for reservation of name shall be made through the web service available at *www.mca.gov.in* by using web service SPICe+ (Simplified Proforma for Incorporating Company Electronically Plus: INC-32), and for change of name by using web service RUN (Reserve Unique Name) along with fee as provided in the Companies (Registration Offices and Fees) Rules, 2014, which may either be approved or rejected, as the case may be, by the Registrar, Central Registration Centre after allowing re-submission of such web form within fifteen days for rectification of the defects, if any, with effect from the 23rd February, 2020.

3. Obtaining ROC Approval and Name Availability Letter

After approval of name, ROC will issue a name availability letter w.r.t. approval for availability of name for a proposed company. As per section 4(5), upon receipt of an application for reservation of name, the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of twenty days from the date of approval or such other period as may be prescribed.

Provided that in case of an application for reservation of name or for change of its name by an existing company, the Registrar may reserve the name for a period of sixty days from the date of approval.

On receipt of approval of name, the Company Secretary/Director shall convene another Board meeting:

(a) To take note of the name approval received from ROC.

(b) To fix date, time and place for holding Extra-ordinary General meeting (EGM) to get approval of shareholders, by way of Special Resolution, for amendment in Name clause of Memorandum. This amendment in Name clause of Memorandum shall be in accordance with the requirement of section 13 of the Companies Act, 2013.

(c) To approve notice of EGM along with agenda and explanatory statement pursuant to section 102 of the Companies Act, 2013 to be annexed to the notice of General Meeting as per section 102(1) of the Companies Act, 2013.

(d) To authorize the Director or Company Secretary to issue Notice of the Extra-ordinary General meeting (EGM) as approved by the board.

4. Issue of Notice of Extra-ordinary General Meeting (EGM)

Issue Notice of the EGM to all the Members, Legal Representatives of any deceased member or assignee of an insolvent member, Directors and the Auditors of the company in accordance with the provisions of Section 101 of the Companies Act, 2013.

5. **Holding of Extra ordinary General Meeting**

   Hold the Extra-ordinary General meeting on the fixed date and pass the necessary Special Resolution under section 13(1) of the Companies Act, 2013, for change in the Name clause of Memorandum.

6. **ROC filings**

   As per section 13(6), the Company is required to file Special Resolution passed by shareholders for alteration of Memorandum with concerned ROC and file Form MGT -14 (certified by a Practicing Professional i.e. CS/ CA/CWA) within 30 days of passing the resolution with prescribed fees.

   Also, the application for the fresh certificate of incorporation in the new name of the company be made in form INC-24 to the Registrar within the 30 days along with the prescribed fees.

7. After scrutiny of the documents filed, the ROC shall issue a fresh certificate of incorporation digitally signed in Form INC-25.

8. Intimate all concerned persons/authorities about the changed name of the Company, particularly the Stock Exchanges, National Securities Depository Ltd., Central Depository Services (India) Ltd., statutory and other authorities like Inspector of Factories, Regional Provident Fund Commissioner, suppliers of raw materials, customers, banks etc.

9. Arrange for a new Common Seal and have the same adopted at a meeting of the Board of directors and keep it under safe custody and get stationery printed with the new name and/or affix rubber stamp of the new name on all the existing documents. However, it is also to be noted that having the common seal is no longer mandatory requirement.

10. Get the new name of the Company painted on all the signboards or name boards wherever they are displayed.

11. Correct all records, registers including the Register of Members, every copy of Memorandum and Articles of Association, other books and documents pertaining to the company's business and affairs to display the new name.

12. It is also to be noted that in every document as above-mentioned the company shall paint, affix or print as the may be the former name or names so changed during the period of last two years. (First proviso to Section 12(3)).

Name change requirement under regulation 45 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015

All listed companies which decide to change their names shall be required to comply with the following conditions:

1. A time period of at least 1 year should have elapsed from the last name change;
2. At least 50% of its total revenue in the preceding one year period should have been accounted for by the new activity suggested by the new name; or
3. The amount invested in the new activity/project is at least fifty percent. of the assets of the listed entity.

   Provided that if any listed entity has changed its activities which are not reflected in its name, it shall change its name in line with its activities within a period of six months from the change of activities in compliance of provisions as applicable to change of name prescribed under Companies Act, 2013.

   For the purpose of this regulation - (i) 'assets' of the listed entity means the sum of fixed assets, advances, works in Progress / Inventories, investments, trade receivables cash & cash equivalents;

(ii) 'advances' shall include only those amounts extended to contractors and suppliers towards execution of project, specific to new activity as reflected in the new name.

4. On satisfaction of conditions as laid above, the listed entity shall file an application for name availability with Registrar of Companies.
5. Upon compliance with the conditions for change of name laid down in Companies Act, 2013 and rules made thereunder, the listed entity, in the explanatory statement to the notice seeking shareholders' approval for change in name, shall include a certificate from a practicing chartered accountant stating compliance with aforesaid conditions.
6. The listed entity shall disseminate on its website, new name and the old name of the listed entity for a continuous period of one year, from the date of the last name change.

EFFECT OF CHANGE IN NAME CLAUSE

The change of name shall not affect any rights or obligations of the company or render defective any legal proceedings by or against it, and any legal proceedings which might have been continued or commenced by or against the company in its former name may be continued by or against the company in its new name.

By change of name, constitution of company does not change; the only thing changes is its name; all the rights and obligations under the law of old company pass to the new company.

CASE LAWS
In Re *Malhati Tea Syndicate Ltd. v. Revenue Officer, (1973) 43 Com Cases 337* Where a company changes its name and the new name has been registered by the Registrar, the commencing of legal proceedings in the former name is not valid.
In Re *Pioneer Protective Glass Fibre (P) Ltd. v. Fibre Glass Pilkington Ltd., (1986) 60 Com Cases 707 (Cal.)* In spite of a change in name the entity of the company continues. The company is not dissolved nor does any new company come into existence. If any legal proceeding is commenced, after change in the name, against the company in its old name, the company should be treated as if it is not in existence. It is not an incurable defect and the plaint can be amended to substitute the new name.

Methods of changing the name

After incorporation, a company can change their name through following methods:

- Conversion of private limited company into public limited company and thereby change in the name from private to public; or
- Conversion of public limited company into private limited company and thereby change in the name from public to private; or
- Change of name from ABC limited to XYZ limited.

Recapitulate: As per Section 13 of the Companies Act, 2013, the name of the company can be changed by passing a Special Resolution by the members of the company in their general meeting and with the approval of the Central Government. But on the other hand, if the change relates to the addition/deletion of the words "private" to the name, then approval of Central Government is not required.

SPECIMEN RESOLUTIONS:

Sample Board Resolution for Change in the Name of the Company

"RESOLVED THAT pursuant to the provisions of section 13 and other applicable provisions of the Companies Act, 2013 if any and the rules framed there under, and subject to the approval of the Registrar of Companies, Central Registration Center, Ministry of Corporate Affairs and the approval of the members, the consent of the board be and is hereby accorded to change the name of the company from ..... to..... or ..... or ..... as may be approved by the Registrar.

FURTHER RESOLVED THAT for the purpose of giving effect to this resolution ..... Director of the Company be and is hereby authorized, on behalf of the Company, to make an application to the MCA for ascertaining availability of proposed name and to do all acts, deeds, and things as may be necessary, proper or desirable and to sign and execute all necessary documents, applications and returns, e-forms for the purpose of giving effect to the aforesaid resolution."

Sample Shareholder's Resolution to be passed in the General Meetings for Change in the Name Clause of MOA

"RESOLVED THAT pursuant to section 13(2) and other applicable provisions of the Companies Act, 2013 if any and the rules framed there under, the consent of members be and is hereby accorded to change the name of the company from _____ PRIVATE LIMITED to _____ PRIVATE LIMITED".

RESOLVED FURTHER THAT Clause I of the Memorandum of Association of the Company be substituted by the following:

'The Name of the company is _____ PRIVATE LIMITED".

RESOLVED FURTHER THAT Clause of the Articles of Association of the Company be substituted by the following:

The company means _____ PRIVATE LIMITED".

Explanatory Statement pursuant to section 102 of the Companies Act, 2013

Item No.....

The Board of Directors of the Company at its meeting held on DD/MM/YYYY decided to change the name of the Company from _____to _____.

Pursuant to provisions of Section 4 and 13(2) of the Companies Act, 2013, any change in name of the Company and alteration in the name clause of the Memorandum of Association of the Company shall be made only after obtaining the consent of the shareholders by passing a Special Resolution and the approval of the Central Government, Registrar of Companies and all other statutory approvals.

None of the Directors, Key Managerial Personnel of the Company or their relatives is in any way, concerned or interested, financially or otherwise, in the Resolution, except as shareholders of the Company.

The Board of Directors recommend passing of the Special Resolution.

B. ALTERATION OF SITUATION/REGISTERED OFFICE CLAUSE IN THE MOA [SECTION 13(4)(5) AND (7)]

(a) Change within the local limits of same town

- A company by passing Board Resolution can change the situation of its registered office within the limits of same city, town or village
- An intimation of the change of registered office and verification of registered address shall be given to the Registrar
- E-Form INC-22 is required to be filed within 30 days of such change
- This does not involve alteration of memorandum

(b) Change outside the local limits of any city, town or village

According to Section 12(5) of the Act, except on the authority of a special resolution passed by a company, the registered office of the company shall not be changed –

(i) in the case of an existing company, outside the local limits of any city, town or village where such office is situated at the commencement of this Act or where it may be situated later by virtue of a special resolution passed by the company; and

(ii) in the case of any other company, outside the local limits of any city, town or village where such office is first situated or where it may be situated later by virtue of a special resolution passed by the company.

In case the company is eligible for conducting business through postal ballot any change in place of registered office outside the local limits of any city, town or village the same shall be transacted only by means of voting through a Postal Ballot [Rule 22 of the Companies (Management and Administration) Rules, 2014].

(c) Change within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies

- No company shall change the place of its registered office from the jurisdiction of one Registrar to the jurisdiction of another Registrar within the same State unless such change is confirmed by the Regional Director. {Proviso to Section 12(5)}
- Section 12(6) states that the Regional Director, after hearing the parties shall pass necessary orders within a period of thirty days from the date of the receipt of the application.
- Thereafter, the company concerned shall file a copy of the said order with the Registrar of Companies (ROC) within a period of sixty days from the date of the confirmation order by Regional Director.
- The said ROC shall record the ordered changes in its records.
- The ROC of the state where the registered office of the company was previously situated, shall transfer all the documents and papers to the new ROC.

Rule 28 of Companies (Incorporation) Rules, 2014 states that an application seeking confirmation from the Regional Director for shifting the registered office within the same State from the jurisdiction of one Registrar of Companies to the jurisdiction of another Registrar of Companies, shall be filed by the company with the Regional Director in Form No.INC.23 along with the fee and following details and documents,-

(a) Board Resolution for shifting of registered office;

(b) Special Resolution of the members of the company approving the shifting of registered office;

(c) a declaration given by the Key Managerial Personnel or any two directors authorised by the Board, that the company has not defaulted in payment of dues to its workmen and has either the consent of its creditors for the proposed shifting or has made necessary provision for the payment thereof ;

(d) a declaration not to seek change in the jurisdiction of the Court where cases for prosecution are pending;

(e) acknowledged copy of intimation to the Chief Secretary of the state as to the proposed shifting and that the employees interest is not adversely affected consequent to proposed shifting.

The Regional Director shall examine the application and the application may be put up for orders without hearing and the order either approving or rejecting the application shall be passed within fifteen days of the receipt of application complete in all respects.

The certified copy of order of the Regional Director, approving the alternation of memorandum for transfer of registered office company within the same State, shall be filed in Form No.INC-28 along with fee with the Registrar of State within thirty days from the date of receipt of certified copy of the order.

(d) Change of Registered office from one State to another

- The change of registered office from one State to another State involves alteration of memorandum, and the change can be effected by a special resolution passed by the company which must be confirmed by the Central Government on an application made to it [Section 13(4)].
- The Central Government shall dispose of the application under sub-section (4) within a period of sixty days and before passing its order may satisfy itself that the alteration has the consent of the creditors, debenture-holders and other persons concerned with the company or that a sufficient provision has been made by the company either for the due discharge of all its debts and obligations or that adequate security has been provided for such discharge. [Section 13(5)].
- A company shall, in relation to any alteration of its memorandum involving change of registered office from one State to another, file with the Registrar the special resolution passed by it in MGT-14 [Section 13(6)].
- Where an alteration of the memorandum results in the shifting of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within 30 days' time from the receipt of the certified copy of the order and in INC-28, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration. [Section 13(7) read with Rule 31 of the Companies (Incorporation) Rules, 2014].

Procedure to be followed as laid down in Rule 30 of the Companies (Incorporation) Rules, 2014 (as amended from time to time) are enumerated below:

1. Send notice of Board Meeting at least seven days before the date of Board Meeting for:
   - Shifting of Registered office form one state to another state.
   - Approval of Notice for Calling of Extraordinary General Meeting (EGM) for passing special resolution for altering the memorandum.
   - Authorization to Director/ Company Secretary to sign the documents.
   - Engagement of Company Secretary to represent the company before Regional Director (RD).
2. In Case of Listed Company, at least 7 days before of the Board Meeting, publish notice of the board meeting in the newspaper. Simultaneously, send the copies of said publication to the Stock exchanges.
3. Hold the Board Meeting and approve the :
   - Resolution Shifting of Registered office from one state to another state.
   - Notice for Calling of EGM for passing special resolution for shifting of registered office.
   - Authorization to Director/ Company Secretary to sign the documents.
   - Engagement of Company Secretary to represent the company before RD.
4. Intimate the Stock Exchanges about passing of resolution in the board meeting at the earliest within 24 hours of the occurrence of such event or information and in case of any delay the disclosure should be made along with an explanation for such delay [Regulation 30(6) of the SEBI (LODR) Regulations, 2015].
5. Send Notice of the EGM to at least 21 days clear days before the members of the company. Send copies of the notice to the stock exchanges simultaneously. Also, an intimation to be sent to the concerned stock exchanges that the notice of the extra-ordinary general meeting was sent to the shareholders of the company at the earliest within 24 hours of the occurrence of such event or information and in case of any delay the disclosure should be made along with an explanation for such delay. [Regulation 30(6) of SEBI (LODR) Regulations, 2015].
6. Publish the notice of EGM in newspaper and send the copy of such publication to the stock exchanges.
7. Hold EGM of the company and pass the special resolution for shifting of registered office from one state to another state and authorize Director/ Company Secretary to sign/ file/ deal with department.
8. Intimate about the proceedings of the EGM and the amendments to the memorandum and articles of association to the stock exchanges at the earliest within 24 hours of the conclusion of such extra-ordinary general meeting and in case of any delay the disclosure should be made along with an explanation for such delay. [Regulation 30(6) of SEBI (LODR) Regulations, 2015].
9. File e-form MGT-14 with ROC for registering special resolution passed in the EGM within 30 days from the date of passing such resolution.
10. Prepare the application for shifting of registered office to be filed to RD. File a copy of the application along with all annexures to ROC in form INC-23 along with the following details and documents:-
    a. A copy of Memorandum of Association, with proposed alterations;
    b. A copy of the minutes of the general meeting at which the resolution authorising such alteration was passed, giving details of the number of votes cast in favour or against the resolution;

c. A copy of Board Resolution or Power of Attorney or the executed vakalatnama, as the case may be.

d. There shall be particulars of, a list of creditors and debenture holders, drawn up to the latest practicable date preceding the date of filing of application by not more than one month, setting forth the following details in the application, namely:-

(i) the names and address of every creditor and debenture holder of the company;

(ii) the nature and respective amounts due to them in respect of debts, claims or liabilities

e. List of creditors and debenture holders, accompanied by declaration signed by the Company Secretary of the company, if any, and not less than two directors of the company, one of whom shall be a managing director, where there is one, stating that:

(i) they have made a full enquiry into the affairs of the company and, having done so, have concluded that the list of creditors are correct, and that the estimated value as given in the list of the debts or claims payable on a contingency or not ascertained are proper estimates of the values of such debts and claims and that there are no other debts of or claims against the company to their knowledge, and

(ii) no employee shall be retrenched as a consequence of shifting of the registered office from one state to another state and also there shall be an application filed by the company to the Chief Secretary of the concerned State Government or the Union territory.

f. A duly authenticated copy of the list of creditors shall be kept at the registered office of the company and any person desirous of inspecting the same may, at any time during the ordinary hours of business, inspect and take extracts from the same on payment of a sum not exceeding ten rupees per page to the company.

g. There shall also be attached to the application a copy of the acknowledgment of service of a copy of the application with complete annexures to the Chief Secretary of the State Government or Union territory where the registered office is situated at the time of filing the application.

h. Applicant need not to submit separate copy of application with the Registrar and an intimation of filing of application in Form no. INC-23 with the Regional Director shall be shared with the Registrar through MCA system.

11. The company shall, not more than thirty days before the date of filing the application in Form No. INC-23 -

(a) advertise in the Form No.INC-26 in the vernacular newspaper in the principal vernacular language in the district and in English language in an English newspaper with the widest circulation in the State in which the registered office of the company is situated:

Provided that a copy of advertisement shall be served on the Central Government immediately on its publication.

(b) serve, by registered post with acknowledgement due, individual notice, to the effect set out in clause (a) on each debenture-holder and creditor of the company; and

(c) serve, by registered post with acknowledgement due, a notice together with the copy of the application to the Registrar and to the Securities and Exchange Board of India, in the case of listed companies and to the regulatory body, if the company is regulated under any special Act or law for the time being in force.

12. There shall be attached to the application a duly authenticated copy of the advertisement and notices issued, a copy each of the objection received by the applicant, and tabulated details of responses along with the counter response from the company received either in the electronic mode or in physical mode in response to the advertisements and notices issued under sub-rule (5).

13. Where no objection has been received from any person in response to the advertisement or notice or otherwise, the application may be put up for orders without hearing and the order either approving or rejecting the application shall be passed within fifteen days of the receipt of the application.

14. Where an objection has been received,

    (i) the Central Government shall hold a hearing or hearings, as required and direct the company to file an affidavit to record the consensus reached at the hearing, upon executing which, the Central Government shall pass an order approving the shifting, within sixty days of filing the application.

    (ii) where no consensus is reached at the hearings the company shall file an affidavit specifying the manner in which objection is to be resolved within a definite time frame, duly reserving the original jurisdiction to the objector for pursuing its legal remedies, even after the registered office is shifted, upon execution of which the Central Government shall pass an order confirming or rejecting the alteration within sixty days of the filing of application.

15. The order passed by the Central Government confirming the alteration may be on such terms and conditions, if any, as it thinks fit and proper:

    Provided that the shifting of registered office shall not be allowed if any inquiry, inspection or investigation has been initiated against the company or any prosecution is pending against the company under the Act.

    Provided further that where the management of the company has been taken over by new management under a resolution plan approved under section 31 of the Insolvency Bankruptcy Code, 2016 and no appeal against the resolution plan is pending in any Court or Tribunal and no inquiry, inspection, investigation is pending or initiated after the approval of the said resolution plan, the shifting of the registered office may be allowed.

16. On completion of such inquiry, inspection or investigation as a consequence of which no prosecution is envisaged or no prosecution is pending, shifting of registered office shall be allowed.

17. The change of address of the registered office shall be effective from the date of issue of registration certificate by the ROC of the State to which the registered office is shifted.

18. Once the order is passed by the RD, approving shifting of the registered office, file form INC-22 with the ROC along with supportive documents –

    - the registered document of the title of the premises of the registered office in the name of the company; or
    - the notarized copy of lease or rent agreement in the name of the company along with a copy of rent paid receipt not older than one month;
    - the authorization from the owner or authorized occupant of the premises along with proof of ownership or occupancy authorization, to use the premises by the company as its registered office altered, Memorandum of Association; and
    - the proof of evidence of any utility service like telephone, gas, electricity, etc. depicting the address of the premises in the name of the owner or document, as the case may be, which is not older than two months;
    - Certified copy of order passed by the competent Authority.
    - List of Companies (mentioned along with CIN) having same registered office address, if any.

If the documents are in order, Registrars of both states will approve the forms and the change in registered office will be updated in register of companies with the Registrar and new Certificate of Incorporation will be issued by the Registrar of the State within 30 days, where the company's registered office is going to be shifted.

Rule 31* the Companies (Incorporation) Rules, 2014*: The certified copy of the order of the Central Government, approving the alteration of the memorandum for transfer of registered office of the company from one State to another, shall be filed in Form No.INC-28 along with the fee as with the Registrar of the State within thirty days from the date of receipt of certified copy of the order.

Steps after obtaining new certificate from ROC

- Make alteration in the MOA with respect to the state in every copy of Memorandum.
- Each stationery, banner, signboard, bills, invoice etc. should show the new address and necessary advice should be sent to shareholders, debenture holders, and other concerned parties.
- Necessary changes are required to be made in the letter heads, books, records etc. of the company. The necessary changes are required to be made in PAN, TAN or various returns under the GST etc and inform all the Government departments, banks, customers and others wherever required.

CASE LAWS

- No notice of the petition is required to be served on the State, but in view of the wider language of Section 17 [Corresponds to section 13 of the Companies Act, 2013] Central Government may direct notice to be served on the State if it is of the view that the interest of the State will be affected by the alteration. Where the alteration is affected by changing the registered office from one State to another State, the loss of revenue in one State would be accompanied by increase in revenue in the other and in such a case the interest of a particular State ought not to be considered but it is the interest of the country as a whole which should be considered. The decision to shift the registered office of the company to another state being a domestic matter rests with shareholders and the company is the best judge of how to run its business more economically, efficiently or conveniently, even though it would result in loss of revenue to the State. [*Satyashree Balaji Wires & Cables (P) Ltd., In re (2006) 71 CLA 231 (CLB)].*
- A company was allowed to shift its registered office from Bihar to West Bengal in spite of the fact that Bihar Government had granted lease of land for the company's factory on the condition that it would not shift its registered office. The CLB also held that interest free loans, sales tax, electricity and other subsidies would have no bearing on the shifting *[Usha Beltron Re, (2000) 27 SCL 124]*.

Employees' right to object in case of shifting of registered office from one state to another – Some legal cases

CASE LAWS

- In the case of *Bharat Commerce and Industries Ltd., Re, (1973) 43 Com Cases 162 (Cal.),* it was held that employees' union, which was a registered body and which represented quite a number of the employees at the registered office of the company, would have the legal standing to appear before the court and oppose the application on the ground that their interests are likely to be prejudicially affected if the resolution for shifting the registered office of the company from one state to another is confirmed by the court. However, it was held that the employees' union cannot oppose on the ground that there would be loss of revenue or unemployment in the State or that the meeting at which the special resolution was passed was itself not valid.

- Further, in the case of *Metal Box India Ltd. Re, (2000) 37 CLA 15,* it was held that where the shifting of the registered office was in accordance with a scheme approved by the BIFR, it was held that the workers had no right of objection because their continuation in the company's employment was ensured unless, of course, a worker preferred voluntary retirement.
- A different dimension to the employees' right can be seen in the case of *Kwality Ice Creams (India) P Ltd., Re, (2009) 91 SCL 231 : (2009) 148 Com Cases 631 : (2010) 98 CLA 218 (CLB).* In that case, the company's petition for shifting its registered office from West Bengal to Delhi was opposed by two employees of the head office on the ground that their action against the company would be prejudiced.

  The CLB said that the facility for litigation is not a valid ground to stall shifting. There was no restraint order from any Court against the proposed shifting. The Company Law Board allowed shifting subject to the condition that the interest of none of the employees at the registered office would be prejudiced by retrenchment or otherwise.

SPECIMEN RESOLUTIONS

Sample Board Resolution for Changing the Situation of Registered Office Clause in MOA:

"RESOLVED THAT pursuant to the provisions of Sections 12 and 13 of the Companies Act, 2013 and the rules made there under (including any statutory modifications or re-enactment thereof for the time being in force) and subject to the confirmation of the Central Government and subject to the confirmation of the members, approval of the Board of Directors of the company be and is hereby accorded for shifting of the registered office of the company from the state of Maharashtra to the state of Gujarat".

"RESOLVED FURTHER THAT Shri _____ and Shri _____, the Company Secretary and

Director of the company respectively, be and are hereby jointly and severally authorised –

(i) to sign and file, the petition under Sub-section (4) of Section 13 of the Act to the Regional Director for securing confirmation to the alteration to the memorandum of association of the company so as to change the place of the Registered office of the company from the State of Maharashtra to the State of Gujarat;

(ii) to represent the company in all hearings concerning the petition of the company; and

(iii) to appoint, on behalf of the company, Company Secretaries in whole-time practice, Advocates, lawyers, counsels and other consultants, if and when required, to represent the company and plead on its behalf before the concerned Regional Director and or any other agency in all matters connected with the petition of the company".

"RESOLVED FURTHER THAT Shri _____, Director of the Company be & is hereby authorised on behalf of the Company, including to prepare, sign, execute Power of Attorney in favour of Shri. _____ and Shri _____, the Company secretary and the Director of the company respectively in this regard but not limited to file & submit necessary E-forms, applications, documents & returns with Registrar of Companies, Ministry of Corporate of Affairs & to do all acts, deeds & things as may deem necessary, proper or desirable for the purpose of giving effect to above resolution".

Sample Shareholder's Resolution to be passed in the General Meeting for Shifting of Registered Office of the Company from One State to Another

"RESOLVED THAT pursuant to the provisions of section 13 read with section 12 and other applicable provisions, if any, of the Companies Act, 2013 and rules made thereunder, and subject to the approval of the Regional Director, _____ Region or any other Government Authority, the consent of the members of the Company be and is hereby accorded to shift the registered office of the Company from the State of _____ (State) to (State)".

"RESOLVED FURTHER THAT Clause No. II of the Memorandum of Association of the Company be and is hereby substituted by the following clause:

'II. The Registered Office of the Company shall be situated in the State'"_____"

"RESOLVED FURTHER THAT Mr. _____ and Mr. _____, the director and the company secretary of the Company respectively, be and are hereby severally authorized for and on behalf of the Company to do all such acts, deeds and things as may be necessary or desirable in this regard for the purpose of giving effect to this resolution."

Explanatory Statement Pursuant to Section 102 of the Companies Act 2013

Item No. _____

When the company was incorporated it was decided that the main manufacturing unit of the company would be located in the State of Maharashtra and in the memorandum of association it was stated that the registered office of the company would be situated in that State.

Subsequently it was found that the location of the main manufacturing unit in the State of Gujarat would be more advantageous to the company. At present, all the factories of the company are located in the State of Gujarat. for better management and control, the Head Office of the company has already been shifted to Ahmedabad. Gujarat. The directors, therefore, consider that the memorandum of association of the company should be altered so as to change the place of its registered office from its present situation at _____ in the State of Maharashtra to _____ a place situated in the State of Gujarat. After the proposal is approved by the shareholders, a petition is required to be made, under Section 13(4) of the Companies Act, 2013, to the Regional Director for confirmation of the alteration to the memorandum of association of the company so as to shift the company's registered office from the State of Maharashtra to the State of Gujarat. It is also proposed to authorize severally to Mr. _____ and Mr. _____, the Director and Company Secretary of the company respectively to sign and file the petition and appear before the Regional Director in connection with the petition. An enabling clause has also been provided authorizing the Director and Company Secretary of the company to appoint any other authorized representative such as the company secretary in the whole-time practice, Advocate, counsel etc., as they consider necessary in connection with the petition.

The Board recommends the resolution to the members for their consideration and approval.

None of the directors of the company or KMP or their relatives are concerned or interested in the proposed resolution.

C. ALTERATION OF MOA DUE TO CHANGE IN OBJECT CLAUSE [SECTION 13 (8) AND (9)]

- According to section 13(1), a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum.
- It means that a company can change its objects by passing a special resolution.

- Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1).
- As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13(6)(a).

Further, in case the company is eligible for conducting business through postal ballot any alteration in the objects clause of the Memorandum of Association, shall implement the same through Postal Ballot in terms of section 110 read with Rule 22 of the Companies (Management & Administration) Rules, 2014.

Further, section 13(8) lays down that a company, which has raised money from public through prospectus and has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and –

(i) the details, as may be prescribed, in respect of such resolution shall be published in the newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated and shall also be placed on the website of the company, if any, indicating there in the justification for such change;

(ii) the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

Also, for deleting any portion of the objects clause, the procedure laid down in this section has to be followed. A company may wish to alter its objects stated in its memorandum due to various reasons e.g. if a company wishes to cut-back i.e. where it feels it has diversified in various directions and that management of the company has become difficult or uneconomical, it may alter its objects to sell or dispose of whole or part of its undertaking(s).

Following companies are required to pass special resolution for alteration of Object clause of Memorandum of Association by means of Postal Ballot only:

- All Companies having more than 200 members. [Section 110 read with Rule 22 of the Companies (Management and Administration) Rules, 2014,
- Company which has raised money from public through prospectus and still has any unutilized amount out of the money so raised. [Section 13(8) read with Rule 32 of the Companies (Incorporation) Rules, 2014].

Procedure is to be followed for alteration of objects clause of MOA under Section 13 read with Rule No.32 of Companies (Incorporation) Rules, 2014 and Rule No 22 (Postal Ballot, if applicable) of Companies (Management and Administration) Rules, 2014:

1. Issue not less than 7 days' notice and agenda of Board meeting, or a shorter notice in case of urgent business, in writing to every director of the company at his address registered with the company and call a Board Meeting to consider the proposal of alteration of objects clause of memorandum of association of company. [Section 173(3)]. Also follow the procedure prescribed for issuing and signing of notice of Board Meeting.
2. Hold a meeting of Board of Directors-
    - To pass the Board Resolution for approving the proposed amendments to the objects clause of MOA of the company subject to the approval of shareholders in General meeting.

- To delegate authority to any one director of the company to sign, certify and file the requisite forms with ROC and to do all such acts and deeds as may be necessary to give effect to the proposed alteration.
- To fix day, date, time and venue for holding the general meeting of the Company for passing a special resolution as required by section 13.
- To approve the draft notice of general meeting along with explanatory statement annexed to the notice as per requirement of the Section 102.
- To authorize the Director or Company Secretary to sign and issue notice of the general meeting.

3. If the company has raised money from public through prospectus and has any unutilized amount out of the money so raised, it shall follow the following additional steps for altering the objects clause of MOA of the Company:

   (a) Pass special resolution for alteration of Object clause of Memorandum of Association by means of Postal Ballot only.

   (b) Notice of the resolution for altering the objects shall contain the following particulars:

   - total money received;
   - total money utilized for the objects stated in the prospectus;
   - unutilized amount out of the money so raised through prospectus,
   - particulars of proposed alteration/ change in the objects;
   - justification for the alteration/change;
   - amount proposed to be utilized for the new objects;
   - estimated financial impact of the proposed alteration on the earnings and cash flow of the company;
   - other relevant information which is necessary for the members to take an informed decision on the proposed resolution;
   - Place from where any interested person may obtain a copy of the notice of the resolution to be passed.

   (c) Publish an advertisement, giving above mentioned details of special resolution to be passed, which shall be published simultaneously with the dispatch of postal ballot notices to shareholder at least once in a vernacular newspaper in the principal vernacular language and in English language in an English newspaper circulating at the place where the registered office of the company is situated and place it on the website of the Company if any, along with the justification for such change.

   (d) Give an opportunity to the dissenting shareholders to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

4. Send notice of the General meeting proposing the aforementioned special resolution to all the shareholders, directors, auditors and other persons entitled to receive it, by giving not less than clear 21 days' notice or shorter notice, if consent for shorter notice is given by at least 95% of members entitled to vote at such meeting, either in writing or through electronic mode in accordance with Section 101 of the Act.

5. Hold a shareholders meeting on the date for the meeting and pass the Special Resolution for altering the object clause of Memorandum of Association by 3/4th majority in accordance with Section 114 (2) of the Act.

   Special Resolution shall be passed by means of Postal ballot, if company has more than 200 members or the company has raised money from public through prospectus and still has any unutilized amount out of the money so raised.

6. Follow the procedure prescribed for preparing, signing and compiling of minutes of General Meeting.

7. After passing special resolution, file a certified copy of special resolution with the Registrar in form MGT-14 under Section 117 of the Act within 30 days of passing Special Resolution in general meeting along with the following attachments:

   (a) Copy of Special Resolution passed along with explanatory statement.

   (b) Notice for convening the General Meeting of the Company

   (c) Altered Memorandum of Association.

   (d) Shorter Notice Consent Letters from the members in case the General Meeting was convened and held at a shorter notice.

   (e) Any other attachment as may be considered as necessary in this regard.

Notes:

1. No alteration of object clause of Memorandum of Association shall have any effect until it has been registered in accordance with the provisions of this section. [Section 13(10)]
2. Any alteration of the memorandum, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void. [Section 13(11)]
3. The Registrar shall register the alteration of objects in Memorandum and certify the registration within a period of 30 days from the date of filing of the special resolution. [Section 13(9)]
4. Every Alteration made in the memorandum of the company shall be noted in every copy of the Memorandum of Association. [Section 15(1)]

SPECIMEN RESOLUTIONS

Sample Board Resolution for Alteration of Object Clause in MOA

"RESOLVED THAT pursuant to the provisions of section 13 and other applicable provisions, if any, of the Companies Act, 2013 (Act) read with rule 32 of the Companies (Incorporation) Rules, 2014 (including any statutory modification(s) or re-enactment thereof for the time being in force)and subject to the consent of the members in General meeting and approval from the Registrar of Companies and or any other statutory or regulatory authority, as may be necessary, Clause III (Objects Clause) of the Memorandum of Association of the Company, be and is hereby altered by inserting the following sub-clause under Part - A of Clause III, after the existing sub-clause 3 and the remaining sub-clauses be re-numbered accordingly:

'.....'

RESOLVED FURTHER THAT any of the Directors, and the Company Secretary of the company, be and are hereby severally authorized to file, sign, verify, execute and submit all such e-forms, papers or documents, as may be required and do all such acts, deeds and things as may be necessary and incidental for giving effect to this Resolution."

Sample Shareholder's Resolution to be passed in the General Meeting for Alteration of Object Clause in MOA

"RESOLVED THAT pursuant to the provisions of section 13 and other applicable provisions, if any, of the Companies Act, 2013 (Act) read with rule no. 32 (to be mentioned if applicable), of Companies (Incorporation) Rules, 2014 (including any statutory modification(s) or re-enactment thereof for the time being in force) consent of the members in General meeting be and is hereby given for re-structuring of the Object clause of the memorandum of association of the company subject to the approval from the Registrar of Companies and or any other statutory or regulatory authority, as may be necessary, Clause III (Objects Clause) of the Memorandum of Association of the Company, be and is hereby altered by inserting the following sub-clause under Part - A of Clause III, after the existing sub-clause 3 and the remaining sub-clauses be re-numbered accordingly:

'.....'

"**RESOLVED FURTHER THAT** any Director, the Chief Financial Officer and the Company Secretary of the Company, be and are hereby severally authorized to file, sign, verify, execute and submit all such e-forms, papers or documents, as may be required and do all such acts, deeds, matters and things as may be necessary and incidental for giving effect to this Resolution, including agreeing to any change to the aforesaid sub-Clause 4 under Clause III of the Memorandum of Association of the Company which pertains to the Objects of the company, as may be required by the ROC and/or any statutory/regulatory authority."

Explanatory Statement Pursuant to Section 102 of the Companies Act, 2013

Item No. _____

The principal business of the Company is providing long term finance to any person or persons, company or corporation, society or association of persons with or without interest and with or without any security, to construct/ purchase any houses, buildings or flats, furnished or otherwise. The Company proposes to undertake the activity of distribution of life insurance products of PQR Life Insurance Company Limited with no risk participation.

To enable the Company to commence the aforesaid business, it is proposed to amend the Main Objects under the Objects Clause of the Memorandum of Association of the Company, by the insertion of sub-clause 4 after the existing sub-clause 3 as stated in the Resolution in the annexed notice. The above amendment would be subject to the approval of the Registrar of Companies, Maharashtra, Mumbai and any other Statutory or Regulatory Authority, as may be necessary in this regard.

A copy of the Memorandum and Articles of Association of the Company together with the proposed alterations is available for inspection by the Members of the Company at its Registered Office during normal business hours on all working days up to the date of the Meeting and is also attached to the annexed notice, The Directors recommend the passing of the Draft Resolution placed under Item No. 1 of the accompanying Notice for the approval of the Members of the Company.

None of the other Directors of the Company or the Key Managerial Persons of the Company or their relatives, are concerned or interested in the passing of the above resolution.

D. ALTERATION OF LIABILITY CLAUSE

According to section 13(1) of the Act, a company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum. It means that a company can change the liability clause of its memorandum of association by passing a special resolution.

Further section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar the special resolution passed by the company under section 13(1) through E-Form MGT-14.

SPECIMEN RESOLUTION:

Sample Shareholders' Resolution to be passed in the General Meeting

"RESOLVED THAT pursuant to the provisions of Section 13 and other applicable provisions of the Companies Act, 2013 read with rules made thereunder, as amended time to time and subject to such approvals, permissions and sanctions of Registrar of Companies, the consent of the members of the company be and is hereby accorded for substitution of Clause VI of the Memorandum of Association of the company the following clause:

"The liability of members is limited and this liability is limited to the amount unpaid, if any, on the shares held by them."

RESOLVED FURTHER THAT the Board of Directors of the company or any other officer, authorized by the Board, be and are/is hereby authorized to do all such, acts, things. deeds and matters that may be deemed necessary, proper, expedient or incidental for the purpose of giving effect to the aforesaid resolution."

E. ALTERATION OF CAPITAL CLAUSE IN MOA [SECTION 61 READ WITH SECTION 64]

Types of alteration of capital clause in the general meeting of a company limited by shares as per section 61 (1) of the Companies Act, 2013 can be enumerated as below: -

(a) increase its authorised share capital by such amount as it thinks expedient;

(b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares:

Provided that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;

(c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;

(d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

All the above alterations do not require the confirmation by the Tribunal except that alteration relating to consolidation and division which results in changes in the voting percentage of shareholders shall not take effect unless it is approved by the Tribunal on an application made in the prescribed manner.

These alterations are, however, required to be notified and a copy of the resolution should be filed with the Registrar within 30 days of the passing of the resolution along with an altered memorandum. [Section 64(1)]

The Registrar shall record the notice and make any alteration which may be necessary in the company's memorandum or articles or both.

The cancellation of shares under section 61(1) of the Act shall not be deemed to be a reduction of share capital. Section 64 (1) provides that a notice is required to be given to the Registrar for alteration for share capital.

Procedure for altering the Memorandum of Association for increasing the Authorised Capital of the Company under Section 61 and 64 of the Companies Act 2013 read with Rule 15 of the Companies (Share Capital and Debenture) Rules, 2014

1. **Check for Authorization in Articles**: Section 61 of the Companies Act, 2013, mandates that for increasing the Authorised share capital, authorization in Articles of Association is a pre-condition.

   If there is no such provision then the company has to take steps for alteration of its Articles of Association in accordance with the provision of Section 14 of the Companies Act, 2013, so as to insert the clause enabling increase in the authorised share capital.

2. **Calling of Board Meeting**: Issue notice in accordance with the provisions of section 173(3) for convening a meeting of the Board of Directors. Main agenda for this Board meeting would be:

   (a) To get in-principal approval of Directors for Increase in authorised share Capital;

   (b) Fix date, time and place for holding Extra-ordinary General meeting (EGM) to get approval of shareholders, by way of Ordinary Resolution, for amendment in authorised share Capital clause of Memorandum of Association. This amendment in authorised share Capital clause of Memorandum of Association shall be in accordance with the requirement of section 61 of the Companies Act, 2013;

   (c) To approve notice of EGM along with Agenda and explanatory statement pursuant to be annexed to the notice of General Meeting as per section 102(1) of the Companies Act, 2013;

   (d) To authorize the Director or Company Secretary to issue Notice of the Extra-ordinary General meeting (EGM) as approved by the board under clause 2(c) mentioned above.

3. Issue Notice of the EGM to all members, legal representative of deceased member, assignee of an insolvent member if any, directors and the auditors of the company in accordance with the provisions of Section 101.

4. Holding of general meeting: To hold the EGM on fixed date and pass the necessary ordinary resolution under section 61(1)(a) for increase in the authorized share capital of the Company.

5. ROC Form filing: File Form SH-7 within 30 days of passing of Ordinary Resolution with the concerned ROC, with prescribed fees and along with following attachments as desired by section 64 read with Rule 15 of the Companies (Share Capital and Debentures) Rules, 2014:

   a. Notice of EGM;

   b. Certified True copy of Ordinary Resolution along with the explanatory statement pursuant to Section 102 of the Act;

   c. Altered Memorandum of Association.

6. Concerned ROC will check the e-form and attached documents and will approve the increase in authorize share capital.

7. The company shall file a notice in the prescribed form with the Registrar within a period of 30 days of alteration to its share capital along with a copy of altered Memorandum. [Section 64].
8. No need to pass Special Resolution for increase in authorised share capital.

However, in case the alteration of capital clause of the Memorandum of Association of the company requires the alteration of the Articles of Association of the company then, the special resolution for the alteration of articles of association of the company be passed and form MGT-14 should also be filed for the filing of copy of such special resolution with the concerned Registrar within 30 days from the date of passing of such resolution along with the prescribed fees.

SPECIMEN RESOLUTIONS

Sample Board Resolution for Alteration of Capital Clause in MOA

A. Increase in Authorised Share Capital

"**RESOLVED THAT** pursuant to the provisions of Section 61 and 64 and other applicable provisions, if any, of the Companies Act, 2013 (including any amendment thereto or re-enactment thereof) and the rules framed there under, the consent of the Board of Directors of the Company be and is hereby accorded, subject to the approvals of shareholders in the General meeting, to increase the Authorized Share Capital of the Company from existing Rs. 50,00,000 (Rupees Fifty Lacs) divided into 5,00,000 (Five Lacs) Equity Shares of Rs. 10/- each to Rs. 75,00,000 (Rupees Seventy Five Lacs) divided into 7,50,000 (Seven Lacs Fifty Thousand) Equity Shares of Rs. 10/- each by creation of additional 2,50,000 (Two Lacs Fifty Thousand) Equity Shares of Rs. 10/- each ranking pari passu in all respect with the existing Equity Shares of the Company.

B. Alteration in the Capital Clause of Memorandum of Association of the company

"**RESOLVED THAT** pursuant to the provisions of Section 13, 61 and 64 and other applicable provisions of the Companies Act, 2013 (including any amendment thereto or re-enactment thereof) and the rules framed thereunder, the consent of the Board of Directors of the Company be and is hereby accorded, subject to the approvals of shareholders in the General meeting, for substituting Clause V of the Memorandum of Association of the Company with the following clause.

"V. The Authorised Share Capital of the Company is Rs. 75,00,000/- (Rupees Seventy Five Lacs Only) divided into 7,50,000 (Seven Lacs Fifty Thousand) Equity Shares of face value of Rs. 10/- (Rupees Ten Only) each."

Sample Shareholders' Resolution to be passed in the General Meeting

a. Increase in Authorised Share Capital

Special Business

To consider, and if thought fit, to pass with or without modification(s), the following resolution as an Ordinary Resolution:

"RESOLVED THAT pursuant to the provisions of Section 61 read with Section 64 and other applicable provisions, if any, of the Companies Act, 2013 (including any amendment thereto or re-enactment thereof) and the rules framed there under, the consent of the members of the Company be and is hereby accorded to increase the Authorized Share Capital of the Company from existing Rs. 50,00,000/- (Rupees Fifty Lacs Only) divided into 5,00,000 (Five Lacs) Equity Shares of Rs.10/- each to Rs. 75,00,000/- (Rupees Seventy Five Lacs Only) divided into 7,50,000 (Seven Lacs Fifty Thousand) Equity Shares of Rs.10/- (Rupees Ten Only) each by creation of additional 2,50,000 (Two Lacs Fifty Thousand) Equity Shares of Rs.10/- each ranking pari passu in all respect with the existing Equity Shares of the Company."

"RESOLVED FURTHER THAT the Memorandum of Association of the Company be altered in the following manner i.e. existing Clause V of the Memorandum of Association of the company be deleted and the same be substituted with the following new clause as Clause V:

'V. The Authorised Share Capital of the Company is Rs.75,00,000/- (Rupees Seventy Five Lacs) divided into 7,50,000 (Seven Lacs Fifty Thousand) Equity Shares of face value of Rs.10/- (Rupees Ten Only) each.'"

"RESOLVED FURTHER THAT for the purpose of giving effect to this resolution, the Board of Directors of the Company (hereinafter referred to as "Board" which term shall include a Committee thereof authorized for the purpose) be and is hereby authorized to take all such steps and actions and give such directions as may be in its absolute discretion deemed necessary and to settle any question that may arise in this regard, without being required to seek any further consent or approval of the shareholders or otherwise and that the shareholders shall be deemed to have given their approval thereto expressly by the authority of this resolution."

REGISTRATION OF ALTERATION

Section 13(6)(a) provides that a company shall, in relation to any alteration of its memorandum, file with the Registrar:

(a) the special resolution passed by the company under section 13(1); and

(b) the approval of the Central Government under section 13(2), if the alteration involves any change in the name of the company.

The special resolution shall be filed with the Registrar within thirty days of the passing or making thereof in the prescribed manner and payment of prescribed fees within the time specified under section 403.

As per section 13(9), the Registrar shall register any alteration of the memorandum with respect to the objects of the company and certify the registration within a period of thirty days from the date of filing of the special resolution in accordance with section 13 (6)(a).

Further section 13(7) provides that where an alteration of the memorandum results in the transfer of the registered office of a company from one State to another, a certified copy of the order of the Central Government approving the alteration shall be filed by the company with the Registrar of each of the States within such time and in such manner as may be prescribed, who shall register the same, and the Registrar of the State where the registered office is being shifted to, shall issue a fresh certificate of incorporation indicating the alteration.

The certificate of incorporation shall be conclusive evidence that all the requirements of this Act with respect to the alteration and confirmation thereof have been complied with. The Registrar of the State from which the registered office is transferred will send to the Registrar of the other State all the documents relating to the company registered in his office.

No alteration made under section 13 (i.e., alteration of memorandum) shall have any effect until it has been registered in accordance with the provisions of this section. [Section 13(10)].

The main spirit behind Section 13(7) of the Companies Act, 2013 in regard to the filing of the order confirming the transfer of the company's registered office from one State to another State with the Registrar of Companies of each State is that the Registrar of Companies from whose State the registered office is transferred should keep the order duly registered in his office as an evidence to such shifting and should transfer all other records of the company to the Registrar of Companies to whose State the Registered Office of the company has been so shifted. The other Registrar of Companies will register the other copy of the order and keep that order with the records transferred to him by his counterpart.

ARTICLES OF ASSOCIATION

Introduction

- Articles of association form a document that specifies the regulations for a company's operations and defines the company's purpose.
- The document can be thought of as a user's manual for a company, defining its purpose and outlining the methodology for accomplishing necessary day-to-day tasks.
- Articles of association lays out how tasks are to be accomplished within the organization, including the process for appointing directors and the handling of financial records.

Definition and provisions pertaining to Articles

According to Section 2(5) of the Companies Act, 2013, 'articles' means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act. It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company.

Further, In terms of section 5(1), the articles of a company shall contain the regulations for management of the company.

The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business. The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company *inter se*. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in *Ashbury Railway Carriage and Iron Co. Ltd.* v. *Riche, (1875) L.R. 7 H.L. 653* as follows:

"The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit".

Thus, the memorandum lays down the scope and powers of the company, and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members.

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or *ultra vires* the memorandum, nor should it be contrary to the provisions of the Companies Act 2013.

CASE LAWS

The articles regulate the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contract between the company and the members and between the members *inter se*. This contract governs the ordinary rights and obligations incidental to membership in the company [*Naresh Chandra Sanyal* v. *The Calcutta Stock Exchange Association Ltd.,* AIR 1971 SC 422, (1971) 41 Com Cases 51].

But the Articles of Association of a company are not 'law' and do not have the force of law. In *Kinetic Engineering Ltd.* v. *Sadhana Gadia,* (1992) 74 Com Cases 82 : (1992) 1 Comp LJ 62 (CLB), the Hon'ble CLB held that if any provision of the articles or the memorandum is contrary to any provisions of any law, it will be invalid in total.

Articles Subordinate to Memorandum

CASE LAWS

The articles of a company are subordinate to and subject to the memorandum of association and the Act. Any clause in the Articles going beyond the memorandum will be *ultra vires*. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to what they think fit. Only care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum *[Ashbury v. Watson, (1885) 30 Ch. D 376 (CA)]*. Articles that go beyond the company's sphere of action are inoperative, and anything done under the authority of such article is void and incapable of ratification.

But, neither the articles nor the memorandum can authorize the company to do anything so as to contravene any of the provisions of the Act. *[See Re Peveril Gold Mines, (1989) 1 Ch 122 (CA)]*.

The functions of the Articles in relation to the Memorandum have already been summed up in the Ashbury Railway Carriage case and even though the articles are subordinate to the memorandum yet if there be any ambiguity in the memorandum, the articles may be used to explain it but not so as to extend the objects. *[Re. South Durham Brewery Company (1885) 3 Ch. D 261]*. The memorandum of a company was not clear as to the classes of shares to be issued by a company, but the articles made clear the doubt by giving the power to the company to issue shares of different classes.

The relationship between the two documents was further emphasized in *Guinness v. Land Corporation of Ireland, (1882) 22 Ch D 349,* where it was observed: "The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors, and the outside public, as well as of the shareholders. The articles of association are the internal regulations of the company. How can it be said that in all cases the fundamental conditions of the charter of incorporation and the internal regulations of the company are to be construed together... In any case it is, as it seems to me, certain that for anything which the Act of Parliament says shall be in the memorandum you must look at the memorandum alone. If the legislature has said one instrument is to be dominant you cannot turn to another instrument and read it in order to modify the provisions of the dominant instrument".

Where the memorandum clearly establishes the rights of shareholders, a reference in the memorandum to the articles and an ambiguity said to arise from the construction of the articles should not be used to depart from the clear meaning of the memorandum so as to diminish those rights *[Scottish National Trust Co. Ltd. 1928 SC 499 (Scot); Kinetic Engineering Ltd. v. Sadhana Gadia, (1992) 1 Comp LJ 62 (CLB)]*.

REGISTRATION OF ARTICLES

Section 7(1) provides that at the time of incorporation of a company the company shall file with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company duly signed by all the subscribers to the memorandum in the prescribed manner.

- The articles of a company shall be in respective forms specified in Tables, F, G, H, I and J in Schedule I as may be applicable to such company either in totality or otherwise. [Section 5(6)].
- A company may adopt all or any of the regulations contained in the model articles applicable to such company. [Section 5(*7*)].
- In case of any company, which is registered after the commencement of this Act, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company. [Section 5(8)].
- The articles of a private company must contain the three restrictions as contained in Section 2(68).
- However, nothing in section 5 shall apply to the articles of a company registered under any previous company law unless amended under this Act [Section 5(9)].

Alignment of AoA with the Companies Act, 2013:

Section 6 of the Companies Act, 2013 provides that: -

(a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and

(b) any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be.

In the light of above provisions, if there is a provision in the Articles empowering the Directors of the company to expel any member of the company under any of the given conditions, then such a provision shall be totally inconsistent with the provisions of Section 6 of the Act. It is opposed to the fundamental principles of the company's jurisprudence and is *ultra vires* of the company. [(Circular No. 32 of 1975) dated 01.11.1975)]

But the Stock exchanges, registered under the provisions of the Companies Act, can carry such a provision in its Articles. The regulation of stock exchanges is mainly governed by Securities Contracts Regulation Act, 1956 (SCRA) and SEBI, Act, 1992 which are Special Acts. Hence, the Articles of Stock Exchange may provide for additional matters as per SCR Act, which may not be possible for inclusion in the Articles of a company, as per the provisions of the Companies Act. [*Madras Stock Exchange Ltd*. v. *S.S.R. Rajkumar* (2003) 116 Com Cases 214 (Mad.)].

ENTRENCHMENT PROVISIONS

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution, are met or complied with. [Section 5 (3)]

The Companies Act 2013, recognizes an interesting concept of entrenchment. Essentially, the entrenchment provisions allow for certain clauses in the articles to be amended upon satisfaction of certain conditions or restrictions greater than those prescribed under the Act (such as obtaining 100% consent). This provision acts as a protection to the minority shareholders and is of specific interest to the investment community. This shall empower the enforcement of any pre-agreed rights and provide greater certainty to investors, especially in joint ventures.

According to section 5(4), the provisions for entrenchment referred in section 5(3) shall be made either :

(a) on formation of a company, or

(b) by an amendment in the articles agreed to by all the members of the company in the case of a private company and by a special resolution in the case of a public company.

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed. [Section 5 (5)].

Where the articles contain the provisions for entrenchment, the company shall give notice to the Registrar of such provisions in SPICe+ *(Simplified Proforma for Incorporating company Electronically Plus: INC-32)* as the case may be, along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014 at the time of incorporation of the company or in case of existing companies, the same shall be filed in Form No.MGT.14 within thirty days from the date of entrenchment of the articles, as the case may be, along with the fee as provided in the Companies (Registration offices and fees) Rules, 2014.

CONTENTS OF ARTICLES

The articles of association usually specifies the way a company issues securities, distributes dividends, and performs financial records. The document is focused on giving the streamlined information about the methods a company uses to achieve its goals. In general, it includes the following:

1. Exclusion wholly or in part of Table F
2. Adoption of preliminary contracts
3. Share capital variation of rights, Number and value of shares.
4. Meetings and rules regarding committees of the Board.
5. Provisions on shareholder meetings

The articles must contain provisions in respect of all matters which are required to be contained therein so as not to hamper the working of the company later.

INTERPRETATION OF MEMORANDUM AND ARTICLES

Articles should be construed as a business document so as to give business efficacy preference to a construction which will prove unworkable [*Holmes v. Keyes (Lord) (1958) 2 All ER 129 (CA)*;]. Where the conduct of the parties reveals that there has been some practice in vogue for several years which was accepted by everyone concerned without any challenge or question, then that practice in the course of long years in itself becomes an indication that the rules or articles which are framed by way of internal management were understood in that sense [*Krishnaswamy (S)* v. *South India film Chamber of Commerce, AIR 1969 Mad 42 : (1968) 1 Comp LJ 75;* cited in *Sunil Dev* v. *Delhi and District Cricket Assn., (1990) 2 Comp LJ 245, 255 : (1994) 80 Com Cases 174 (Del)].*

The memorandum must like any other document be construed according to accepted principles applicable to the interpretation of all legal documents. No rigid canon of construction is to be applied to such a document. Like any other document, it must be read fairly and its import derived from a reasonable interpretation of the language which it employs. [*A Lakshamanaswami Mudaliar* v. *LIC of India (1963) 33 Com Cases 420, 430 (SC); Egyptian Salt & Soda Co. Ltd. v. Port Said Salt Assn Ltd., (1931) AC 677 : AIR 1931 PC 182)].*

The memorandum and articles must be read together in the event of any ambiguity. In *Angostura Bitters & Co. Ltd.* v. *Kerr, (1933) AC 550 : (1934) 4 Com Cases 1*; the Privy Council held, "Except in respect of such matters as must be statutorily provided for by the conjunction with the articles. The two documents must be read together at all events so far as may be necessary to explain any ambiguity appearing in the terms of the memorandum or to supplement it upon any matter as to which it is silent" – quoted with approval by the Supreme Court in *A. Lakshmanaswami Mudaliar* v. *LIC of India Ltd. (1963) SC 1185*.

DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The main points of distinction between the memorandum and articles are given below:

Memorandum of Association	***Articles of Association***
Memorandum of association is the charter of the company and defines the fundamental conditions and objects for which the company is granted incorporation.	Articles of association are the rules and regulations framed to govern this internal management of the company.
Clauses of the memorandum cannot be easily altered. They can only be altered in accordance with the mode prescribed by the Act. In some of the cases, alteration requires the permission of the Central Government or the Court.	In the case of articles of association, members have a right to alter the articles by a special resolution. Generally, there is no need to obtain the permission of the Court or the Central Government for alteration of the articles.
Memorandum of association cannot include any clause contrary to the provisions of the Companies Act.	The articles of association are subsidiary both to the Companies Act and the memorandum of association.
The memorandum generally defines the relation between the company and the outsiders.	The articles regulate the relationship between the company and its members and between the members *inter se*.
Acts done by a company beyond the scope of the memorandum are absolutely void and *ultra vires* and cannot be ratified even by unanimous vote of all the shareholders.	The acts of the directors beyond the articles can be ratified by the shareholders.

LEGAL EFFECT OF THE MEMORANDUM AND ARTICLES

According to section 10(1):

The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles.

Further sub-section 2 of section 10 of the Act states that, all monies payable by any member to the company under the memorandum or articles shall be a debt due from him to the company.

We shall examine the extent to which the memorandum and articles bind:

(a) the members to the company;

(b) the company to the members;

(c) the members *inter se;* and

(d) the company to outsiders.

Members Bound to the Company

The memorandum and articles constitute a contract binding on the members of the company. The members, as members, are bound to the company. Each member must, therefore, observe the provisions of the memorandum and articles.

Each member is bound by the covenants of the Memorandum as originally made and as altered from time to time [*Malleson v. National Insurance Co.*]. In another case, the shareholders could not enter into an agreement which was contrary to or inconsistent with the articles of association of the company [*V.B. Rangaraj v. V.B. Gopalkrishnan (1992) 73 Com Cases 201 (SC)].*

CASE LAW

In *Boreland's Trustee v. Steel Brother and Co. Ltd. (1901) 1 Ch. 279,* the articles of a company contained a clause that on the bankruptcy of a member his shares would be sold to other persons and at a price fixed by the directors. B, a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at their true value. It was held that the trustee was bound by the articles, as the shares were purchased by B in terms of the articles

Company Bound to the Members

Since the articles constitute a contract binding the company to its members in their capacity as members, a member can bring an action against the company for infringement by it of the memorandum or articles. For example, an individual member can sue the company for an injunction restraining it from improper payment of dividend [*Hoole* v. *Great Western Railway (1867) 3 Ch. D. 262].* Further, the company is bound to individual members in respect of their ordinary rights as members, e.g. the right to receive share certificate in respect of shares allotted to them, or to receive notice of general meeting, etc. Normally, action for breach of articles against the company can be brought only by a majority of the members. Individual or minority members cannot bring such a suit except when it is intended for enforcement of personal rights of members or to prevent the company from doing any *ultra vires* or illegal act, fraud, or oppression and mismanagement.

Member bound to Member

As between the members inter se each member is bound by the articles to the other members but that does not mean the memorandum and articles create an express contract among the members of the company. Thus, a member of a company has no right to bring a suit to enforce the articles in his own name against any other member or members. It is the company alone which can sue the offender so as to protect the aggrieved member. It is in this way that the rights of members inter se are regulated. A shareholder may, however, sue in his own name to restrain another, or others from doing fraudulent or *ultra vires* acts.

Articles do not affect or regulate the rights arising out of a commercial contract, with which the members have no concern, i.e., rights completely outside the company's relationship.

Company not bound to Outsiders

The term "outsider" signifies a person who is not a member of the company even if he is a director of or solicitor to the company. Even in regard to members, the articles bind the company to them in their capacity as members.

As between outsiders and the company, neither the memorandum nor the articles would give any contractual rights to outsiders against the company or its members even though the names of outsiders are mentioned in those documents in connection with the arrangements that the company might have contemplated for carrying on its business. The articles do not confer any contractual rights even upon a member in a capacity other than that of a member. To succeed, the party suing must prove a contract outside and independent of the articles [*Eley* v. *Positive Life Insurance Co., (1876) 1 E.X.D. 88*].

In this case the articles provided that the solicitor to the company would not be removed from office except for misconduct. Eley acted as solicitor to the company and also became a member of the company. The company discontinued his services and then he sued the company for damages for breach of contract. It was held that he had no cause of action because the articles did not constitute any contract between the company and himself. His action was dismissed.

This rule, however, proved to be rather harsh and so the Courts later on modified it. The modified rule is as follows:

(i) While the articles cannot create a contract between the company and any person other than a member in his capacity as a member, they may indicate the basis upon which contracts may be made by the company. If such a contract is entered into whether with a member of the company or any other person, the conditions stated in the articles will be tacitly adopted by that contract, unless expressly stated in the negative form or varied by the contract itself.

(ii) The question sometimes arises as to whether directors are bound by whatever is contained in the articles. In case the directors contravene the provisions in the articles, the directors render themselves liable for an action by members. On the other hand, members can also ratify acts of directors. If any loss is incurred by the company, directors are liable to reimburse to the company any loss so incurred.

ALTERATION OF ARTICLES OF ASSOCIATION OF A COMPANY

Any Company which intended to make any change to the Articles, will have to comply with the provisions as mentioned under section 14 of Act along with any other applicable provisions of the Act and applicable rules.

A Company may alter its Articles in accordance with the above provisions in any of the following manner:

(a) by adoption of new set of articles;

(b) by addition/insertion of a new Clause/s;

(c) by deletion of a Clause/s ;

(d) by amendment of a specific Clause/s ;

(e) by substitution of a specific Clause/s.

i) Section 14(1) provides that subject to the provisions of the Act and the conditions contained in its memorandum, if any, a company may, by a special resolution, alter its articles including alterations having the effect of conversion of –

A) a private company into a public company; or

B) a public company into a private company.

First proviso to section 14(1) lays down that where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company.

Further, the second proviso to section 14(1) stipulates that any alteration having the effect of conversion of a public company into a private company shall not take effect unless it is approved by an order of the Central Government on an application made in prescribed form shall make such order as it may deem fit.

ii) Every alteration of the articles under this section and a copy of the order of the Central Government approving the alteration as per section 14(1) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same. [Section 14 (2)]

iii) Any alteration of the articles registered under section 14(2) shall, subject to the provisions of this Act, be valid as if it were originally in the articles. [Section 14(3)]

CASE LAWS

In Re Cyrus Investments (P.) Ltd. vs. Tata Sons Ltd. [2019] 112 taxmann.com 264 (NCLAT)

If any company decides to alter its articles having effect of conversion of a 'Private Company' into a 'Public Company' or a 'Public Company' into a 'Private Company', it is required to pass a special resolution and as per sub-section (2) of section 14, it requires approval by Tribunal

In Re *Walker v. London Tramway Co. (1879) 12 Ch. D. 705*

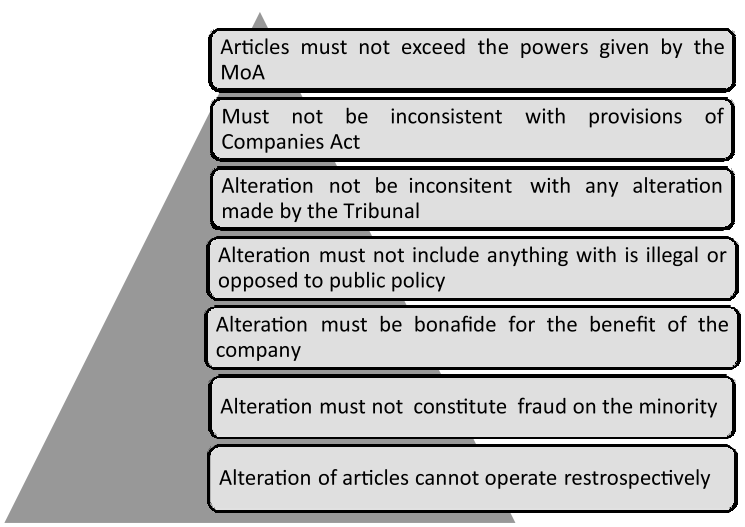
The right to alter the articles is so important that a company cannot in any manner, either by express provisions in the articles or by independent contract, deprive itself of the powers to alter its articles.

Alterations of memorandum or articles to be noted in every copy

Every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be. [Section 15(1)]

If a company makes any default in complying with the provisions of section 15(1), the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the memorandum or articles issued without such alteration. [Section 15(2)]

Limitations on power to alter Articles



In spite of the power to alter its articles, a company can exercise this power subject only to certain limitations. These are:

1. The alteration must not exceed the powers given by the memorandum. In the event of conflict between the memorandum and the articles, it is the memorandum that will prevail.
2. The alteration must not be inconsistent with any provisions of the Companies Act or any other statute.

   Similarly, where a resolution was passed expelling a member and authorizing the director to register the transfer of his shares without an instrument of transfer, the resolution was held to be invalid as being against the provisions of the Act *[Madhava Ramachandra Kamath v. Canara Banking Corporation [1941] 11 Com Cases 78 (Mad)]*.

   On the other hand, articles may impose on the company conditions stricter than those provided under the law; for example, they may provide that a matter should be passed by a special resolution when the Act requires it to be passed by an ordinary resolution.
3. The Articles must not include anything which is illegal or opposed to public policy.
4. The alteration must be bona fide for the benefit of the company as a whole.
5. The alteration must not constitute a fraud on the minority by a majority. If the alteration is not for the benefit of the company as a whole, but for majority of shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage over the latter. [All India Railway Mens *Benefit Fund v. Jamadar Baheshwarnath Bali (1945) 15 Com Cases 142 (Nag.*)]

   In *Mathrubhumi Printing & Publishing Co. Ltd.* v. *Vardhaman Publishers Ltd. [1992] 73 Com Cases 80 (Ker.)*, the Hon'ble Kerala High Court held that no majority of shareholders can, by altering the article retrospectively, affect, the prejudice of the consenting owners of shares, the right already existing under a contract nor take away the right accrued, e.g., after a transfer of share is lodged, the company cannot have a right of lien so as to defeat the transfer.
6. Articles cannot be altered so as to compel an existing member to take or subscribe for more shares or in any way increase his liability to contribute to the share capital, unless he gives his consent in writing (Section 38 of the Companies Act, 1956).
7. By effecting alteration in its articles, a company cannot defeat escape from its contractual obligation with any person. The company will always be liable in such a case.
8. The Articles of Association cannot be altered so as to have retrospective effects. The articles only operate from the date of the amendment *[Pyare Lal Sharma v. Managing Director, J.K. Industries Ltd. (1989) 3 Comp LJ (SL) 70]*.

CASE LAWS

In Re *See Menier N. Hooper Telegraph Works (1874) 9 Ch. App. 350*

A section or a class of shareholders cannot be unfairly or oppressively treated. Thus, though the requisite majority of members could pass a special resolution to alter the Articles and if the alteration has the effect of making a fraud on the minority, the minority shareholders not being less than the number specified under law could move the Court for redressing their grievances. The Courts have entertained such applications from shareholders even where they are smaller in number.

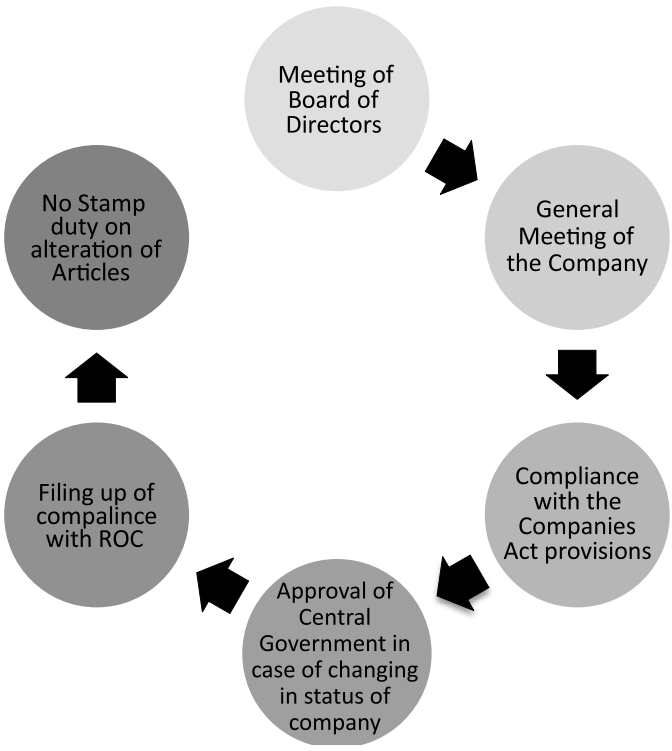
In Re *Southern Foundries v. Shirlaw, [1940] AC 701*

As already mentioned, a company is not prevented from altering its Articles on the ground that such an alteration would be breach of a contract but an action for damages may lie against the company.

In Re *Foss v. Harbottle (1843) 2 Hare 461*

The discussion on the above matter will not be complete without referring to the rule in Foss v. Harbottle (1843) 2 Hare 461 where the court held that no individual shareholder nor a minority of shareholders in a company can take it upon himself or themselves to remedy an alleged wrong involved in the actions of directors if the said wrongful act is something which the majority can regularize and approve.

Procedure for alteration of AOA under Section 14



1. **Meeting of Board of Directors:**

   Issue not less than 7 days' notice and agenda of Board meeting, or a shorter notice in case of urgent business, in writing to every director of the company at his address registered with the company and call a Board Meeting to consider the proposal of alteration of articles of association of a company.

   1.1 Hold a meeting of Board of Directors-

   - To consider and decide the articles required to be changed/altered.
   - To pass the necessary Board Resolution for approving proposal of alteration of articles of association of a company subject to the approval of Shareholders.
   - To delegate authority to any one director of the company to sign, certify and file the requisite forms with Registrar of Companies or any statutory authority to do all such acts, deeds as may be necessary to give effect to the proposed alteration.

- To fix day, date, time and venue for holding general meeting of the Company for passing a special resolution as required by section 14(1) of the Companies Act, 2013.
- To approve the draft notice of general meeting along with Explanatory Statement.
- To authorize the Director or Company Secretary to sign and issue notice of the general meeting.

1.2 Prepare and circulate draft minutes within 15 days from the date of the conclusion of the Board Meeting, by hand/speed post/registered post/courier/e-mail to all the Directors for their comments. Follow the procedure prescribed for preparing, circulation, signing and compiling of Board Minutes. (Revised Secretarial Standards-1 w.e.f. 1st October, 2017).

2. General Meeting of the company:

Send notice of the General meeting proposing the aforementioned special resolution to all the shareholders, directors, auditors and other persons entitled to receive it, by giving not less than clear 21 days' notice or shorter notice, if consent for shorter notice is given by at least 95% of members entitled to vote at such meeting, either in writing or through electronic mode in accordance with the Section 101 of the Act. Also follow the procedure prescribed for issuing and Signing of notice and convening of General Meeting. (Revised Secretarial Standards-2)

2.1 Hold a shareholders meeting on the date fixed for the meeting and pass the Special Resolution for altering the Articles of Association by 3/4th majority or unanimously, in case of insertion of provisions of entrenchment by a private company in accordance with Section 114 (2) of the Act read with Section 5(4) and Section 14 of the Companies Act, 2013.

2.2 After passing special resolution, file a certified copy of special resolution with the Registrar in e-Form MGT- 14 under Section 117 of the Act within 30 days of passing Special Resolution in general meeting along with the following attachments:

(a) Copy of Special Resolution passed along with explanatory statement.

(b) Notice for convening the General Meeting of the Company along with explanatory statement as an optional attachment.

(c) Certified True copy of the Altered Articles including the provisions of entrenchment inserted in the articles, if any.

(d) Shorter Notice Consent Letters from at least 95% of the members in case the General Meeting was convened at a shorter notice.

(e) Any other attachment as may be required/applicable.

2.3 Follow the procedure prescribed for preparing, signing and compiling of minutes of General Meeting. (Revised Secretarial Standards-2)

3. Make necessary amendments in all the copies of Articles of association of the Company. [Section 15(1)]

4. Compliance with the Companies Act, 2013 and Memorandum of Association

The alteration to AOA should conform to the provisions of the Companies Act, 2013. For example, the alteration should not modify the membership or shareholding of the company. The alteration should not increase or alter the liability of any member or shareholder of the company. The articles are procedural, and hence the alteration can be of only the procedural matters contained therein.

Likewise, the alteration of the articles should not violate the memorandum of association of the company. The alteration should be in accordance with the powers conferred by the memorandum. The AOA is subordinate to the memorandum of association of the company. The alteration cannot alter the objects of the company or the address of the registered office of the company. These matters are dealt with by the Memorandum of Association of the company.

5. **Stamp duty on alteration of articles:**

   The company need not pay any stamp duty on the alteration of articles. Stamp duty has to be paid only at the time of incorporation of a company.

Note:

Where a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company. [First proviso to Section 14(1)]

Any alteration having the effect of conversion of a public company into a private company shall not be valid unless it is approved by an order of the Central Government on an application made in such form and manner as may be prescribed. [Second proviso to section 14(1)]

For effecting the conversion of a public company into a private company, Service Request Number (SRN) of Form No. RD- 1, pertaining to order of the Regional Director approving the alteration, shall be mentioned in Form No. INC-27 to be filed with Registrar along with fee together with the altered e-Memorandum of Association and e-Article of Association within fifteen days from the date of receipt of the order from the Regional Director. Explanation.- the term "competent authority" means, the Central Government.]Section 14 read with rule 33 of the Companies (Incorporation) Rules, 2014]

Section 8(4)(i) provides that a company registered under section 8 i.e. companies with charitable objects shall not alter the provisions of its memorandum or articles except with the previous approval of the Central Government.

Effect of Altered Articles:

- The altered articles shall bind the company and the members to the same extent as if they had been signed by the company and by each member, means the articles as originally framed, or as they may from time to time stand altered are valid under the provisions of the Act.
- There is clear power to alter the articles, and as altered, they bind members just in the same way as did the original articles.
- The alteration is effective only when the procedure laid down in the Companies Act and Memorandum is followed.
- The changes shall be made in all the copies of the Articles of Association.

SPECIMEN RESOLUTIONS:

Sample Board Resolution for Alteration of Articles of Association of the Company

Adoption of new set of Articles of Association of the Company:

"RESOLVED THAT pursuant to Section 5 and 14 and other applicable provisions, if any, of Companies Act, 2013, (including any statutory modifications or re-enactment thereof, for the time being in force), and the rules framed there under, consent of the Board of Directors of the Company be and is hereby accorded, subject to the approval of the Registrar of Companies, and subject to the approval of Shareholders in General Meeting, to adopt new set of Articles of Association of Company."

FURTHER RESOLVED THAT for the purpose of giving effect to this resolution, Mr. ABC, Director of the Company be and is hereby authorised, on behalf of the Company, to do all acts, deeds and things as may deemed to be necessary, proper or desirable and to sign and execute all necessary documents, applications and returns for the purpose of giving effect to the aforesaid resolution along with filing of necessary E-forms with the Registrar of Companies,... "

Sample Shareholders Resolution for Alteration of Articles

Adoption of new set of Article of Association of the Company:

"RESOLVED THAT pursuant to the provisions of Section 14 and other applicable provisions, if any, of the Companies Act, 2013, (including any amendment thereto or re-enactment thereof), the Articles of Association of the Company be and are hereby altered by replacing all the existing regulations 1 to 49 with the new regulations 1 to 93, a copy of which is annexed to the Explanatory Statement pursuant to Section 102 of the Companies Act 2013, be and is hereby adopted as new regulations of the Articles of Association of the Company."

FURTHER RESOLVED THAT for the purpose of giving effect to this resolution, Mr. ..... (DIN: .....), Director of the Company be and is hereby authorized, on behalf of the Company, to do all acts, deeds and things as may be deemed to be necessary, proper or desirable and to sign and execute all the necessary documents, applications and returns for the purpose of giving effect to the aforesaid Resolution along with filing of necessary E-forms with the Registrar of Companies."

Explanatory Statement pursuant to Section 102 of the Companies Act, 2013

The Existing regulations 1 to 49 of the Articles of Association of the company are being replaced by the new set of Articles containing regulations 1 to 93 and adopted as new set of Articles of Association of the company. The modification in the Articles of Association of the company is carried out to give effect to the provisions of the Companies Act, 2013. Consent of the shareholders by passing a Special Resolution is required in this regard. New set of regulations forming 1 to 93 articles of Articles of Association of the company is attached herewith separately as Annexure A.

Copy of the Articles of Association of the Company together with the proposed alterations is available for inspection by the Members of the Company at its Registered Office during normal business hours on all working days up to the date of the Meeting and is also attached to the accompanying notice.

The Directors recommend the passing of the Resolution under Item No. 1 of the accompanying Notice for the approval of the Members of the Company by way of Special Resolution.

None of the Directors of the Company or the Key Managerial Persons of the Company or their relatives are concerned or interested in the passing of the above resolution.

Specimen of Notice for the Board Meeting for Convening General Meeting for Alteration of Articles to Convert a Public Company into a Private Company

Shri	Managing Director
Shri	Whole-time Director
Shri	Director
Shri	Director
Shri	Director
Shri	Director

Dear Sirs,

Notice is hereby given that the next meeting of the Board of directors of the company will be held at ....Hrs. on ..... (day), ... (month) ..... 20.... at the Corporate Office of the company at ..... to transact the following business:

1. To grant requests from directors for leave of absence, if any.
2. To confirm the minutes of the previous Board Meeting held on ..... and the chairman to sign the same.
3. Directors to make disclosure of their interest, or changes thereof, if any.
4. To discuss and approve financial results for the quarter ended and to authorise the chairman to sign the same on behalf of the Board of directors of the company.
5. To authorise the company secretary to arrange for the publication of the approved financial results in the English daily newspaper ..... and the Hindi daily newspaper ..... in their earliest available editions and also to send the same to the stock exchanges where the securities of the company are listed within forty-eight hours of the close of the Board meeting.
6. To fix time, date and venue for holding an extraordinary general meeting of the company to transact the business as detailed in the agenda including an item for conversion of the company into a private company the draft whereof would be placed before the meeting as initialled by the chairman as a mark of identification.
7. To authorise the company secretary or any director to issue notice for the general meeting on behalf of the Board in accordance with the provisions of Section 101 of the Companies Act, 2013 along with the Explanatory Statement as required under Section 102 of the Act.
8. Any other business with the permission of the chair. Please make it convenient to attend the meeting. Thanking you,

Yours faithfully,

(.....)

Company Secretary

Incorporation Contracts and Agreements

A company being an artificial person can contract only through its agents. A contract will be binding on a company only, if it is made on its behalf by any person acting under its authority, express or implied. The powers of the company are defined by its Memorandum of Association and any contract made beyond the limits laid down in the Memorandum of Association, will be *ultra vires* to the company and void even if all the shareholders assent to it.

There are various types of pre-incorporation contracts that can be made by a company according to their need before incorporation, such as a lease agreement, employment agreement, founder's agreement, shareholder agreement, etc.

There are two situations as discussed below in the case of every company (whether public or private) in which contracts are made:

(a) Contracts made on behalf of the company before its incorporation—preliminary or pre-incorporation contracts.

(b) Contracts made after the incorporation.

Pre-incorporation Contracts:

It is likely that due to non-availability of a suitable name, lack of clarity among the promoters or for other reasons, the formation of a company may take time. In the meanwhile, the promoters may enter into contracts on behalf of proposed company, like purchase of land, ordering machinery, employing key personnel, investment tie up etc. and also incur expenses relating to incorporation of the company. These must be ratified on the incorporation of the company.

The Articles must authorize the directors to pay the expenses relating to registration of the company. The directors do not have any implied power to incur pre-incorporation expenses.

Promoter's Liability:

During execution, the promoters enter into the contracts on behalf of the company. Although, the promoters act as company's agent to represent their interest, the principal is not in existence while registration. The contracts entered into by the promoters are therefore not binding on the company or third parties.

As per section 15 of Specific Relief Act, 1963; if promoters have made a contract before incorporation of a company for the purpose of the proposed company, and if the contract is warranted by the terms of incorporation, the company may adopt and enforce the contract. The term 'warranted by the terms of incorporation' means 'within the scope of the company's objects as stated in the memorandum of the company'. Thus, the contract should be for the purposes of the company.

As per section 19 of Specific Relief Act, 1963, if the pre-incorporation contract is adopted or accepted by the company after its incorporation and if it is within the terms of incorporation, the other party can also enforce the contract, if such acceptance was communicated to other party to the contract.

However, pre-incorporation contracts are not binding upon the company, if these are not adopted or accepted by the company after its incorporation. Adoption or acceptance of contracts practically means ratification of contract. A Board resolution should be passed for adoption of pre-incorporation contracts at the first Board meeting of the company. On passing such resolution, the contract shall be binding on the company.

CASE LAWS

Preliminary contracts are contracts purported to be made on behalf of a company before its incorporation. Before incorporation, a company is non-existent and has no capacity to contract. Consequently, nobody can contract as agent on its behalf because an act which cannot be done by the principal himself cannot be done by him through an agent. Hence, a contract by a promoter purporting to act on behalf of a company prior to its incorporation never binds the company because at the time the contract was concluded the company was not in existence. Therefore it has no legal existence. Even if the parties act on the contract it will not bind the company. *[Northumberland Avenue Hotel Co., (1886) 33 Ch.D.16 (CA)].*

In *Kelner v. Baxter (ibid)* three persons A B and C purported to enter into a contract as agents on behalf of a company before its incorporation for the purchase of certain goods from Kelner and signed it : "A, B and C, Directors". The company later obtained the certificate of incorporation but collapsed before the money was paid for the goods which were supplied to it by Kelner. It was held that A, B and C were personally liable on the agreement and no subsequent ratification by the company would relieve them from that liability without the assent of Kelner.

A company cannot acquire shares prior to its incorporation. Where a company was named as the transferee in the share transfer forms prior to its incorporation, it was held that such transfers could not be registered. *[Inlec Investment (P) Ltd. v. Dynamatic Hydraulics Ltd., (1989) 3 Comp LJ 221, 225 (CLB)].*

In *Weavers Mills Ltd. v. Balkies Ammal [AIR 1969 Mad 462],* In this case, the promoters had agreed to purchase some properties for and on behalf of the company which was yet to be incorporated. After incorporation of the company, the company assumed possession of the properties and constructed some structures on the property. It was held that even in absence of conveyance of property by the promoter in favor of the company after its incorporation, the company's title over the property could not be set aside.

The procedure for ratification of pre-incorporation contract is as under:-

- Ensure that the power to enter and adopt pre-incorporation contracts is given in the objects, incidental or ancillary to the attainment of the main objects clause of the memorandum of the company.
- Ensure that the articles also give power to the directors to adopt such pre-incorporation contracts in the board meeting.
- Prepare a statement of the pre-incorporation contracts giving the amount involved in the each contract separately.
- Convene the first board meeting after giving notice to all the directors of the company as per section 173 and place the above mentioned statement before the board meeting.
- The statement should be initialed by the Chairman of the Board meeting and then pass a resolution adopting the pre-incorporation contract.

SPECIMEN RESOLUTION AND FORMAT

Specimen of Board Resolution for Adoption of Pre-Incorporation Contracts

"RESOLVED THAT the consent of the Board of Directors be and is hereby given ratifying all the contracts entered into by the promoters of the company before incorporation of the company, as per the statement tabled before the Board and initialed by the chairman for the purpose identification.

RESOLVED FURTHER THAT the preliminary contracts entered into by the promoters in connection with the incorporation of the company as per the statement before the meeting be and are hereby approved.

RESOLVED FURTHER THAT any of the directors of the company and/or Company Secretary, be and are hereby severally authorized to do all acts, deeds and things, including but not limited to execution of any required documents or instruments, which may be necessary to give effect to the foregoing resolution."

Model General Power of Attorney

(On non-judicial Stamp Paper of Requisite Value)

The Registrar of Companies .... I/We, the undersigned, subscribers to the Memorandum and Articles of Association, ... do hereby authorise Shri ..... son of..... resident of..... to make any alteration, addition, correction, deletion, amendment, and such other work as may be necessary on our behalf in the Memorandum and Articles of Association and all other documents filed with you relating to the registration of the above-mentioned company and attest the same on my/our behalf and to receive/collect the Certificate of Incorporation on our behalf and to do such other things as may be necessary in connection with the incorporation of the above named company.

Accepted.

Subscriber(s) to the Memorandum and Articles of Association

Place:

Date:

LESSON ROUND-UP

- The Memorandum of Association is a document which sets out the constitution of the company and is the foundation on which the structure of the company stands. It defines as well as confines the powers of the company. If the company enters into contract or engages in any trade or business which is beyond the powers conferred on it by the memorandum, such a contract or the act will be *ultra vires* the company and hence void. However, the Companies Act, 2013 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act.
- A company may, by a special resolution and after complying with the procedure specified in this section, alter the provisions of its memorandum.
- The memorandum of association of a company may be altered by changing its name, altering it in regard to the State in which the registered office is to be situated or its objects, altering or reorganizing its share capital, reducing its capital or making the liability of the directors unlimited.
- Articles means the articles 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. It also includes the regulations contained in Tables F to J in Schedule I of the Act, in so far as they apply to the company.
- The memorandum lays down the scope and powers of the company and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members.
- A company has a statutory right to alter its articles of association. But the power to alter is subject to the provisions of the Act and to the conditions contained in the memorandum. Any alteration so made shall be as valid as if originally contained in the articles.
- The memorandum and articles, when registered, bind the company and its members to the same extent as if they have been signed by the company and by each member to observe and be bound by all the provisions of the memorandum and of the articles.
- Pre-incorporation contracts are contracts purported to be made on behalf of a company before its incorporation. Before incorporation, a company is non-existent and has no capacity to contract. Consequently, nobody can contract as agent on its behalf because an act which cannot be done by the principal himself cannot be done by him through an agent. Hence, a contract by a promoter purporting to act on behalf of a company prior to its incorporation never binds the company because at the time the contract was concluded the company was not in existence.

GLOSSARY

Alteration : The state of being altered; a change made in the form or nature of a thing; changed condition. In Company Law the memorandum and articles sometime require alterations

Clause : One of the sections of a legal document that says that something must or must not be done

MoA : Memorandum of Association

AoA : Articles of Association

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

1. What do you understand by the memorandum of association? What is its purpose?
2. "Memorandum of association is a charter of the company". Comment upon the statement and explain the clauses which are included in a memorandum of association of a company.
3. What is "registered office" of a company? Within how much time a company must have a registered office? Explain the procedure brief for shifting of Registered office from the jurisdiction of one Registrar of Companies to another within the same state.
4. What do you understand by the doctrine of "*ultra-vires*"? Discuss the decided case *"Ashbury Railway & Iron Co. v. Riche"*.
5. What is the importance of the objects clause of the memorandum of association? If a company undertakes to do anything which is not either expressly or impliedly provided for by the objects clause, what would be the consequences?
6. "The power of altering the articles is wide, yet it is subject to a large number of limitations". Explain.
7. Discuss the extent to which articles of association binds:
   (a) the members to the company,
   (b) the company to the members,
   (c) the members among themselves, and
   (d) the company to the outsiders.
8. Distinguish Articles from Memorandum.
9. "The articles may contain provisions for entrenchment." Comment upon the statement and explain the significance of the entrenchment provisions.
10. What is the meaning and significance of the doctrine of "Indoor Management". Discuss with reference to decided case "*Royal British Bank* v. *Turquand*".
11. While inspecting the Delhi branch of M/s ABC Bank Ltd., the statutory auditor of ABC Bank Ltd. stated that a loan of Rs. 25.00 Lacs sanctioned to M/s STW Private Limited is "*ultra vires*". Which among the following meant by the statutory auditors while categorizing the loan in the above category?
    (a) There is serious contravention of provisions of Companies Act, 2013
    (b) There is some violation relating to some internal procedures i.e. AOA on the part of the company
    (c) The loan has been sanctioned for an activity which is not stated in the objective clause in the MOA of the company
    (d) There is some problem in execution of security documents.
12. The directors of M/s Rajshekar Impex Private Limited wanted to alter its Articles of Association. For that purpose they visited Mr. Abhay, Practicing Company Secretary for redrafting of their AOA. They want to understand the contents of AOA. As an expert, suggest which of the following will not be included in article of association?
    (a) Lien of share
    (b) Objective of the company

(c) Rules governing reserve and funds

(d) Issues of share.

13. What is the time limit provided within which the details of the alteration in the Articles of Association of the company are to be furnished to the ROC as provided under section 14 of Companies Act, 2013:

(a) 15 days

(b) 30 days

(c) 45 days

(d) 60 days.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- Bare Act- The Companies Act, 2013 and Rules made thereunder
- The SEBI (LODR) Regulations, 2015

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==
- https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&ssid=3&smid=0

Shares and Share Capital – Concepts

Lesson 4

KEY CONCEPTS

■ Shares ■ Equity ■ Preference ■ Dividend ■ Transfer ■ Transmission ■ Sweat Equity Shares ■ Prospectus ■ Dematerialization ■ Rematerialization

Learning Objectives

To understand:

The lesson is divided into six parts for easy understanding:

PART A: Meaning and Types of Share Capital

- Definition of 'Capital'
- Definition of term 'Share'
- Defining the classes of Share Capital under the Companies Act, 2013
- Voting rights of equity shareholders and preference shareholders
- Compliance for publication of share capital under the Companies Act, 2013

PART B: Basic Terms related to Issue and Allotment of Shares

- Meaning of term 'Securities'
- Red Herring Prospectus, Shelf Prospectus, Abridged Prospectus, Offer for sale/deemed Prospectus, Matters to be stated in Prospectus
- Share Certificate, Duplicate share certificates, Splitting of share certificates, Maintenance of share certificate, Case laws, etc.

PART C: Issue and Allotment of Securities

- Issue of securities and governing provisions
- Issue of shares at premium, utilisation of share premium, prohibition of issue the shares at discount
- Concept of allotment of securities
- Private Placement of shares; Issue of shares on Preferential Basis; Right Issue; Bonus Issue; ESOP
- Equity shares with Differential Voting Rights; Sweat Equity Shares
- Issue and Redemption of Preference Shares

PART D: Alteration of Share Capital

- Methods of altering share capital
- Buyback of Shares
- Reduction of share capital
- Diminution of share capital is not reduction of Capital
- Reduction of share capital without sanction of Tribunal

PART E: Transferability of Shares

- What is transfer or transmission
- Stamp Duty applicability
- Statutory remedy in case board refuses registration of transfer/transmission of shares
- Dematerialisation and Rematerialisation of shares

Lesson Outline

- Meaning and types of shares capital
- Issue of Share Certificates
- Further Issue of Share Capital
- Issue of shares on Private and Preferential basis
- Right Issue and Bonus Issue
- Sweat Equity and ESOPs
- Preference shares and its types
- Transfer and Transmission of securities
- Reduction of Share Capital
- Dematerialization and Rematerialisatm of shares
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 23-70)
- The Companies (Share Capital & Debentures) Rules, 2014
- The Companies (Prospectus & Allotment of Securities) Rules, 2014
- The SEBI (Depositories and Participants) Regulations, 2018
- The SEBI (ICDR) Regulations, 2018

PART A: MEANING AND TYPES OF SHARE CAPITAL

MEANING AND DEFINITION OF 'CAPITAL'

'Capital' can be defined as the significant element for initiating and running the business for its day to day operations. As well the capital is required for funding its future prospects. Its meaning may vary from person to person. Capital can be termed as the money that can be used to make more money. For a business or say a company can have the capital can be from two sources:

- **Debt:** That a company owes and required to be paid back.
- **Equity:** The amount which investors put in the company in exchange to have ownership of the company and the same amount is not required to be paid.

In relation to a company limited by shares, the word 'capital' means the share capital i.e., the capital in terms of rupees divided into specified number of shares of a fixed amount each.

For example, share capital of a company is Rs.5,00,000 which can be divided into 50,000 shares of Rs.10 each or 5,000 shares of Rs.100 each, whichever is feasible to the company.

DEFINITION

Definition of Share: Under Section 2(84) of the Companies Act, 2013, "share" means a share in the share capital of a company and includes stock.

Section 44 of the Companies Act, 2013 provides that a share or debentures or other interest of any member in a company is a movable property transferable in the manner provided by the articles of the company. According to Section 45 of the Companies Act, 2013 every share in a company having a share capital shall be distinguished by its distinctive number but this provision shall not apply to a share held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

DEFINING THE CLASSES OF SHARE CAPITAL UNDER THE COMPANIES ACT 2013

Share Capital can be classified in the following categories: These are classified on the basis of maximum amount, subscribed amount, called up, issued and paid up capital.

Nominal Authorised or Registered Capital	**Section 2(8) under Companies Act, 2013 :** Such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.
Issued Capital	**Section 2(50) under Companies Act, 2013 :** Such capital as the company issues from time to time for subscription. It is that part of the authorised or nominal capital which the company issues for the time being for public subscription and allotment. This is computed at the face or nominal value.
Subscribed Capital	**Section 2 (86) under Companies Act, 2013 :** Such part of the capital which is for the time being subscribed by the members of a company. It is that portion of the issued capital at face value which has been subscribed for or taken up by the subscribers of shares in the company. It is clear that the entire issued capital may or may not be subscribed.
Called-up Capital	**Section 2(15) under Companies Act, 2013:** Such part of the capital, which has been called for payment. It is that portion of the subscribed capital which has
Paid-up Share Capital	**Section 2(64) under Companies Act, 2013 :** Such aggregate amount of money credited as paid - up as is equivalent to the amount received as paid - up in respect of shares issued and also includes any amount credited as paid - up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called.

Types of Share Capital

Pursuant to Section 43 of Companies Act, 2013, the share capital of a company limited by shares shall be of two kinds, namely: —

(a) Equity share capital—

(i) with voting rights; or

(ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed; and

(b) Preference share capital.

Brief Analysis:

- **Equity share capital:** It means all share capital which is not preference share capital. It consists of the following features:

1. Equity Shares have voting rights at all general meetings of the company. These votes have the affect of the controlling the management of the company.
2. Equity Shares have the right to share the profits of the company in the form of dividend and bonus shares. However, even equity shareholders cannot demand declaration of dividend by the company which is left to the discretion of the Board of Directors.
3. When the company is wound up, payment towards the equity share capital will be made to the respective shareholders only after payment of the claims of all the creditors and the preference share capital.

- **Preference share capital:** It means that part of the issued share capital of the company which carries or would carry a preferential right with respect to-

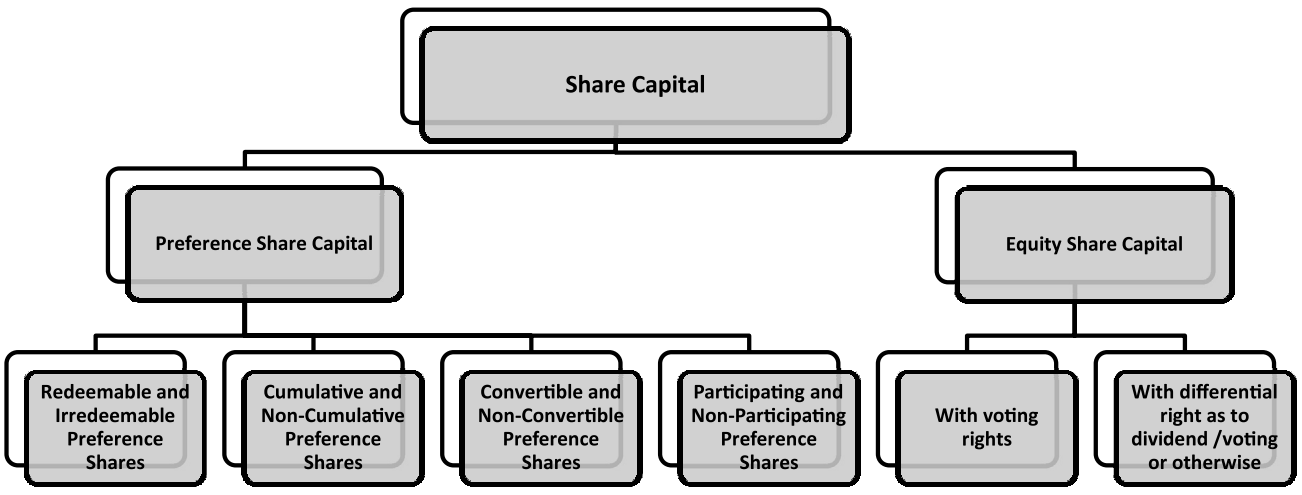
  1. payment of dividend, either as a fixed amount or an amount calculated at a fixed rate, which may either be free of or subject to income-tax; and
  2. repayment, in the case of a winding up or repayment of capital, of the amount of the share capital paid-up or deemed to have been paid-up, whether or not, there is a preferential right to the payment of any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

As per section 55 of the Companies Act, 2013, no company limited by shares shall, issue any preference shares which are irredeemable.

Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either or both of the following rights, namely:-

(a) that in respect of dividends, in addition to the preferential rights to the amounts specified in sub- clause (a) of clause (ii) of section 43, it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(b) that in respect of capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in sub-clause (b) of clause (ii) of section 43, it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.



Cumulative and Non-Cumulative

- Cumulative preference shares: the dividends are accumulated and therefore paid before anything paid to equity shares.
- Non-Cumulative preference shares: if company does not pay dividend in current year, claim of preference shareholder is lost to that extent.

Convertible and Non-Convertible

- Convertible preference shares possess an option or right whereby they can be converted into an ordinary equity share at some agreed terms and conditions.

- Non-Convertible preference shares do not have the option to convert but has all other normal characteristic of a preference share.

Participating and Non-participating

- Participating preferences share has an additional benefit of participating in 'surplus profits or 'surplus assets' of the company apart from preferential dividend.
- The Non-participating preference share are those which are not entitled to participate in the 'surplus profits' or surplus assets'' of the company. They are entitled to only a fixed rate of dividend.

Redeemable and Non-Redeemable

- Redeemable preference share has a maturity date on which date the company will repay the capital amount to the preference shareholders. The paying back of capital is called redemption dividend. Preferences share shall be redeemed within a period not exceeding 20 years (however infrastructure companies can issue preferences shares redeemable within a period not exceeding 30 years).
- Irredeemable Preference Share do not have any maturity date and are repayable only at the time of winding up of the company. However, as per section 55 of the Companies Act, 2013 no company can issue irredeemable preference shares.

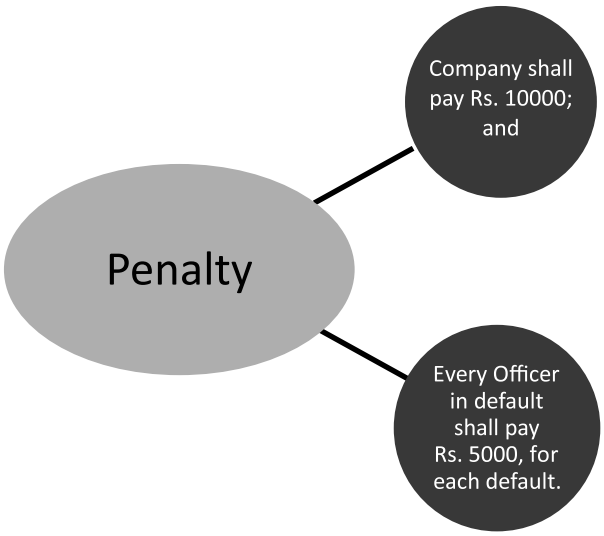
VOTING RIGHTS OF EQUITY SHAREHOLDERS AND PREFERENCE SHAREHOLDERS

Voting Rights of Equity Shareholders	***Voting Rights of Preference Shareholders***
According to section 47, subject to the provisions of section 43, sub-section (2) of section 50 and sub-section (1) of section 188 – (a) every member of a company limited by shares and holding equity share capital therein, shall have a right to vote on every resolution placed before the company; and (b) his voting right on a poll shall be in proportion to his share in the paid-up equity share capital of the company.	Section 47(2) states that every member of a company limited by shares and holding any preference share capital therein shall, in respect of such capital, have a right to vote only on resolutions placed before the company which directly affect the rights attached to his preference shares and, any resolution for the winding up of the company or for the repayment or reduction of its equity or preference share capital and his voting right on a poll shall be in proportion to his share in the paid-up preference share capital of the company: Provided that the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares. Provided further that where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company.

COMPLIANCE FOR PUBLICATION OF SHARE CAPITAL UNDER COMPANIES ACT, 2013

It is provided under section 60 of the Act that, where any notice, advertisement or other official publication, or any business letter, bill head or letter paper of a company contains a statement of the amount of the authorised capital of the company, such notice, advertisement or other official publication, or such letter, bill head or letter paper shall also contain a statement, in an equally prominent position and in equally conspicuous characters, of the amount of the capital which has been subscribed and the amount paid-up.

Penalty for non-compliance:



PART B: BASIC TERMS RELATED TO ISSUE & ALLOTMENT OF SECURITIES

Understanding the basic concepts and definition related to issue and allotment of securities are required before going through the procedure of issue and allotment of securities. It includes understanding the meaning securities, prospectus, kinds of prospectus like shelf prospectus, red herring prospectus , abridged prospectus and offer to sale deemed to prospectus, contents of prospectus, meaning of share certificates, concept of original and duplicate share certificates, etc.

SECURITIES

'Securities' has been defined under section 2(81) of Companies Act, 2013 to mean the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956. The relevant section lays that securities include:-

As per Section 2(h) of the Securities Contracts (Regulation) Act, 1956, 'securities' include-

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or a pooled investment vehicle or other body corporate;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

Explanation.- For the removal of doubts, it is hereby declared that "securities" shall not include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a combined benefit risk on the life of the persons and investment by such persons and issued by an insurer referred to in clause (9) of section 2 of the Insurance Act, 1938;

(ida) units or any other instrument issued by any pooled investment vehicle;

(ie) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable including mortgage debt, as the case may be;

(ii) government securities;

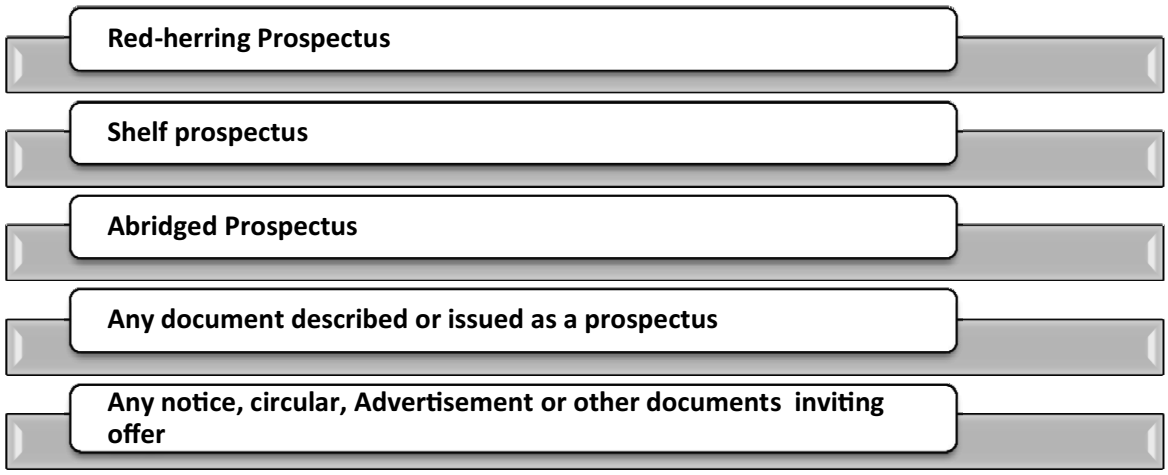
(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interests insecurities.

Thus, the word 'securities' includes shares and other instruments.

PROSPECTUS

In general parlance prospectus refers to an information booklet or offer document on the basis of which an investor invests in the securities of an issuer company. It has been defined under section 2(70) so as to mean any document described or issued as a prospectus and includes a red-herring prospectus referred to in Section 32 or shelf prospectus referred to in section 31 or any notice, circular, advertisement or other document inviting offers from the public for the subscription or purchase of any securities of a body corporate.



RED-HERRING PROSPECTUS

Definition: Red-herring Prospectus means a prospectus which does not include complete particulars of the quantum or price of the securities included therein (under explanation to section 32). In simple terms a red-herring prospectus contains most of the information pertaining to the company's operations and prospects, but does not include key details of the issue such as its price and the number of shares offered.

Timelines for issue: According to section 32 of the Companies Act, 2013 a company proposing to make an offer of securities may issue a red-herring prospectus prior to the issue of a prospectus.

Timeline for filing with ROC: Such company proposing to issue a red herring prospectus shall file it with the Registrar at least three days prior to the opening of the subscription list and the offer.

Other conditions: A red-herring prospectus shall carry the same obligations as are applicable to prospectus and any variation between the red herring prospectus and a prospectus shall be highlighted as variations in the prospectus.

Upon the closing of the offer of securities under this section, the prospectus stating therein the total capital raised, whether by way of debt or share capital, and the closing price of the securities and any other details as are not included in the red-herring prospectus and shall be filed with the Registrar and the Securities and Exchange Board.

SHELF PROSPECTUS

Definition: Shelf Prospectus means a prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus. In simple terms Shelf Prospectus is a single prospectus for multiple public. Issuer is permitted to offer and sell securities to the public without a separate prospectus for each act of offering for a certain period.

Validity Period: Under the Act any class or classes of companies, as the Securities and Exchange Board (SEBI) may provide by regulations in this behalf, may file a shelf prospectus with the Registrar. Such prospectus is to be submitted at the stage of the first offer of securities which shall indicate a period not exceeding one year as the period of validity of such prospectus. The validity period shall commence from the date of opening of the first offer of securities under that prospectus, and in respect of a second or subsequent offer of such securities issued during the period of validity of that prospectus, no further prospectus is required.

Filing of Information Memorandum (FORM PAS-2) with ROC: An information memorandum is required to be filed by a company filing a shelf prospectus which shall contain all material facts relating to:

- new charges created;
- changes in the financial position of the company as have occurred between the first offer of securities or the previous offer of securities and the succeeding offer of securities; and
- such other changes as may be prescribed.

Filed with the Registrar with in ***within one month prior to the issue of a second or subsequent offer of securities under the shelf prospectus*****,** prior to the issue of a second or subsequent offer of securities under the shelf prospectus.

Advantage to investors: The section also provides a benefitting provision for the investors, the proviso provides that where a company or any other person has received applications for the allotment of securities along with advance payments of subscription before the making of any such change, the company or other person shall intimate the changes to such applicants and if they express a desire to withdraw their application, the company or other person shall refund all the monies received as subscription within fifteen days thereof.

Illustration: XYZ Ltd intends to raise share capital by issuing equity shares in different stages over a certain period of time. However, the company does not wish to issue prospectus each and every time of issue of shares. What can be the way out to the company to follow to avoid repeated issuance of prospectus?

Solution: Company can issue shelf prospectus to avoid repeated issuance of prospectus

ABRIDGED PROSPECTUS

Definition: 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 Securities and Exchange Board by making regulations in this behalf. Section 33 of the Act provides that no form of application for the purchase of any of the securities of a company shall be issued unless such form is accompanied by an abridged prospectus. A

copy of the prospectus, on are quest being made by any person before the closing of the subscription list, be furnished to him.

Exceptions: Nothing aforesaid shall apply if it is shown that the form of application was issued—

(a) in connection with a bonafide invitation to a person to enter into an underwrite with respect to such securities; or

(b) in relation to securities which were not offered to the public.

Penalty: The penal provisions provide that a company which makes any default in complying with the provisions shall be liable to a penalty of fifty thousand rupees for each default.

OFFER FOR SALE/DEEMED PROSPECTUS

Definition: Public Offer or an Offer for Sale (OFS) includes of securities to the public by an existing shareholder, through issue of a prospectus. Under section 25 of the Act where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company. The document "Offer for Sale" is an invitation to the general public to purchase the shares of a company through an intermediary, such as an issuing house or a merchant bank. A company may allot or agree to allot any shares or debentures to an "Issue house" without there being any intention on the part of the company to make shares or debentures available directly to the public through issue of prospectus. The issue house in turn makes an "Offer for Sale" to the public.

Additional Information: All enactments and rules of law as to the contents of prospectus and as to liability in respect of misstatements, in and omissions from, prospectus, or otherwise relating to prospectus, shall apply to such Offer for Sale. Following additional information to the matters required to be stated in a prospectus:

(a) the net amount of the consideration received or to be received by the company in respect of the securities to which the offer relates; and

(b) the time and place at which the contract where under the said securities have been or are to be allotted may be inspected.

Conditions to be fulfilled:

(a) "Offer for Sale" to the public was made within six months after the allotment or agreement to allot; or

(b) at the date when the offer was made, the whole consideration to be received by the company in respect of the securities had not been received by it.

Signing Authority: It shall be sufficient if the offer document is signed on behalf of the company by two directors of the company.

Offer for Sale of shares by certain members of a company: Section 28 of the Act permits certain members of a company, in consultation with Board of Directors, to offer, in accordance with the provisions of any law for the time being in force, the whole or a part of their holdings of shares to the public. The document by which the offer of sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company.

All laws and rules made hereunder as to the contents of the prospectus and as to liability in respect of mis-statements in and omission from prospectus or otherwise relating to prospectus shall apply as if this is a prospectus issued by the company.

The section lays that the members, whether individuals or bodies corporate or both, whose shares are proposed to be offered to the public, shall collectively authorize the company, whose share were offered for sale to the public, to take all actions in respect of offer of sale for and on their behalf and they shall reimburse the company all expenses incurred by it on this matter.

The rules in this context provide that the provisions of Part I of Chapter III namely "Prospectus and Allotment of Securities "and rules made there under shall be applicable to an offer of sale referred to in section 28 except for the following, namely:-

(a) the provisions relating to minimum subscription;

(b) the provisions for minimum application value;

(c) the provisions requiring any statement to be made by the Board of Directors in respect of the utilization of money; and

(d) any other provision or information which cannot be compiled or gathered by the offer or, with detailed justifications for not being able to comply with such provisions.

Further the rules provide that such offer document or prospectus issued under the section shall disclose the name of the entity bearing the cost of making the offer for sale along with reasons.

Matters to be stated in the prospectus

- **Setting out the reports on financial information**: According to Section 26(1), every Prospectus shall state such information and set out such reports on financial information as may be specified by the Securities and Exchange Board in consultation with the Central Government:

  Provided that until the Securities and Exchange Board specifies the information and reports on financial information under this sub-section, the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, in respect of such financial information or reports on financial information shall apply.

- **Declaration about the compliance of provisions of Companies Act:** To make a declaration about the compliance of the provisions of this Act and a statement to the effect that nothing in the prospectus is contrary to the provisions of this Act, the Securities Contracts (Regulation) Act, 1956 and the Securities and Exchange Board of India Act, 1992 and the rules and regulations made thereunder.

SHARE CERTIFICATE

Meaning of Share Certificate: Share certificate is a prima facie evidence of the title of the person to such share. According to Section 45 of the Companies Act, 2013 each share of the share capital of the company shall be distinguished with a distinct number for its individual identification. However, such distinction shall not be required, as per provision to Section 45, if the shares are held by a person whose name is entered as holder of beneficial interest in such share in the records of a depository.

Who can sign share certificate:

In terms of Section 46(1) of the Act, a share certificate issued under the common seal, if any, of the company or signed by two Directors or by a Director and the Company Secretary, wherever, the company has appointed a Company Secretary, is a *prima facie* evidence of the title of the person to such share.

Time line for issue of share certificates:

Under Section 56(4) of the Act, every company, unless prohibited by any provision of law or any order of any Court, Tribunal or other authority must deliver the certificates of all securities allotted, transferred or transmitted:-

S. No.	*Event*	*Timelines*
1.	**Subscribers to the memorandum**	within a period of two months from the date of incorporation
2.	**Any allotment of any of its shares**	within a period of two months from the date of allotment
3.	**Transfer or transmission of securities**	within a period of one month from the date of receipt by the company of the instrument of transfer under sub-section (1) or, as the case may be, of the intimation of transmission under sub-section (2)
4.	**Any allotment of debenture**	within a period of six months from the date of allotment

NOTE: In case of Specified IFSC Public Company/Specified IFSC Private Company- It shall deliver the certificates of all securities to subscribers after incorporation, allotment, transfer or transmission with in a period of 60 days.- Notification dated 4th January, 2017.

However, where the securities are dealt within a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities [Proviso to Section 56(4)].

Duplicate Share Certificate

Section 46 (2) states that a duplicate certificate of shares may be issued, if such certificate —

(a) is proved to have been lost or destroyed; or

(b) has been defaced, mutilated or torn and is surrendered to the company.

Splitting of Share Certificate

A split certificate means a separate certificate claimed by a shareholder for a portion of his holding. The advantages of a split certificate are that the shareholder may benefit in case of a transfer by way of sale or mortgage in small lots and the right to multiply the certificates into as many shares held by the shareholder.

Difference between original share certificates and duplicate share certificates

BASIS	*ORIGINAL SHARE CERTIFICATES*	*DUPLICATE SHARE CERTIFICATES*
Governing Provisions	Rule 5 of the Companies (Share Capital and Debentures) Rules 2014	Rule 6 of the Companies (Share Capital and Debentures) Rules 2014
Issues	On allotment of shares	Renewal to be made only on surrender of old certificate
Fee	No fee is chargeable in case of original share certificates	Company may charge fee for duplicate share certificate as the Board decides but not exceeding Rs. 50 per certificate
Timeline for issue	Subscribers to Memorandum: 2 months Allotment: 2 months Transfer/Transmission: 1 month	Listed Company: 45 days Unlisted Company: 3 months from date of submission of documents

Record Maintenance	FORM MBP-2 (Register of Members)	FORM SH-2 (Register of Renewed and Duplicate Share Certificates)
Penalty	Where any default is made in complying with the above provisions, the company and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees [Section 56(6)].	According to Section 46(5), if a company with an intention to defraud, issues a duplicate certificate of shares, the company shall be punishable with fine which shall not be less than five times the face value of the shares involved in the issue of the duplicate certificate but which may extend to ten times the face value of such shares or rupees ten crores whichever is higher and every officer of the company who is in default shall be liable for action under section 447, for fraud.

Maintenance of share certificate forms and related books and documents [Rule 7 of the Companies (Share Capital and Debenture) Rules, 2014]

(1) All blank forms to be used for issue of share certificates shall be printed and the printing shall be done only on the authority of a resolution of the Board and the blank form shall be consecutively machine-numbered and the forms and the blocks, engravings, facsimiles and hues relating to the printing of such forms shall be kept in the custody of the Secretary or such other person as the Board may authorise for the purpose; and the Company Secretary or other person aforesaid shall be responsible for rendering an account of these forms to the Board.

(2) The following persons shall be responsible for the maintenance, preservation and safe custody of all books and documents relating to the issue of share certificates, including the blank forms of share certificates referred above, namely:–

(a) the committee of the Board, if so authorized by the Board or where the company has a Company Secretary, the Company Secretary; or

(b) where the company has no Company Secretary, a Director specifically authorised by the Board for such purpose.

(3) All books mentioned above shall be preserved in good order not less than thirty years and in case of disputed cases, shall be preserved permanently, and all certificates surrendered to a company shall immediately be defaced by stamping or printing the word "cancelled" in bold letters and may be destroyed after the expiry of three years from the date on which they are surrendered, under the authority of a resolution of the Board and in the presence of a person duly appointed by the Board in this behalf.

The above mentioned provisions shall not apply to cancellation of the certificates of securities, under sub-section (2) of section 6 of the Depositories Act, 1996, when such certificates are cancelled in accordance with the SEBI (Depositories and Participants) Regulations, 2018.

Case Laws depicting Significance of Share Certificate

- A certificate of shares is evidence to the effect that the allottee is holding a certain number of shares of the company showing their nominal and paid-up value and distinctive numbers. This certificate is a *prime facie* evidence of title to the shares in the possession of shareholders *[Society Generale De Paris vs. Walker, (1885) 11A AC 20, 29].*

- Share certificate is the only documentary evidence of title and that the share certificate is a declaration by the company that the person in whose name the certificate is issued is a shareholder in the company *[Ghanshyam Chhaturbhuj vs. Industrial Ceramics (Pvt.) Ltd. (1995) 4 Com LJ 51].*
- Also the company cannot dispute the amount mentioned on the certificate as already paid *[Bloomenthal v. Ford (1897) AC 156(HL)].*
- As already mentioned, a person acting on the share certificate issued by the company may recover compensation for the damages suffered by him. The measure of damage is the value of the shares at the time of the refusal by the company to recognize him as a shareholder together with interest from that date. *[Bahla and San Francisco Rly. Co., (1868) LR 3 QB584].*

Query: In case the company on registering the transfer of shares has sent certificate to another person. Elucidate.

Solution: In that case the company should surrender the original share certificate and if the said certificate is not so surrendered, the same should be cancelled by the company and duplicate certificate should be issued to the real owner. It was held in *BPL Sanyo Technology Ltd. vs. Rahul Agarwal [1995] 83 Comp Cas 885* decided by the Rajasthan High Court that the bank should surrender the original share certificate and if the said certificate is not so surrendered, the same should be cancelled by the company and duplicate certificate should be issued to the real owner**.**

Whether Share Certificate an Official Publication

The question whether a share certificate is an official publication was considered by the Department of Company Affairs (Now, Ministry of Corporate Affairs) and the Department has clarified vide *Circular No. 3/73[8/10(47)]/72-CL-V dated 3.2.1973* as follows:

"It will be seen that in terms of section 44 of the Companies Act, 2013, the shares in a company are movable property transferable in the manner provided in the articles of the company.

Section 46 of the Companies Act, 2013 provides that a certificate under the common seal of the company specifying any share held by any member shall be *prima facie* evidence of the title of the member to such share.

Thus, shares are movable property transferable in the manner provided in the articles of the company and that the share certificates are certificates of title and are movable property but are not publications in the nature of prospectus, balance sheet, profit and loss account, notice or advertisement.

Legal Effect of Share Certificate

We have already stated that a share certificate is *prima facie* evidence to the title of the person whose name is entered on it. It means that the share certificate is a statement by the company that the moment when it was issued, the person named in it was the legal owner of the shares specified in it, and those shares were paid-up to the extent stated. It does not constitute title but it is merely evidence of title. It is, however a statement of considerable importance, for it is made with the knowledge that other persons may act upon it in the belief that it is true and this fact brings into operation the doctrine of estoppel. As a result, a share certificate once issued by the company binds it in two ways,namely:

(a) by estoppel as to title, and

(b) by estoppel as to payment.

Estoppel as to Title: A share certificate once issued binds the company in two ways. In the first place, it is a declaration by the company to the entire world that the person in whose name the certificate is made out and to whom it is given is a shareholder in the company. In other words the company is estopped from denying his title to the shares.

Estoppel as to Payment: If the certificate states that on each of the shares full amount has been paid, the company is estopped as against a bonafide purchaser of the shares, from alleging that they are not fully paid.

If a person knows that the statements in a certificate are not true, he cannot claim an estoppel against the company *Barrow case (1880) 14 Ch D 432: 42LT 891CA*.

Despite everything, a certificate must be issued by someone who has the authority. For example, where the secretary forged the signature of two Directors in a company, the company had refused to register the holder of shares as a member. Further a certificate is not evidence as to the equitable interest in, where an individual is aware of the false statements in a certificate, he will not be entitled to claim an estoppel.

Personation of Shareholders [Section 57]

Meaning: To 'personate' means to pretend to be someone else, especially for fraudulent purpose such as casting a vote in another person's name. Personation and impersonation imply the same thing.

Where any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and

(i) thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon; or

(ii) receives or attempt to receive any money due to any such owner.

He shall be punishable with imprisonment for a term which shall not be less than 1 year but which may extend to 3 years and with fine which shall not be less than 1 lakh rupees but which may extend to 5 lakh rupees.

PART C: ISSUE AND ALLOTMENT OF SECURITIES

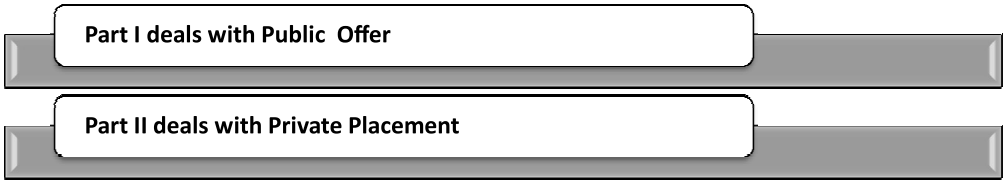
Financial markets have an important relationship with economic development. A company decides to issue securities for different reasons; the main reasons being raising capital to meet its financial requirements may be for starting a –

- new venture;
- repaying debts;
- expansion and diversification etc.

This actually reflects indulgence of enormous investor wealth for the sublime reason of economic development. This economic dependence of the corporate sector is a compelling rationale for an orderly regulated environment that boosts investor confidence and assures conformity with prescribed norms. It helps in creating conducive ownership base and wide capacities to create an impact on the national economy. When an investor buys securities he is enabling the company to carry on its business using those funds.

Primarily, issues can be classified as a Public issue, Rights or Preferential issues (also known as private placements). While public and rights issues involve a detailed procedure, private placements or preferential issues are relatively simpler.

Chapter III of the Companies Act, 2013 deals with "Prospectus and allotment of securities", the chapter is divided into two parts:



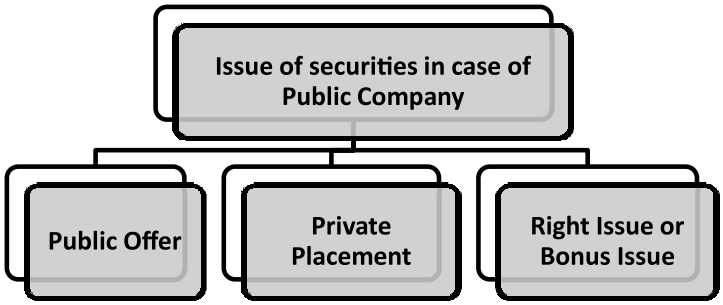
Section 23 of the Companies Act, 2013 provides that a company whether public or private may issue securities.

As per Section 23(1), a public company may issue securities:

(a) to public through prospectus ("public offer") by complying with the provisions of Part I of Chapter III of the Companies Act, 2013; or

(b) through private placement by complying with the provisions of Part II of Chapter III of the Companies Act, 2013; or

(c) through a rights issue or a bonus issue in accordance with the provisions of the Companies Act, 2013 and in case of a listed company or a company which intends to get its securities listed also with the provisions of the SEBI Act, 1992 and the rules and regulations made there under.

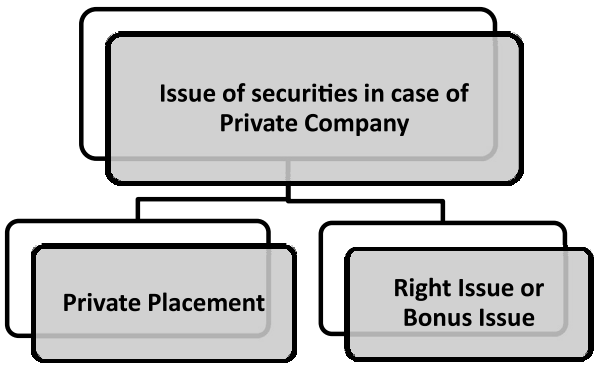


Public offer includes initial public offer or further public offer of securities to the public by a company, or an offer for the sale of securities to the public by an existing shareholder, through issue of prospectus.

For a private company, Section 23(2) provides that a private company may issue securities:

(a) by way of rights issue or bonus issue in accordance with the provisions of this Act; or

(b) through private placement by complying with the provisions of Part II Chapter III of the Act.



The section 23(2) deals with issue of securities, which is a wider term not restricted to equity, preference or debentures.

Section 23(3) – Such class of public companies may issue such class of securities for the purposes of listing on permitted stock exchanges in permissible foreign jurisdictions or such other jurisdictions, as may be prescribed.

Section 23(4) – The Central Government may, by notification, exempt any class or classes of public companies referred to in sub- section (3) from any of the provisions of this Chapter, Chapter IV, section 89, section 90 or section 127 and a copy of every such notification shall, as soon as may be after it is issued, be laid before both Houses of Parliament.

The MCA vide Notification No. 4744(E) dated October 30, 2023, has appointed it as the effective date for the provisions of section 5 of the Companies (Amendment) Act, 2020 i.e. enforcement of sub-section 3 and 4 od section 23 of the Companies Act, 2013.

Explanation I to Section 42 defines private placement as any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in this section.

GOVERNING LAWS

Issue of Securities is governed in the following manner:

In the case of a Public Company, which is a listed entity or is desirous of listing its securities on the recognized stock exchange in India, the issue of securities is governed by –

- The Companies Act, 2013;
- Securities Contract (Regulation) Act, 1956;
- The SEBI Act, 1992; and
- The SEBI (ICDR) Regulations, 2018.

In the case of all issues by Private Companies, the same is governed by the Companies Act and the power of administration is exercised by the Central Government, the Tribunal or the Registrar of Companies as the case may be.

Section 24 of the Companies Act empowers the SEBI to regulate the matters relating to issue and transfer of security non- payment of dividend by listed companies or those companies which intend to get their securities listed. The explanation to Section 24 provides that all powers relating to all other matters relating to prospectus, return of allotment, redemption of preference shares and any other matter specifically provided in the Act shall be exercised by the Central Government, the tribunal or the Registrar of Companies as the case may be. Further the power relating to forward dealing and insider trading has been delegated to SEBI for listed companies or the companies which intend to get their securities listed.

KINDS OF ISSUE OF SHARES

1. Issue of Securities at a Premium

Meaning: A company may issue securities at a premium when it is able to sell them at a price above par or above nominal value. The Companies Act, 2013, does not stipulate any conditions or restrictions regulating the issue of securities by a company at a premium. However, the Companies Act does impose conditions regulating the utilization of the amount of premium collected on securities.

Share Premium to be transferred to 'Securities Premium Account'

Section 52(1) states that when a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account"and the provisions of this Act relating to reduction of share capital of a company shall, except as provided in this section, apply as if the securities premium account were the paid-up share capital of the company.

Utilisation of Securities premium

In accordance with the provisions of Section 52(2) of the Act, the securities premium can be utilised only for:

(a) issuing fully paid bonus shares to members;

(b) writing off the balance of the preliminary expenses of the company;

(c) writing off commission paid or discount allowed, or the expenses incurred on issue of shares or debentures of the company;

(d) for providing for the premium payable on redemption of any redeemable preference shares or debentures of the company; or

(e) for the purchase of its own shares or other securities under section 68.

CASE LAW

Utilisation of securities premium account for selective capital reduction

Brillio Technologies Pvt. Ltd. (Appellant) vs. Registrar of Companies, Karnataka & Ors. (Respondents) dated April 19, 2021

The NCLAT observed that Security Premium Account can be utilized for making payment to non-promoter shareholders. Further, it can be held that selective reduction is permissible if the non-promoter shareholders are being paid fair value of their shares, whose shares have been extinguished pursuant to selective capital reduction, after obtaining prior approval of the NCLT.

Section 52(3) further states that the securities premium account may, notwithstanding anything contained in sub- sections (1) and (2), be applied by such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133,–

Where a company issues shares at a premium, even though the consideration may be other than cash, a sum equal to the amount or value of the premium must be transferred to the securities premium account. (Section 52(1)) *[Head (Henry) & Co. Ltd. v. Ropner Holding Ltd. (1951) 2 All ER 994: (152) Ch 124 (Ch D)].*

(a) in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares; or

(b) in writing off the expenses of or the commission paid or discount allowed on any issue of equity of the company; or

(c) for the purchase of its own shares or other securities under section 68.

POINTS TO REMEMBER:

- Firstly, the premium cannot be treated as profit and as such the amount of premium is not available for distribution as dividend.

- Secondly, the amount of premium whether received in cash or in kind must be kept in a separate account, known as the "Securities Premium Account".
- Thirdly, the amount of premium is to be maintained with the same sanctity as the share capital.

Any premium paid does not give the shareholder any preferential rights in case of a winding up. Monies in the securities premium account cannot be treated as free reserves, as they are in the nature of capital reserve *[Departmental Circular No. 3/77 dated 15.4.1977]*.

Illustration: A company ABC Limited has issued shares on security premium and the amount has been separately kept in Security Premium Account. Now the company wants to use this amount for the following purposes. Guide as Company Secretary of the Company:

a) Writing off the balance of preliminary expenses.

b) For distribution of dividend

c) For buyback of shares.

Solution: The company can use the security premium amount for purpose (a) and (c) and not for the purpose (b).

2. PROHIBITION TO ISSUE THE SHARES AT DISCOUNT

Section 53 states that except as provided in section 54 (i.e. issue of sweat equity shares), a company shall not issue shares at a discount. Any share issued by a company at a discount shall be void.

Exception: A company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

Penalty: Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve percent per annum from the date of issue of such shares to the persons to whom such shares have been issued.

CONCEPT OF ALLOTMENT OF SECURITIES

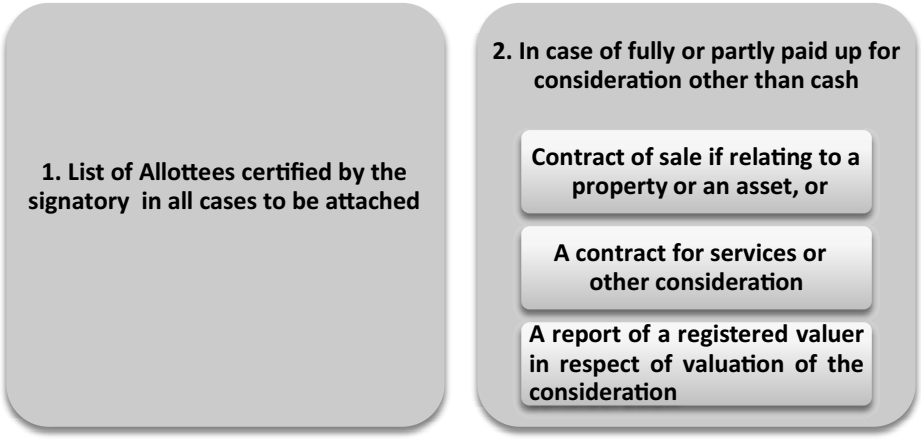
Section 39 of the Companies Act, 2013 read with Rule 12 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 deals with Allotment of Securities.

Allotment

- Allotment of any securities of a company offered to the public for subscription shall be made only when the amount stated in the prospectus as the minimum amount has been subscribed and payable on application for the amount so stated have been paid to and received by the company by cheque or other instrument.
- **Minimum Amount of Application**: The amount payable on application on every security shall not be less than five per cent of the nominal amount of the security or such other percentage or amount, as may be specified by the Securities and Exchange Board by making regulations in this behalf.
- **FORM PAS-3:** Whenever a company having a share capital makes any allotment of securities, it shall file with the Registrar a return of allotment, within thirty days thereafter, in Form PAS-3, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014.

- Along with Form PAS-3 a certified list of allottees stating their names, address, occupation, if any, and number of securities allotted to each of the allottees, shall be attached.
- The list shall be certified by the signatory of Form PAS-3 as being complete and correct as per the records of the company.
- Further, in the case of securities (not being bonus shares) allotted as fully or partly paid up for consideration other than cash, a copy of the contract, duly stamped, pursuant to which the securities have been allotted together with any contract of sale if relating to a property or an asset, or a contract for services or other consideration shall be attached to the Form PAS-3.
- When a contract is not reduced to writing, the company shall furnish along with the Form PAS-3 complete particulars of the contract stamped with the same stamp duty as would have been payable if the contract had been reduced to writing and those particulars shall be deemed to be an instrument within the meaning of the Indian Stamp Act, 1899, and the Registrar may, as a condition of filing the particulars, require that the stamp duty payable thereon be adjudicated under section 31 of the Indian Stamp Act, 1899. Further a report of a registered valuer in respect of valuation of the consideration shall also be attached along with the contract.

FORM PAS-3 AND ITS ATTACHMENTS



Refund of money

In cases where the stated minimum amount has not been subscribed and the sum payable on application received with in a period of thirty days from the date of issue of the prospectus, or such other period as may be specified by the SEBI, the amount received as above shall be returned. The application money shall be repaid within a period of fifteen days from the closure of the issue and if any such money is not so repaid within such period, the directors of the company who are officers in default shall jointly and severally be liable to repay that money with interest at the rate of fifteen percent per annum.

Time to refund the application money	15 days from closure of issue
Interest to be paid in case of default in repayment of application money	15% p.a.

Penalty for default [Section 39(5)]

In case of any default, the company and its officer who is in default shall be liable to a penalty, for each default, of one thousand rupees for each day during which such default continues or one lakh rupees, whichever is less.

CASE LAWS

Related to return of allotment

(A) In case of *Sri Gopal Jalan & Co. vs. Calcutta Stock Exchange Association Ltd. 1963-(033)-Com Cases-0862-SC*, the Supreme Court held that the exchange was not liable to file any return of the forfeited shares under Section 75(1)of the Companies Act,1956 [Corresponds to section 39 of the Companies Act, 2013] when the same were re-issued. The Court observed that when a share is forfeited and re-issued, there is no allotment, in the sense of appropriation of shares out of the authorised and unappropriated capital and approved the observations of Harries C.J. in S.M. Nandy's case that: "On such forfeiture all that happened was that the right of the particular shareholder disappeared but the shares considered as a unit of issued capital continued to exist and was kept in suspense until another shareholder was found for it";

(B) In case of *Alote Estate vs. R.B. Seth Hiralal Kalyanmal Kasliwal [1970] 40 Com Cases 1116 (SC)*, inadequacy of consideration, the shares will be treated as not fully paid and the shareholder will be liable to pay for them in full, unless the contract is fraudulent;

(C) *Harmony and Montage Tin and Copper Mining Company; Spargo's case (1873).*

Any payment which is presently enforceable against the company such as consideration payable for property purchased, will constitute payment in cash;

(D) In case of *Chokkalingam vs. Official Liquidator AIR 1944,* allotment of shares against promissory notes shall not be valid.

GENERAL PRINCIPLES REGARDING ALLOTMENT

"Allotment" of shares means the act of appropriation by the Board of Directors of the company out of the previously un-appropriated capital of a company of a certain number of shares to persons who have made applications for shares *(In Re Calcutta Stock Exchange Association, AIR 1957 Cal. 438).* It is on allotment that shares come into existence.

The following general principles should be observed with regard to allotment of securities:

1. The allotment should be made by proper authority. The proper authority may be the Board of Director of the company, or a committee authorised to allot securities on behalf of the Board.
2. Allotment of securities must be made within a reasonable time (As per Section 6 of the Indian Contract Act, 1872, an offer must be accepted within a reasonable time). What is reasonable time is a question of fact in each case. An applicant may refuse to take securities if the allotment is made after along time. (As per Section 56 within a period of two months from the date of allotment in the case of allotment of any of its shares)
3. The allotment should be absolute and unconditional. Securities must be allotted on same terms on which they were applied for and as they are stated in the application for securities. Allotment of securities subject to certain conditions is also not valid. Similarly, if the number of securities alloted is less than those applied for, it cannot be termed as absolute allotment.
4. The allotment must be communicated. As mentioned earlier posting of letter of allotment or allotment advice will be taken as a valid communication even if the letter is lost in transit.
5. Allotment against application only. Section 2(55) of the Act requires that a person should agree in writing to become a member.

6. Allotment should not be in contravention of any other law. If securities are allotted on an application of a minor, the allotment will be void.

CASE LAWS

Related to allotment

(A) An allotment may be valid even if some defect was there in the appointment of Directors but which was subsequently discovered. [Section 290 and the Rule in *Royal British Bank vs. Turquand* (1856)];

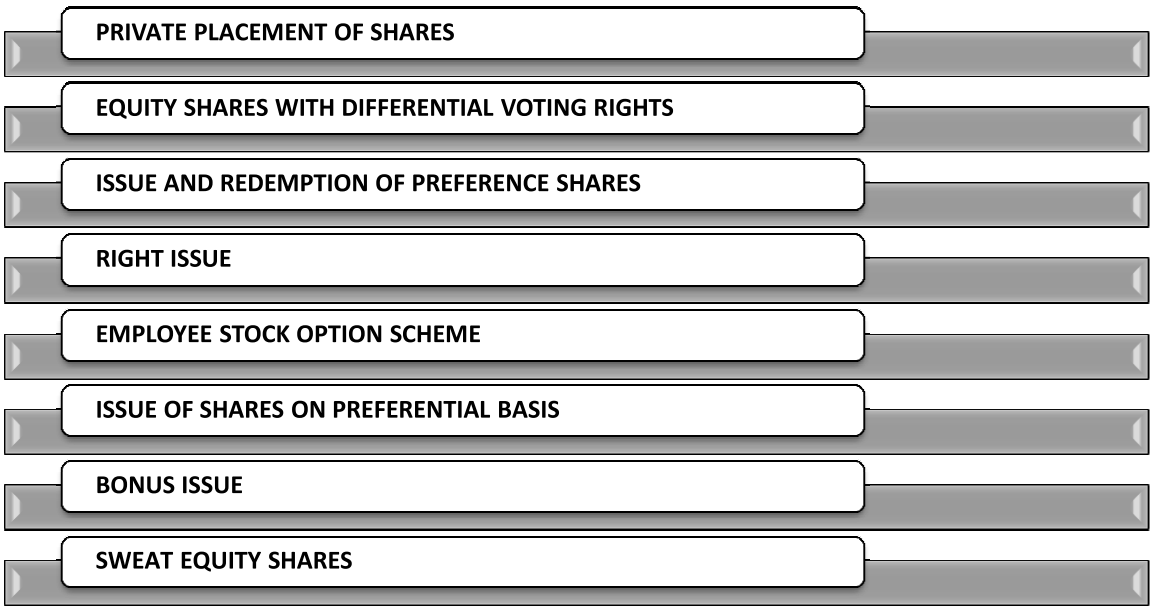
(B) An allotment by a Board irregularly constituted may be subsequently ratified by a regular Board *[Portugese Consolidated Copper Mines, (1889) 42 Ch. D 160 (CA)]*;

(C) A director who has joined in an allotment to himself will be estopped from alleging the invalidity of the allotment *[Yark Tramways Co. vs. Willows*, (1882)];

(D) Grant applied for certain shares in a company, the company dispatched letter of allotment to him which never reached him. It was held that he was liable for the balance amount due on the shares. *[Household Fire And Carriage Accident Insurance Co. Ltd. vs. Grant* (1879)];

(E) There can be no proper allotment of shares unless the applicant has been informed of the allotment *[British and American Steam Navigation Co. Re. (1870)]*.

ISSUE OF SECURITIES



I. PRIVATE PLACEMENT OF SHARES

Governing Provisions of Companies Act 2013: Section 42 and Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014.

- **Meaning:** As per Explanation I to Section 42(3), "private placement" means any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in this section.

- **Private Placement offer-cum-application:** Section 42(1) provides that a company may, subject to the provisions of this section, make a private placement of securities. Section 42(3) reads, a company making private placement shall issue private placement offer and application in **Form PAS-4** serially numbered and addressed specifically to the person to whom the offer is made and shall be sent to him, either in writing or in electronic mode within 30 days of recording the name of such person pursuant to sub-section (3) of section 42.

  The private placement offer and application shall not carry any right of renunciation.

- **Maximum number of persons to whom offer can be made and other incidental matters:** As per section 42(2), a private placement shall be made only to a select group of persons who have been identified by the Board, whose numbers shall not exceed 200, excluding the qualified institutional buyers and employees of the company being offered securities under a scheme of employees stock option in terms of provisions of clause(b) of sub-section (1) of section 62, in a financial year subject to such conditions as may be prescribed.

  It is further clarified that the restrictions aforesaid would be reckoned individually for each kind of security that is equity share, preference share or debenture.

  "Qualified institutional buyer" means the qualified institutional buyer as defined in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 as amended from time to time, made under the Securities and Exchange Board of India Act, 1992.

  Where a company, listed or unlisted, makes an offer to allot or invites subscription, or allots, or enters into an agreement to allot, securities to more than the prescribed number of persons, whether the payment for the securities has been received or not or whether the company intends to list its securities or not on any recognised stock exchange in or outside India, the same shall be deemed to be the public offer and shall be accordingly dealt.

  Further sub-rule (7) provides that the provisions of sub-rule (2) shall not be applicable to:

  (a) Non-banking financial companies which are registered with the Reserve Bank of India under the Reserve Bank of India Act, 1934; and

  (b) Housing finance companies which are registered with the National Housing Bank under the National Housing Bank Act, 1987.

  If they are complying with regulations made by the Reserve Bank of India or the National Housing Bank in respect of offer or invitation to be issued on private placement basis.

- **Application to Private Placement:** As per section 42(4) states that every identified person willing to subscribe to the private placement issue shall apply in the private placement and application issued to such person along with subscription money paid either by cheque or demand draft or other banking channel and not by cash. However, a company shall not utilise monies raised through private placement unless allotment is made and the return of allotment is filed with the Registrar.

- Time limit for allotment and payment of interest/refund of subscription money otherwise:

  Section 42(6) states that a company:

  - Allot the securities within 60 days from receipt of application money.
  - If not allotted, Repay the application money within 15 days from the expiry of 60 days.
  - If not repaid, liable to pay interest @12% p.a. from the expiry of the 60th day.

- **Subscription money to be kept in a separate bank account**

  Proviso to Section 42(6) states that monies received on application received by the company shall be kept in a separate bank account in a scheduled bank and shall not be utilised for any purpose other than-

  (a) for adjustment against allotment of securities; or

  (b) for the repayment of monies where the company is unable to allot securities.

- **No information to Public about issue:** Section 42(7) states that no company issuing securities under this section shall release any public advertisements or utilise any media, marketing or distribution channels or agents to inform the public at large about such an issue.

Return of allotment

- **Filing with the Registrar a return of allotment (FORM PAS-3)** within fifteen days from the date of the allotment, including a complete list of all allottees, with their full name, address, PAN No. and e-mail id of security holder, the class of security held, the date of allotment of security, the number of securities held, nominal value and amount paid on such securities and particulars of consideration received if the securities were issued for consideration other than cash.
- **Penalty for non-filing Form PAS-3**: The company, its promoters and directors shall be liable to a penalty for each default of one thousand rupees for each day during which such default continues but not exceeding twenty-five lakh rupees.

Penalty

According to section 42(10), if a company makes an offer or accepts monies in contravention of section 42, the company, its promoters and directors shall be liable for a penalty which may extend to the amount raised through the private placement or two crore rupees, whichever is lower, and the company shall also refund all monies with interest to subscribers within a period of thirty days of the order imposing the penalty.

CONDITIONS APPLICABLE TO PRIVATE PLACEMENT

1. Special Resolution of Shareholders: A Company shall not make an offer or invitation to subscribe to securities through private placement unless the proposal has been previously approved by the shareholders of the company, by a special resolution for each of the offers or invitation.

The explanatory statement annexed to the notice for shareholders' approval shall contain the following disclosure:

(a) particulars of the offer including date of passing of Board Resolution;

(b) kinds of securities offered and the price at which such security is being offered;

(c) basis or justification for the price (including premium, if any) at which the offer or invitation is being made;

(d) name and address of valuer who performed valuation;

(e) amount which the company intends to raise by way of such securities;

(f) material terms of raising such securities, proposed time schedule, purposes or objects of offer, contribution being made by the promoters or directors either as part of the offer or separately in furtherance of objects; principle terms of assets charged as securities:

Where the amount to be raised through such offer or invitation does not exceed the limit specified in Section 180(1)(a) in such cases relevant Board Resolution under Section 179(3)(c) would be adequate.

In case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation exceeds the limit specified in Section 180(1)(c), it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitations for such debentures during the year.

In case of offer or invitation of any securities to qualified institutional buyers, it shall be sufficient if the company passes a previous special resolution only in a year for all the allotments to such buyers during the year.

2. Records to be maintained: The Company shall maintain a complete record of private placement offers in Form PAS-5.

3. Filing with ROC:

- FORM PAS-3 within 15 days of allotment.
- FORM MGT-14 for filing with ROC Special Resolution/Board Resolution within 30 days.

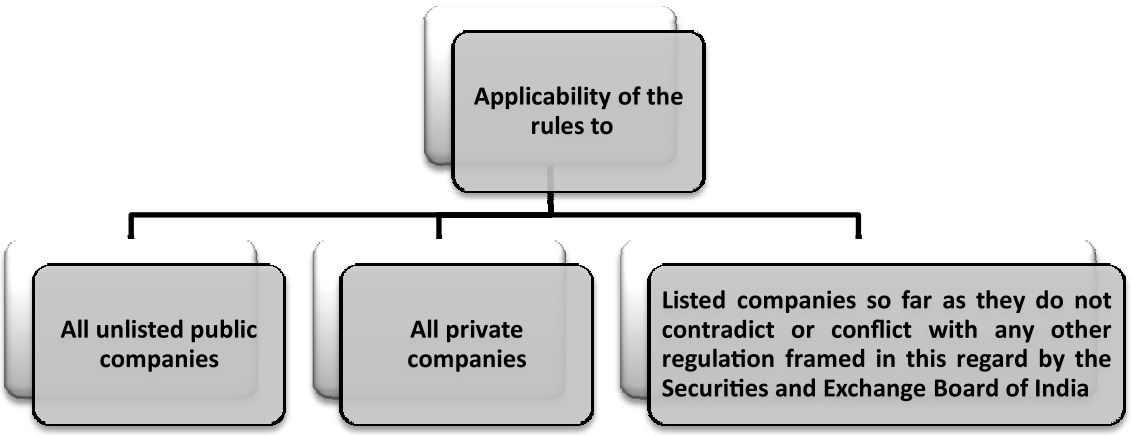
CASE LAW

In the case of ***Mayasheel Retail India Limited***, ROC of Delhi & Haryana observed that the Company has violated the provisions of section 42(2), 42(7) and 42(8) of the Act r/w Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014 that include exceeding the permissible limit of subscribers, publicizing the offering through advertisements, and failing to file requisite returns with the Registrar of Companies.

II. EQUITY SHARES WITH DIFFERENTIAL VOTING RIGHTS

Governing Provisions of Companies Act 2013: Section 43 and Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014.

While Section 43 enables companies to issue equity shares with differential rights as to dividend, voting rights etc., Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014 states the conditions regarding shares with differential voting rights.



Conditions for issuing shares with differential rights [Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014]

Only a company limited by shares can issue equity shares with differential rights as to dividend, voting or otherwise. Such company has to comply with the following conditions, namely:-

(a) **Authorization in Articles of Association:** The articles of association of the company authorizes the issue of shares with differential rights;

(b) **Passing of Ordinary Resolution at General Meeting**: The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders. When the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot. (Though with Companies (Amendment) Act, 2017 coming into force, any item of business required to be transacted by means of postal ballot, may be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108);

(c) **Limit for voting power not exceeding 74 percent:** the voting power in respect of shares with differential rights of the company shall not exceed seventy four percent of total voting power including voting power in respect of equity shares with differential rights issued at any point of time;

(d) **No defaults:** The company has not defaulted in the following:

- the company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares;
- the company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits or redemption of its preference shares or debentures that have become due for redemption or payment of interest on such deposits or debentures or payment of dividend;
- the company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution or State level financial institution or scheduled Bank that has become repayable or interest payable thereon or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government;

A company may issue equity shares with differential rights upon expiry of five years from the end financial year in which such default was made good.

The company has not been penalized by Court or Tribunal during the last three years of any offence under the RBI Act, 1934, the SEBI Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act,1999 or any other Special Act, under which such companies being regulated by sectoral regulators.

(e) Conversion of existing equity share capital into differential voting rights and vice-versa not possible: The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and *vice versa*;

(f) Register of Members: The Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of these;

(g) The holders of the equity shares with differential rights enjoys all other rights such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

Illustration:

The Company ABC Private Limited wants to issue shares with differential voting rights up to 40% of its share capital? Can it do so?

Solution: Rule 4 of the Companies (Share capital and Debentures) Rules, 2014 specifies a condition that the voting power in respect of shares with differential rights of the company shall not exceed 74% of total voting power including voting power in respect of equity shares with differential rights issued at any point of time. Therefore, a company can issue shares with differential voting rights upto 40 percent of its share capital which is within limit mentioned in Rule 4.

Disclosures in the explanatory statement to the notice of the meeting

While taking a decision it is important that all information is provided with regard to the matter, hence rule 4(2) of the Companies (Share Capital and Debentures) Rules, 2014 requires that the explanatory statement shall be annexed to the notice of the general meeting or of a postal ballot. The explanatory statement shall contain the following particulars, namely:-

(a) the total number of shares to be issued with differential rights;

(b) the details of the differential rights;

(c) the percentage of the shares with differential rights to the total post issue paid up equity share capital including equity shares with differential rights issued at any point of time;

(d) the reasons or justification for the issue;

(e) the price at which such shares are proposed to be issued either at par or at premium;

(f) the basis on which the price has been arrived at;

(g) (i) in case of private placement or preferential issue:

(a) details of total number of shares proposed to be allotted to promoters, directors and key managerial personnel;

(b) details of total number of shares proposed to be allotted to persons other than promoters, directors and key managerial personnel and their relationship if any with any promoter, director or key managerial personnel;

(ii) in case of public issue - reservation, if any, for different classes of applicants including promoters, directors or key managerial personnel;

(h) the percentage of voting right which the equity share capital with differential voting right shall carry the total voting right of the aggregate equity share capital;

(i) the scale or proportion in which the voting rights of such class or type of shares shall vary;

(j) the change in control, if any, in the company that may occur consequent to the issue of equity differential voting rights;

(k) the diluted Earning Per Share pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;

(l) the pre and post issue share holding pattern along with voting rights as per Regulation 31 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Disclosures in the Boards' Report

The Board of Directors are required to disclose the details of the issue of equity shares with differential rights in the Board's Report for the financial year in which was completed.

(a) the total number of shares allotted with differential rights;

(b) the details of the differential rights relating to voting rights and dividends;

(c) the percentage of the shares with differential rights to the total post issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;

(d) the price at which such shares have been issued;

(e) the particulars of promoters, directors or key managerial personnel to whom such shares are issued;

(f) the change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;

(g) the diluted Earning Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;

(h) the pre and post issue shareholding pattern along with voting rights in the format specified under sub-rule (2) of rule 4.

III. ISSUE AND REDEMPTION OF PREFERENCE SHARES

Governing Provisions of Companies Act 2013: Section 55 and Rule 9 of the Companies (Share Capital and Debentures) Rules, 2014.

CONDITIONS FOR ISSUE OF PREFERENCE SHARES

- **Time Period**: Company cannot issue irredeemable preference shares or redeemable preference shares with the redemption period beyond 20 years.
- **Authorisation by Articles of Association:** Section 55 (2) further states that a company limited by shares may, if so authorised by its articles, issue preference shares which are liable to be redeemed within a period not exceeding twenty years from the date of their issue subject to such conditions as may be prescribed.

> Section 55 (1) states that no company limited by shares shall issue any preference shares which are irredeemable.

> ***Exceptions***
>
> **Issue and redemption of preference shares by company in infrastructure projects**
>
> A company engaged in the setting up and dealing with of infrastructural projects may issue preference shares for a period exceeding 20 years but not exceeding 30 years, subject to the redemption of a minimum 10% of such preference shares per year from the twenty first year onwards or earlier, on proportionate basis, at the option of the preference shareholders.
>
> The term ''Infrastructure Projects'' means the infrastructure projects specified in Schedule VI.

- **Authorized by passing a special resolution in the general meeting of the company:** the issue of such shares has been authorized by passing a special resolution in the general meeting of the company.

- **No subsisting default:** the company, at the time of such issue of preference shares, has no subsisting default in the redemption of preference shares issued earlier or in payment of dividend due on any preference shares.
- **Redemption out of the profits of the company**: Preference Shares shall be redeemed out of the profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of such redemption.
- **Fully paid up shares:** Such shares shall be redeemed only if they are fully paid.
- **Capital Redemption Reserve Account:** where such shares are proposed to be redeemed out of the profits of the company, there shall, out of such profits, be transferred, a sum equal to the nominal amount of the shares to be redeemed, to a reserve, to be called the Capital Redemption Reserve Account.
- **Premium if any payable on redemption of preference shares:**

  (i) in case of such class of companies, as may be prescribed and whose financial statement comply with the accounting standards prescribed for such class of companies under section 133, the premium, if any, payable on redemption shall be provided for out of the profits of the company, before the shares are redeemed. Premium, if any, payable on redemption of any preference shares issued on or before the commencement of this Act by any such company shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

  (ii) in a case not falling under sub-clause (i) above, the premium, if any, payable on redemption shall be provided for out of the profits of the company or out of the company's securities premium account, before such shares are redeemed.

  In case Company is not in position to redeem preference shares: Section 55(3) states that when a company is not in a position to redeem any preference shares or to pay dividend, if any, on such shares in accordance with the terms of issue (such shares here in after referred to as unredeemed preference shares), it may, with the consent of the holders of three-fourths in value of such preference shares and with the approval of the Tribunal on a petition made by it in this behalf, issue further redeemable preference shares equal to the amount due, including the dividend thereon, in respect of the unredeemed preference shares, and on the issue of such further redeemable preference shares, the unredeemed preference shares shall be deemed to have been redeemed.

  The issue of further redeemable preference shares or the redemption of preference shares under this section shall not be deemed to be an increase or, as the case may be, a reduction, in the share capital of the company.

  The capital redemption reserve account may, notwithstanding anything in this section, be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Resolution authorising preference shares to set out certain particulars

A company issuing preference shares shall set out in the resolution, particulars in respect of the following matters relating to such shares, namely:-

(a) the priority with respect to payment of dividend or repayment of capital vis-a-vis equity shares;

(b) the participation in surplus fund;

(c) the participation in surplus assets and profits, on winding-up which may remain after the entire capital has been repaid;

(d) the payment of dividend on cumulative or non-cumulative basis;

(e) the conversion of preference shares into equity shares;

(f) the voting rights;

(g) the redemption of preference shares.

Explanatory statement to special resolution to set out certain particulars

While taking a decision it is important that all information is provided with regard to the matter, hence rule 9(3) states that the explanatory statement to be annexed to the notice of the general meeting which shall provide the material facts concerned with and relevant to the issue of such shares, including -

(a) the size of the issue and number of preference shares to be issued and nominal value of each share;

(b) the nature of such shares i.e. cumulative or non-cumulative, participating or non-participating, convertible or non-convertible;

(c) the objectives of the issue;

(d) the manner of issue of shares;

(e) the price at which such shares are proposed to be issued;

(f) the basis on which the price has been arrived at;

(g) the terms of issue, including terms and rate of dividend on each share, etc.;

(h) the terms of redemption, including the tenure of redemption, redemption of shares at premium and if the preference shares are convertible, the terms of conversion;

(i) the manner and modes of redemption;

(j) the current share holding pattern of the company;

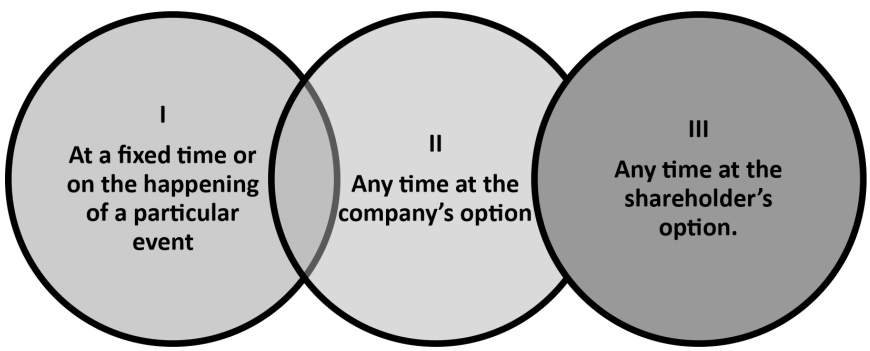
(k) the expected dilution in equity share capital upon conversion of preference shares.

Register of Members to contain the particulars of preference share holder(s)

When a company issues preference shares, the Register of Members maintained under section 88 shall contain the particulars in respect of such preference shareholder(s).

Redemption of preference shares

Rule 9 (6) states that a company may redeem its preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders under section 48 of the Act and the preference shares may be redeemed:-



Procedure to issue and redemption of Preference Shares

(1) For issue of preference shares the articles of the company should authorize for it, if not, then amendment in the articles of the company is required. Also ensure that there is no subsisting defaults in redemption of preference shares earlier or in payment of dividend due on any preference shares.

(2) Ensure that the resolution for issuing preference shares contains all the relevant particulars as mentioned above.

(3) Issue the notice of general meeting along with the explanatory statement, to provide the required details.

In the case of listed entity, intimate the stock exchange at least two working days in advance of board meeting (Regulation 29 of Listing Regulations).

(4) Pass special resolution and file with the Registrar **Form MGT-14** along with the fee so specified in the Companies (Registration of Offices and Fees) Rules, 2014 within 30 days of passing the resolution.

> *Note:* in case of One Person Company for the purpose of passing of ordinary and special resolution in general meeting, it shall be sufficient if the resolution is communicated by the member to the company and entered in the minutes book and signed and dated by the member and such date shall be deemed to be the date of meeting for all purpose under this Act.

(5) Within 30 days of allotment file with the Registrar, the Return of allotment in **Form PAS-3** along with fee as specified in companies (Registration of Offices and Fees), Rules 2014.

(6) Update the register of members maintained under section 88 after issue of preference shares.

(7) The company may redeem the preference shares only on the terms on which they were issued or as varied after due approval of preference shareholders.

(8) The preference shares may be redeemed as given below:

(a) At affixed time or happening of a particular event;

(b) Any time at the company's option;

(c) Any time at the shareholders option.

(9) The notice of redemption of preference shares shall be filed by the company with the Registrar in **Form SH-7** along with altered MOA with the fee as specified in Companies (Registration of Offices and Fees), Rules, 2014 within 30 days of redemption of preference shares.

(10) Once the allotment is made, the company shall within 30 days of allotment, file with the Registrar a return of allotment in **Form PAS. 3**, along with the fee as specified in Companies (Registration of Offices and Fees) Rules, 2014.

(11) Deliver the share certificates of allotted shares within a period of 2 months from the date of allotment.

(12) Intimate the details of allotment of shares to the Depository immediately on allotment of such shares.

Remedies available for Preference shareholders in relation to redemption of preference shares

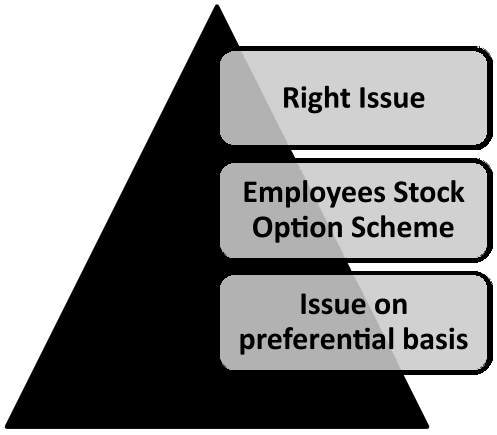
The National Company Law Appellate Tribunal (NCLAT) in the matter of *Bank of Baroda (Appellant) vs. Aban Offshore Limited (Respondent), Company Appeal (AT) No.35 of 2019*, held that intention of the legislature while promulgating Section 55 of the Companies Act, 2013 was to compulsorily provide for redemption of preference shares by doing away with the issue of or redeemable preference shares.

Therefore, even though there is no specific provision stipulated under the Companies Act, 2013 through which relief can be sought by preference shareholders in case of non- redemption by the company or consequent non-filing of petition under Section 55 of the said Act, the intention of the legislature being clear and absolute, Tribunal's inherent power can be invoked to get an appropriate relief by an aggrieved preference shareholder(s).

Alternatively, preference shareholders coming within the definition of 'member(s)' under Section 2(55) read with Section 88 of the Companies Act, 2013, may file a petition under Section 245 of the said Act, as a class action suit, being aggrieved by the conduct of affairs of the company. Thereby, it was held that preference shareholders are not remediless and for redemption of preference shares, they can file an application under Section 55(3) of the Companies Act, 2013 or alternatively they may also file application under Section 245 of the Companies Act, 2013 as a class action suit and the NCLT while exercising the inherent power viz. Rule 11 of NCLT Rules, 2016 can pass appropriate order.

FURTHER ISSUE OF SHARE CAPITAL

Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered:



(A) ***PERSONS***	*(B)* ***EMPLOYEES***	*(C)* ***ANY PERSONS***
[u/s 62(1)(a)]	***[u/s 62(1)(b)]***	***[u/s 62(1)(c)]***
• Who, at the date of the offer, are holders of equity shares of the company • In proportion to the paid-up share capital on those shares • By sending a letter of offer Subject to such conditions as may be prescribed.	• Under a Scheme of Employees Stock Option • Subject to special resolution passed by company (Ordinary Resolution in Private Company) Subject to such conditions as may be prescribed.	• Whether or not those persons include the persons referred to in Clause (a) or (b) • If it is authorised by a special resolution either for cash or for a consideration other than cash, if the price of such shares is determined by the valuation report of a registered valuer Subject to such conditions as may be prescribed.

IV. RIGHT ISSUE:

Governing Provisions of the Companies Act, 2013: Section 62(1)(a) and Rule 12A of the Companies (Share Capital and Debentures) Rules, 2014.

Definition: Issue of shares to those who, at the date of the offer, are holders of equity shares of the company in proportion to the paid-up share capital on those shares by sending a letter of offer.

Conditions: The offer shall be made by notice:

- specifying the number of shares offered; and
- limiting a time not being less than fifteen days or such lesser number of days as may be prescribed and not more than 30 days from the date of the offer within which the offer, if not accepted, shall be deemed to have been declined;
- The offer shall be deemed to include right of renunciation, unless the articles of the company otherwise provide; and the notice referred above shall contain a statement of this right;
- If the offer is rejected by the equity shareholders after the expiry of the time specified in the notice aforesaid; or
- on receipt of earlier intimation from the person to whom such notice is given that he declines to accept the shares offered;
- the Board of Directors may dispose of them in such manner which is not dis-advantageous to the shareholders and the company.

Period of Notice for offer under Right Issue under Section 62(1) (a)(i)

As per Rule 12A of the Companies (Share Capital and Debenture) Rules, 2014, the time period within which the offer shall be made to shareholders for acceptance shall be not less than seven days from the date of offer.

The said notice shall be dispatched through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to all the existing shareholders at least three days before the opening of the issue.

Right to renounce the offer: Unless the articles of the company otherwise provide, the Directors must state in the notice of offer of rights shares the fact that the shareholder has also the right to renounce the offer in whole or in part, in favour of some other persons. However, in case of a private company case ninety percent of the members of a private company have given their consent in writing or in electronic mode, the periods lesser than those specified in the said sub-clause or sub- section shall apply.

The provisions of section 62 are applicable to all types of companies except the Nidhi companies.

Restrictions: The restrictions contained in Section 62 of the Act regarding issue of further shares do not apply to:-

(a) Increase of the subscribed capital of a company caused by the exercise of an option as a term attached to the debentures issued or loans raised by the company to convert such debentures or loans into shares in the company [Section 62(3)].

The terms of issue of such debentures or loan containing such an option have been approved before the issue of such debentures or the raising of loans by a special resolution passed by the company in the general meeting.

(b) conversion of part or whole of the debentures issued to or loans obtained from any Government in shares of the company in pursuance of a direction issued by that Government in public interest on such terms and conditions as appear to be fair and reasonable to the Government even if the terms of issue of such debentures or loans do not contain a term providing for an option for such conversion [Section 62(4)].

Where the terms and conditions of such conversion are not acceptable to the company, it may, within sixty days from the date of communication of such order, appeal to the Tribunal which shall after hearing the company and the Government pass such order as it deems fit.

In determining the terms and conditions of conversion under section 62(4), the Government shall have due regard to the financial position of the company, the terms of issue of debentures or loans, as the case may be, the rate of interest payable on such debentures or loans and such other matters as it may consider necessary [Section 62(5)].

Where the Government has, by an order made under section 62(4), directed that any debenture or loan or any part thereof shall be converted into shares in a company and where no appeal has been preferred to the Tribunal under section 62(4) or where such appeal has been dismissed, the memorandum of such company shall, where such order has the effect of increasing the authorised share capital of the company, stand altered and the authorised share capital of such company shall stand increased by an amount equal to the amount of the value of shares which such debentures or loans or part thereof has been converted into [Section 62(6)].

CASE LAW

Related to further issue of shares by a company

(1) *Nanalal Zaver vs. Bombay Life Assurance Co. Ltd., AIR 1950 SC 172: (1950)*: Section 81 (Corresponding to section 62 of the Companies Act, 2013) is intended to cover cases where the Directors decide to increase the capital by issuing further shares within the authorised limit, because it is within that limit that the Directors can decide to issue further shares, unless, of course, they are precluded from doing that by the Articles of Association of the company. Accordingly, the section becomes applicable only when the Directors decide to increase the capital within the authorised limit, by issue of further shares.

The above judgement was followed by the Supreme Court in *Needle Industries (India) Ltd. vs. Needle Industries Newey (India) Holding Ltd.*(1981). The Court pointed out that the Directors of a company must exercise their powers for the benefit of the company. The Directors are in a fiduciary position and if they does not exercise powers for the benefit of the company but simply and solely for personal aggrandisement and to the detriment of the company, the Court will interfere and prevent the Directors from doing so;

(2) *Needle Industries (India) Ltd. vs. Needle Industries Newey (India) Holding Ltd.:* The power to issue shares need not be used only when there is a need to raise additional capital. The power can be used to create a sufficient number of shareholders to enable a company to exercise statutory powers or to enable it to comply with statutory requirements.

The Department of Company Affairs, now Ministry of Corporate Affairs has clarified that 'one year' specified in the section is to be counted from the date on which the company has allotted any share for the first time;

(3) *Balkrishan Gupta vs. Swadeshi Polytex Ltd.* (1985): Although the term 'holders of the equity shares' is used in Sub-section (1)(a) and 'members' in Sub-section (1A)(b) of Section 81 (Corresponding to section 62 of the Companies Act, 2013), the two terms are synonymous and mean persons whose names are entered in the register of members;

(4) In *Worldwide Agencies (P) Ltd. vs. Margaret T. Desor, (1990)*, it was held that persons who have become entitled to the shares of a deceased member can exercise all the membership rights of the deceased irrespective of the fact whether their name is in the register of members or not;

(5) *Mathalone (R) vs. Bombay Life Assurance Co. Ltd. AIR 1953 SC 385: (1954):* The Court held that the transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

V. EMPLOYEE STOCK OPTION SCHEME

Governing Provisions of the Companies Act 2013: Section 62(1)(b) and Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014.

Definition: The term 'Employee Stock Option' (ESOP) has been defined under sub-section (37) of Section 2 of the Companies Act, 2013, according to which "employees' stock option" means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

Type of Resolution:

- **For public Company:** Special Resolution
- **For Private Company**: Ordinary Resolution

Who are employees?

(a) a permanent employee of the company who has been working in India or outside India; or

(b) a Director of the company, whether a whole time Director or not but excluding an Independent Director; or

(c) an employee as defined in clauses (a) or (b) of a subsidiary, in India or outside India, or of a holding company of the company but does not include -

  (i) an employee who is a promoter or a person belonging to the promoter group; or

  (ii) a Director who either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten percent of the outstanding equity shares of the company.

In case of a startup company, as defined in notification number [G.S.R. 127(E), dated 19th February, 2019 issued by the Department for Promotion of industry and Internal Trade, Ministry of Commerce and Industry Government of India, Government of India] the conditions mentioned in sub-clause (i) and (ii) shall not apply upto ten years from the date of its incorporation or registration.

Details in explanatory statement

While taking a decision it is important that all information is provide with regard to the matter, hence rule 12(2) states that the company shall make the following disclosures in the explanatory statement annexed to the notice for passing of the resolution–

(a) total number of stock options to be granted;

(b) identification of classes of employees entitled to participate in the Employees Stock Option Scheme;

(c) the appraisal process for determining the eligibility of employees to the Employees Stock Option Scheme;

(d) the requirements of vesting and period of vesting;

(e) the maximum period within which the options shall be vested;

(f) the exercise price or the formula for arriving at the same;

(g) the exercise period and process of exercise;

(h) the Lock-in period, if any;

(i) the maximum number of options to be granted per employee and in aggregate;

(j) the method which the company shall use to value its options;

(k) the conditions under which option vested in employees may lapse e.g. in case of termination of employment form is conduct;

(l) the specified time period within which the employee shall exercise the vested options in the event of a proposed termination of employment or resignation of employee; and

(m) a statement to the effect that the company shall comply with the applicable accounting standards.

Free pricing in conformity with accounting policies

The companies granting option to its employees pursuant to Employees Stock Option Scheme will have the freedom to determine the exercise price in conformity with the applicable accounting policies, if any.

Rule 12(4) states that the approval of shareholders by way of separate resolution shall be obtained by the company in case of –

(a) grant of option to employees of subsidiary or holding company; or

(b) grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant of option.

Varying the terms of ESOP requires special resolution

Rule 12(5) states that the company may by special resolution, vary the terms of Employees Stock Option Scheme not yet exercised by the employees provided such variation is not prejudicial to the interests of the option holders. The notice shall disclose full of the variation, the rationale therefor, and the details of the employees who are beneficiaries of such.

Minimum one year vesting period

Rule 12 (6)(a) states that there shall be a minimum period of one year between the grant of options and vesting of option. In a case where options are granted by a company under its Employees Stock Option Scheme in lieu of options held by the same person under an Employees Stock Option Scheme in another company, which has merged or amalgamated with the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under this clause.

Company has freedom to specify lock-in period

Rule 12(6)(b) states that the company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option.

No right of dividend or voting till exercise of option

Rule 12 (6)(c) states that the Employees shall not have right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till shares are issued on exercise of option.

Forfeiture/refund

Rule 12 (7) states that the amount, if any, payable by the employees, at the time of grant of option –

(a) may be forfeited by the company if the option is not exercised by the employees within the exercise period; or

(b) the amount maybe refunded to the employees if the options are not vested due to non-fulfillment of conditions relating to vesting of option as per the Employees Stock Option Scheme.

Conditions

Rule 12(8) states the following conditions:

- The option granted to employees shall not be transferable to any other person.
- The option granted to the employees shall not be pledged, hypothecated, mortgaged or otherwise encumbered or alienated in any other manner.
- No person other than the employees to whom the option is granted shall be entitled to exercise the option.

Death/Permanent disability/Resignation of employees who were granted with options

Rule 12(8) states that in the event of the death of employee while in employment, all the options granted to him till such date shall vest in the legal heirs or nominees of the deceased employee.

In case the employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.

In the event of resignation or termination of employment, all options not vested in the employee as on that day shall expire. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options as approved by the Board.

Disclosure in the Board's Report

Rule 12(9) states that the Board of Directors, shall, *inter alia,* disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme issued during the year.

Maintenance of Register

- Rule 12(10) states that the company shall maintain a Register of Employee Stock Options in **Form No. SH.6** and shall forthwith enter therein the particulars of option granted under clause (b) of sub-section (1) of section 62.
- The Register of Employee Stock Options shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authorized by the Board for the purpose.

Listed companies has to comply with the SEBI guidelines

Where the equity shares of the company are listed on a recognized stock exchange, the Employees Stock Option Scheme shall be issued, in accordance with the regulations made by the Securities and Exchange Board of India in this behalf.

Forms to be filed with ROC for ESOP

- Form MGT-14 for Special Resolution within 30 days
- Form PAS- 3 for allotment within 30 days

VI. ISSUE OF SHARES ON PREFERENTIAL BASIS

Governing Provisions of the Companies Act, 2013: Section 62(1)(c) and Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014.

As discussed earlier, section 62(1)(c) deals with issue of shares to persons other than existing shareholders and provides that a company can issue further shares to persons other than existing shareholders either for cash or for a consideration other than cash, if —

(a) The company in General Meeting passes a special resolution to this effect; and

(b) The price of such shares is determined by the valuation report of a registered valuer, subject to the compliance with the applicable provisions of Chapter III and any other conditions as may be prescribed.

Meaning:

The expression *'Preferential Offer'* means an issue of shares or other securities, by a company to any select person or group of persons on a preferential basis and does not include shares or other securities offered through a public issue, rights issue, employee stock option scheme, employee stock purchase scheme or an issue of sweat equity shares or bonus shares or depository receipts issued in a country outside India or foreign securities.

Conditions for Preferential Offer

(a) **Authorisation by its Articles of Association and Special Resolution**: The issue is authorized by its articles of association. The issue has been authorized by a special resolution of the members;

(b) **Contents of Explanatory Statement**: While taking a decision it is important that all information is provided with regard to the matter, hence the company shall make the following disclosures in the explanatory statement to be annexed to the notice of general meeting:

(i) The objects of the issue;

(ii) The total number of shares or other securities to be issued;

(iii) The price or price band at/within which the allotment is proposed;

(iv) Basis on which the price has been arrived at along with report of the registered valuer;

(v) Relevant date with reference to which the price has been arrived at;

(vi) The class or classes of persons to whom the allotment is proposed to be made;

(vii) Intention of promoters, directors or key managerial personnel to subscribe to the offer;

(viii) The proposed time within which the allotment shall be completed;

(ix) The names of the proposed allottees and the percentage of post preferential offer capital that may be held by them;

(x) The change in control, if any, in the company that would occur consequent to the preferential offer;

(xi) The number of persons to whom allotment on preferential basis have already been made during the year, in terms of number of securities as well as price;

(xii) The justification for the allotment proposed to be made for consideration other than cash together with valuation report of the registered valuer;

(xiii) The pre-issue and post-issue share holding pattern of the company in the prescribed format.

(c) **Completion of issue:** The allotment of securities on a preferential basis shall be completed within a period of twelve months from the date of passing of the special resolution; If the allotment of securities is not completed within twelve months from the date of passing of the special resolution, another special resolution shall be passed for the company to complete such allotment thereafter;

(d) **Price for issue:** The price of the shares or other securities to be issued on a preferential basis, either for cash or for consideration other than cash, shall be determined on the basis of valuation report of a registered valuer;

(e) where convertible securities are offered on a preferential basis with an option to apply for and get equity shares allotted, the price of the resultant shares pursuant to conversion shall be determined-

(i) either up front at the time when the offer of convertible securities is made, on the basis of valuation report of the registered valuer given at the stage of such offer, or

(ii) at the time, which shall not be earlier than thirty days to the date when the holder of convertible security becomes entitled to apply for shares, on the basis of valuation report of the registered valuer given not earlier than sixty days of the date when the holder of convertible security becomes entitled to apply for shares.

The company should take a decision on sub-clauses (i) or (ii) at the time of offer of convertible security itself and make such disclosure in explanatory statement;

(f) Where shares or other securities are to be allotted for consideration other than cash, the valuation of such consideration shall be done by a registered valuer who shall submit a valuation report to the company giving justification for the valuation;

(g) Where the preferential offer of shares is made for a non-cash consideration, such non-cash consideration shall be treated in the following manner in the books of account of the company;

(i) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be where clause (i) is not applicable, it shall be expensed as provided in the accounting standards.

According to Rule 13(3), the price of shares or other securities to be issued on preferential basis shall not be less than the price determined on the basis of valuation report of a registered valuer.

(Further in case of listed companies the price of shares to be issued on a preferential basis is not required to be determined by the valuation report of a registered valuer).

In case the preferential offer is made by a company to one or more existing members only, few provisions relating to private placement in PAS-5 & offer letter in PAS-4 shall not apply.

Difference between Private Placement and Preferential Allotment

Particulars	*Private Placement*	*Preferential Allotment*
Governing	Section 42	Section 62(1)(c)
Meaning	Offer or invitation made to a select group of persons	Issue of shares to any persons whether or not they include members and employees
Securities to be issued	Any security including Equity, Preference and Debentures	Only Equity and other securities convertible into Equity can be issued
Shareholders' Approval	Required	Required
Allottees	Any person as identified by the Board	To members, employees or any other persons
Disclosures in Explanatory Statement	Only a few as per Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014	Detailed disclosures as per Rule 13 of the Companies (Share Capital and Debentures) Rules, 2014
Offer Letter	In prescribed format (PAS-4)	No format prescribed
Mode of payment	Through any banking channel but not cash	Either for cash or consideration other than cash
Time limit for allotment	Within 60 days of receipt of subscription money	Within 12 months from the date of passing Special Resolution
Authorisation in Articles	Not Required	Required
Bank Account	Separate Bank account is required	No such requirement.

Difference Between Right Issue and Preferential Allotment

Sr. No.	*Particulars*	*Right Issue*	*Preferential Allotment*
1	**Provisions**	Section 62(1)(a) of the Companies Act, 2013	Section 62(1)(c) of the Companies Act, 2013. In addition to the above, it is subject to the compliance with the applicable provisions of Chapter III (i.e. Public Offer and Private Placement)
2	**Rules**	No Rule has been prescribed for Right Issue	Pursuant to Section 62(1)(c) of the Companies Act, 2013, Rule 13 (issue of shares on Preferential basis) of Companies (Share Capital and Debentures) Rules, 2014 is applicable. Further, in addition to above Rule, Rule 14 (Private Placement) of Companies (Prospectus of Securities) Rules, 2014 is applicable.

Sr. No.	*Particulars*	*Right Issue*	*Preferential Allotment*
3	**Type of Securities**	Only shares can be issued (Equity as well as Preference Shares)	Shares and other securities mean equity shares, fully convertible debentures, partly convertible debentures or any other securities, which would be convertible into exchanged with equity shares at a later date. [Section 62(1)(c) & Rule 13] However, under Private Placement any security can issue. (Equity, Preference Debenture etc.) [Section 42]
4	**Person to whom offer is made**	Shares are issued in proportion to existing shareholding. [Section 62(1)(a)]	Shares may be issued to both existing shareholders and even outsiders. [Section 62(1)(c)]
5	**Limit of Person to whom offer is made**	No limit but offer to all existing shareholder.	No Limit under Section 62(1)(c) and Rule 13 but under Section 42 shall not exceed fifty or such higher number as may be prescribed. Not more than 200 in the aggregate in a financial year [Provison to Rule 14(2)]
6	**Approval**	Board approval through Board Meeting is required. [Section 62(1)(c) and Section 179(3)(c)]	Both Board Resolution and Special Resolution is needed to approve Preferential Allotment. [Section 62(1)(c) and Section 179(3)(c)]
7	**Period of Offer**	Offer remains open for the minimum period 15 days and maximum 30 days. [Section 62(1)(a)(i)]	No provisions for offer period
8	**Offer Letter**	No specific format has been prescribed. Offer letter can be in any format.	Offer letter shall be in prescribed format i.e. PAS-4 [Section 42(3) & Rule 14(3)]
9	**Dispatch of offer letter**	Through registered post or speed post or through electronic mode or courier or any other mode having proof of delivery to all the existing shareholders at least 3 days before opening the issue [Section 62(2)]	Either in writing or in electronic mode within in 30 days of recording the name of identified person pursuant to sub-section (3) of Section 42. [Rule 14(3)]
10	**Filing with ROC before issue of offer letter**	No filing required	Offer letter can be issued only after SR has been filed with ROC in MGT14
11	**Return of Allotment**	E-form PAS-3 for allotment of shares within 30 days	PAS-3 for allotment of shares within 15 days of allotment

Sr. No.	*Particulars*	*Right Issue*	*Preferential Allotment*
12	**Period of Allotment**	Allot shares within 60 days of receipt of application money [Otherwise treated as deposit under Rule 2(1)(c)(vii) of Companies (Acceptance of Deposit) Rules, 2014]	The allotment shall be made of the earlier of these two - – 12 months of Special Resolution; or – 60 days from receipt of application money.
13	**Separate Bank Account**	No separate Bank account is required to receive application money.	Separate Bank account is mandatorily required to receive application money
14	**Mode of Allotment Money**	Company can issue share on cash or through banking Channels [no restriction]	Shares can be issued for Cash or for a Consideration other than Cash. But, all the monies payable towards subscription shall be paid through Cheque, Demand Draft or banking channels, but not in cash
15	**Utilization of application money**	No restriction for filing of return of allotment before utilization of application money	No utilization of application money unless return of allotment is filed with ROC
16	**Valuation Report**	No need of any valuation report	Valuation Report is mandatory for making preferential allotment
17	**Price of Shares or securities**	No provision	The price of shares or other securities to be issued on preferential basis shall not be less than the price determined on the basis of valuation report of a registered valuer
18	**Attachment of valuation report with PAS-3**	Not required	Mandatory required to attached valuation report with PAS-3
19	**Right to renounce**	Shareholders under this option have right to renounce, reject or approve the offer.	No such right under this option
20	**Explanatory Statement**	Not applicable because no shareholder approval is required.	Notice should contain Explanatory statement according to Rule 13 (d) & Rule 14(2).

VII. BONUS SHARES

Meaning: A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares. The issue of bonus shares by a company is a common feature. The vesting of rights in bonus shares takes place when the shares are actually allotted; and not from any earlier date.

Governing Provisions of the Companies Act, 2013: Section 63 and Rule 14 of the Companies (Share Capital and Debentures) Rules, 2014 and SEBI Regulations (if the company is listed) are applicable.

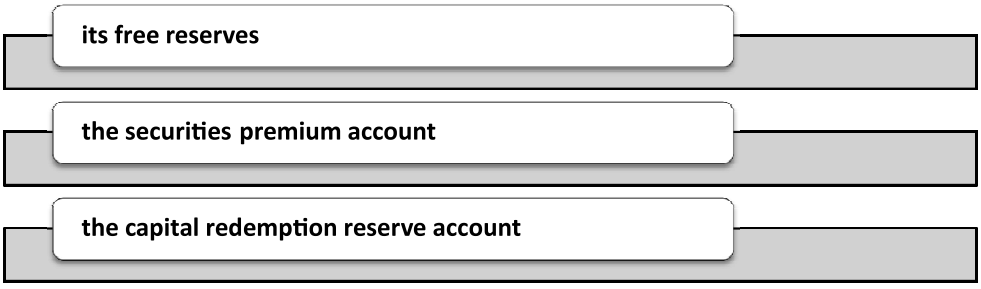
Benefits of Issuing Bonus Shares:

1. It is meant for capitalizing undistributed profits.
2. Fund flow is not affected adversely.
3. Market value of the company's shares comes down to their nominal value by issue of bonus shares.
4. Market value of the members' share holdings increases with the increase in number of shares in the company.
5. 'Bonus shares' is not an income. Hence, it is not a taxable income.

The company which has once announced the decision of its Board recommending a bonus issue, shall not subsequently withdraw the same.

Sources for issue of Bonus Shares

According to section 63(1), a company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of-



Note: No issue of bonus shares shall be made by capitalising reserves created by the revaluation of assets.

Conditions for issue of Bonus Shares

In terms of section 63(2), no company shall capitalise its profits or reserves for the purpose of issuing fully paid-up bonus shares, unless-

(a) **Authorisation in AOA:** It is authorised by its articles;

(b) **General Meeting Resolution:** It has, on the recommendation of the Board, been authorised in the general meeting of the company;

(c) **No defaults:**

- it has not defaulted in payment of interest or principal in respect of fixed deposits or debt securities issued by it;

- it has not defaulted in respect of the payment of statutory dues of the employees, such as, contribution to provident fund, gratuity and bonus.

(d) **Fully paid up shares:** The partly paid-up shares, if any outstanding on the date of allotment, are made fully paid-up.

(e) **No issue in lieu of dividend**: The bonus shares shall not be issued in lieu of dividend.

FORMS TO BE FILED WITH ROC

- **FORM MGT-14:** In case special resolution for altering the Article of Association for authorizing bonus issues of shares, then to file Form MGT-14 within 30 days of passing the special resolution.
- **FORM PAS-3:** Within 30 days of allotment file with the Registrar the Return of allotment in **Form PAS-3** along with fee as specified in Companies (Registration of Offices and Fees), Rules 2014.

The Ministry of Corporate Affairs has notified the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2023 to amend the Companies (Prospectus and Allotment of Securities) Rules, 2014 which omitted rule 12(6) that required a copy of the resolution passed in the general meeting authorizing the issue of such shares shall be attached to the Form PAS-3, In the case of issue of bonus shares.

Illustration: *A Company wants to issue bonus shares but its Article of Association prohibits the same. What steps can be taken by the company to issue bonus shares?*

Answer: *The company is required to alter its AOA by passing special resolution under Section 14 of Companies Act, 2013.*

Illustration: *What will be issue price for Bonus Shares?*

Answer: *The bonus shares are issued at free of cost.*

Illustration*: ABC Private Limited has the following:*

- *Authorised Equity Share Capital: Rs. 85 Crores.*
- *Paid Up Equity Share Capital: Rs.60 Crores.*
- *Reserves & Surplus: Rs.780 Crores.*

However, ABC Private Limited has defaulted in making payment towards contribution of provident fund for last two years. The Board plans to issue bonus shares in ratio of 1:1. Can the Board do so?

Answer: As the Company has defaulted in making payment of statutory dues , it do not satisfy the conditions permissible to issue bonus shares. Therefore, ABC Private Limited can't issue bonus shares.

VIII. SWEAT EQUITY SHARES

What are Sweat Equity Shares?

According to section 2 (88), sweat equity shares means such equity shares issued by a company to its directors or employees at a discount or for consideration, other than cash for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

What are Value additions?

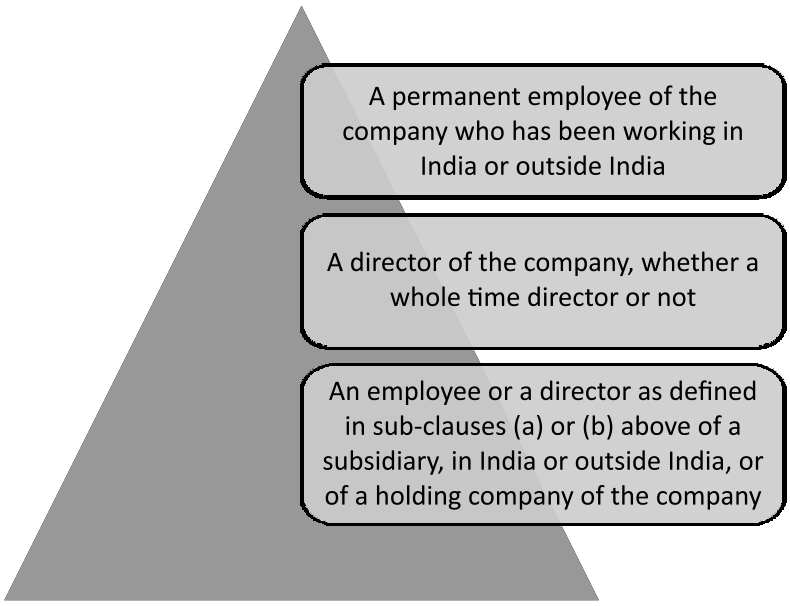
It means actual or anticipated economic benefits derived or to be by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by

such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Who are Employees?

According to Explanation to Rule 8(1) of the Companies (Share Capital and Debentures) Rules, 2014: For the purposes of this rule-

The expressions ''Employee'' means –



Governing Provisions of the Companies Act, 2013: Section 54 and Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014 and SEBI Regulations if the company is listed are applicable.

Conditions for Issue of Sweat Equity Shares

Section 54(1) provides that notwithstanding anything contained in Section 53, a company can issue sweat equity shares, of a class of shares already issued, if the following conditions are satisfied:

1. **Authorisation by Special Resolution:** The issue has been authorized by a special resolution passed by the company in the general meeting.
2. **Matters to be stated in Special Resolution:** The following are clearly specified in there solution:
   (a) number of shares;
   (b) current market price;
   (c) consideration, if any; and
   (d) class or classes of directors or employees to whom such equity shares are to be issued.
3. **Compliance with SEBI Regulations:** Where shares are listed on a recognized stock exchange, the company issuing sweat equity shares should comply with the regulations made in this behalf by SEBI.
4. **Sweat Equity Shares have the same rights and limitations as that of Equity Shares:** Section 54(2) provides that the rights, limitations, restrictions and provisions as are for the time being applicable to

equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

5. **Special Resolution remains valid for not more than 12 months:** Rule 8(3) states the special resolution authorising the issue of sweat equity shares shall be valid for making the allotment within a period of not more than twelve months from the date of passing of the special resolution.

6. ***Three Years Locking Period:*** The sweat equity shares issued to directors or employees shall be locked for a period of three years from the date of allotment and the fact that the share certificates are under lock-in and the period of expiry of lock in shall be stamped in bold or mentioned in any other prominent manner on the share certificate.

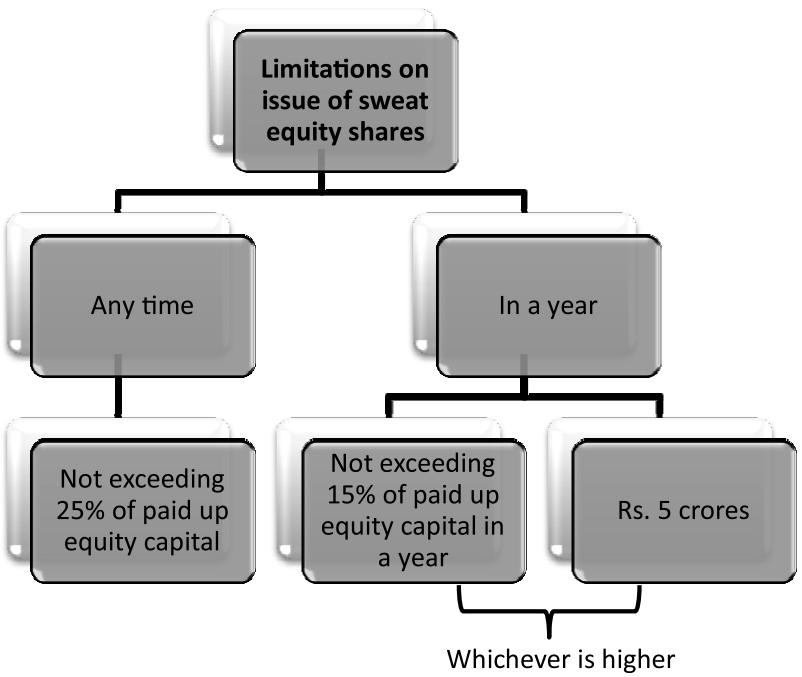
7. **Limitations on issue of sweat equity shares:**

Rule 8(4) states that the company shall not issue sweat equity shares for more than fifteen percent of the existing paid up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher. The issuance of sweat equity shares in the company shall not exceed twenty five percent, of the paid up equity capital of the company at any time.

Note: A startup company, as defined by Ministry of Commerce and Industry, Government of India, may issue sweat equity shares not exceeding fifty percent of its paid up capital upto ten years from the date of its incorporation or registration.

Valuation: A significant Aspect in case of Sweat Equity Shares:

- The sweat equity shares to be issued shall be valued at a price determined by a registered valuer as the fair price giving justification for such valuation.
- The valuation of intellectual property rights or of know how or value additions for which sweat equity shares are to be issued, shall be carried out by a registered valuer, who shall provide a proper report addressed to the **Board of Directors** with justification for such valuation.
- This valuation report shall be sent to the **shareholders with the notice of the general meeting.**



8. **Sweat equity shares for non-cash consideration:** The non-cash consideration shall be treated in the following manner in the books of account of the company –

   (a) where the non-cash consideration takes the form of a depreciable or amortizable asset, it shall be carried to the balance sheet of the company in accordance with the accounting standards; or

   (b) where clause (a) is not applicable, it shall be expensed as provided in the accounting standards.

9. **Sweat equity shares forming part of managerial remuneration:** The amount of sweat equity shares issued shall be treated as part of managerial remuneration for the purposes of sections 197 and 198 of the Act, if the following conditions are fulfilled, namely –

   (a) the sweat equity shares are issued to any director or manager; and

   (b) they are issued for consideration other than cash, which does not take the form of an asset which can be carried to the balance sheet of the company in accordance with the applicable accounting standards.

10. **Sweat equity shares and compensation aspects**

   - **If the sweat equity shares are not issued pursuant to acquisition of an asset**

     Rule 8(11) states that in respect of sweat equity shares issued during an accounting period, the accounting value of sweat equity shares (*i.e.*, fair value by Registered valuer shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

   - **If the shares are issued pursuant to acquisition of an asset**

     Rule 8(12) states that if the shares are issued pursuant to acquisition of an asset, the value of the asset, as determined by the valuation report, shall be carried in the balance sheet as per the Accounting Standards and such amount to the accounting value of the sweat equity shares that is in excess value of the asset acquired, as per the valuation report, shall be treated as a form of compensation to the employee or the director in the financial statements of the company.

11. **Disclosure in Board Report:**

   (a) the class of director or employee to whom sweat equity shares were issued;

   (b) the class of shares issued as Sweat Equity Shares;

   (c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them , if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;

   (d) the reasons or justification for the issue;

   (e) the principal terms and conditions for issue of sweat equity shares, including pricing formula;

   (f) the total number of shares arising as a result of issue of sweat equity shares;

   (g) the percentage of the sweat equity shares of the total post issued and paid up share capital;

   (h) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;

   (i) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

12. **Maintenance of Register**

Rule 8(14) states that the company shall maintain a Register of Sweat Equity Shares in **Form No. SH.3** and shall forthwith enter therein the particulars of Sweat Equity Shares issued under section 54. The Register of Sweat Equity Shares shall be maintained at the registered office of the company or such other place as the Board may decide. The entries in the register shall be authenticated by the Company Secretary of the company or by any other person authority.

Illustration: The share capital of the company ABC Pvt. Ltd. is ₹*20* Crore. Mr. Raj is appointed as Managing Director of the company, the company wants to compensate him by issue of shares for supplying technical know-how without any cost. What can be the quantum of the shares that can be allotted?

Solution: the paid-up capital of the company is ₹20 crore. Hence he can be allotted with 15% of existing equity i.e. (15% of ₹20 crore up to ₹3 Crore) value of shares or ₹ 5 crore whichever is higher.

Explanatory Statement to Special Resolution to contain certain particulars [Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014]

While taking a decision it is important that all information is provide with regard to the matter, hence rule 8(2) states that the explanatory statement to be annexed to the notice of the general meeting shall contain the following particulars, namely:-

(e) the date of the Board meeting at which the proposal for issue of sweat equity shares was approved;

(f) the reasons or justification for the issue;

(g) the class of shares under which sweat equity shares are intended to be issued;

(h) the total number of shares to be issued as sweat equity;

(i) the class or classes of directors or employees to whom such equity shares are to be issued;

(j) the principal terms and conditions on which sweat equity shares are to be issued, including basis of valuation;

(k) the time period of association of such person with the company;

(l) the names of the directors or employees to whom the sweat equity shares will be issued and their relationship with the promoter or/and Key Managerial Personnel;

(m) the price at which the sweat equity shares are proposed to be issued;

(n) the consideration including consideration other than cash, if any to be received for the sweat equity;

(o) the ceiling on managerial remuneration, if any, be breached by issuance of such sweat equity and how it is proposed to be dealt with;

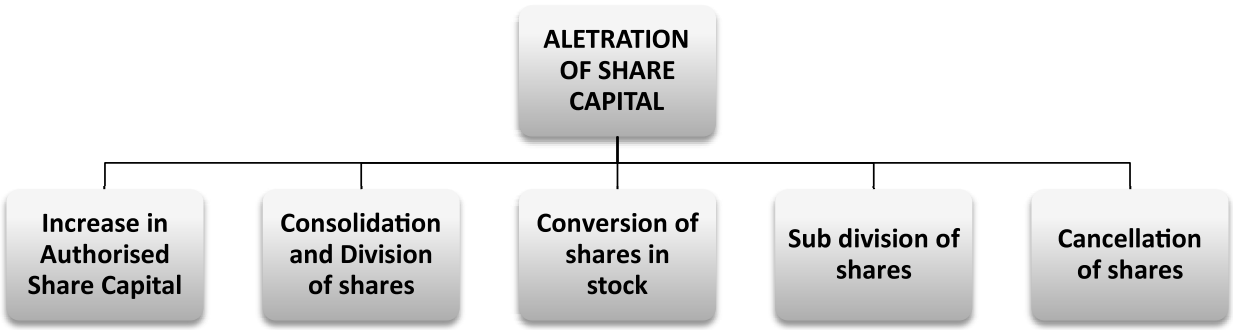
(p) a statement to the effect that the company shall conform to the applicable accounting standards; and

(q) diluted Earning Per Share pursuant to the issue of sweat equity shares, calculated in accordance with the applicable accounting standards.

PART D : ALTERATION IN SHARE CAPITAL, BUY-BACK AND REDUCTION OF SHARE CAPITAL

ALTERATION OF SHARE CAPITAL (SECTION 61)

The company may for commercial reasons, alter its share capital. Section 61 of the Companies Act, 2013 provides that a limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting to:



(a) **Increase Authorised Capital**: It includes to increase its authorised share capital by such amount, as it thinks expedient;

(b) **Consolidation and division of shares:** It includes to consolidate and divide, all or any of its existing shares into a larger denomination than of its existing shares e.g., by consolidating ten shares of Rs. 10/- each into one share of Rs. 100/- each. Proviso to Section 61(1)(b) states that no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;

(c) **Conversion in stock:** It includes to convert all or any of its fully paid-up shares into stock or reconvert that stock into fully paid-up shares of any denomination;

(d) **Sub-division:** It includes to sub-divide its existing shares or any of them, into shares of smaller amount than is fixed by the Memorandum, so however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced shall be the same as it was in the case of the share from which the reduced share is derived;

(e) **Cancellation of Shares:** It includes to cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken up or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled.

Points to be noted

- The cancellation of shares shall not be deemed to be a reduction of share capital.
- In order to alter its capital clause in the Memorandum, the company requires authority in its articles. But if the articles give no power to this effect, the articles must be amended by a special resolution before the power to alter the capital clause can be exercised by the company [*Re. Patent Invert Sugar Co. (1885) 31 Ch. D. 166*].
- Any amendment in Articles of Association will require the filing of **Form MGT-14** with ROC within 30 days of passing the special resolution.
- An ordinary resolution will be enough for altering capital clause in the Memorandum of Association.

Filing of FORM SH-7 with ROC:

Section 64(1) states that when-

- a company alters its share capital in any manner specified in sub-section (1) of section 61;
- an order made by the Government under sub-section (4) read with sub-section (6) of section 62 has the effect of increasing authorised capital of a company; or
- a company redeems any redeemable preference shares.

The company shall file a notice in the prescribed **Form SH-7** with the Registrar with in a period of thirty days of such alteration or increase or redemption, as the case may be, along with an altered memorandum.

PENALTY:

As per Section 64 (2), contravention in this case will make the such company and every officer who is in default shall be liable to a penalty of five hundred rupees for each day during which such default continues, subject to a maximum of five lakh rupees in case of a company and one lakh rupees in case of an officer who is in default.

BUY-BACK OF SECURITIES

What is Buy-Back?

The term buy-back implies the act of purchasing its own shares/securities by a company. This facility enables the Company to go back to the holders of its own shares/securities and make an offer to purchase such shares/ securities from them.

Governing Provisions of Companies Act, 2013

- Section 68-70.
- Rule 17 of Companies (Share Capital and Debentures) Rules, 2014.
- For Listed Companies: SEBI Regulations are also applicable.

Sources

According to Section 68(1) of the Companies Act, 2013 a company may purchase its own shares or other specified securities (hereinafter referred to as “buy-back”) out of:

However, no buy-back of any kind of shares or other specified securities can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Thus, the company must have at the time of buy-back, sufficient balance in any one or more of these accounts to accommodate the total value of the buy-back.

What are Free Reserves?

Free reserves has been defined under section 2(43) of the Act as such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend: Further it has been provided that the following shall not be treated as free reserves:

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

Conditions for Buy Back

1. **Authorisation by AOA**: The primary requirement is that the articles of association of the company should authorise buy-back. In case, such a provision is not available, it would be necessary to alter the articles of association to authorise buy-back. Buy-back can be made with the approval of the Board of Directors at a Board meeting and/or by a special resolution passed by shareholders in a general meeting, depending on the quantum of buy-back.

   In case of a listed company, approval of shareholders shall be obtained only by postal ballot.

2. **Approval:**

   Board of Directors can approve buy-back up to 10% of the total paid-up equity capital and free reserves of the company and authorize such buy-back by means of a resolution passed at the meeting.

   Shareholders by a special resolution can approve buy-back up to 25% of the total paid-up capital and free reserves of the company, in respect of any financial year.

3. **Quantum:**

   The buy-back is twenty-five per cent. or less of the aggregate of paid-up capital and free reserves of the company. In respect of buy-back of equity shares in any financial year the reserve of 25% shall be construed with respect to its paid-up equity capital in that financial year.

4. **Debt Equity Ratio after Buy Back**

   The ratio of the aggregate of secured and unsecured debts owed by the company after buy-back is not more than twice the paid-up capital and its free reserves. However, the Central Government may, by order, notify a higher ratio of the debt to capital and free reserves for a class or classes of companies.

As per MCA order [S.O. 702(E)], dated 10th March 2016 the Central Government notified that the debt to capital and free reserves ratio shall be 6:1 for Government companies within the meaning of clause (45) of section 2 of the Companies Act, 2013 which carry on Non-Banking Finance Institution activities and Housing Finance activities.

5. **Fully paid up shares:** all the shares or other specified securities for buy-back are fully paid-up.

6. **Time Gap between two Buy Back:** No offer of buy-back under this sub-section shall be made within a period of one year reckoned from the date of the closure of the preceding offer of buy-back, if any.

7. **Completion of Buy Back:** Every buy-back shall be completed within a period of one year from the date of passing of the special resolution, or as the case may be, the resolution passed by the Board.

8. **Methods of Buy Back:** The buy-back may be—

   (a) from the existing shareholders or security holders on a proportionate basis;

   (b) from the open market;

   (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

9. **Extinguishment of shares**: When a company buys-back its own shares or other specified securities, it shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back.

10. **Prohibition of further issue of shares:** Where a company completes a buy-back of its shares or other specified securities under this section, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares under clause (a) of sub-section (1) of section 62 or other specified securities within a period of six months except by way of a bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

11. **Period of offer for buy-back:** The offer for buy-back shall remain open for a period of not less than 15 days and not exceeding 30 days from the date of dispatch of the letter of offer.

    Provided that where all members of a company agree, the offer for buy-back may remain open for a period less than fifteen days.

12. **Register of Buy Back:** When a company buys-back its shares or other specified securities under this section, it shall maintain a register of the shares or securities so bought in **Form No. SH-10**, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities and other particulars.

    The said register shall be maintained at the registered office of the company and shall be kept in the custody of Secretary of the company or any other person authorized by the Board in this behalf.

    The entries in the register shall be authenticated by the Secretary of the company or any other person authorized by the Board in this behalf.

13. **Dispatch of letter of offer to shareholders:** The letter of offer shall be dispatched to the shareholders or security holders immediately after filing the same with the Registrar of Companies but not later than 21 days from its filing with the Registrar of Companies.

14. **Filing with ROC:**

    - **Filing of Special Resolution (Form MGT-14):** Within 30 days of passing special resolution for buy back.
    - **Letter of Offer (Form No. SH-8):** The company which has been authorized by a special resolution shall, before the buy-back of shares, file with the Registrar of Companies a letter of offer in Form No. SH.8, along with the fee. Such letter of offer shall be dated and signed on behalf of the Board

of directors of the company by not less than two directors of the company, one of whom shall be the managing director, where there is one.

- **Declaration of Solvency (Form No. SH-9):** The company shall file with the Registrar, along with the letter of offer, and in case of a listed company with the Registrar and the Securities and Exchange Board, a declaration of solvency in Form No. SH.9 along with the fee and signed by at least two directors of the company, one of whom shall be the managing director, if any, and by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent with in a period of one year from the date of declaration adopted by the Board.
- **Return (Form No. SH-11**): The company, after the completion of the buy-back, shall file with the Registrar, and in case of a listed company with the Registrar and the Securities and Exchange Board of India, a return in the Form No. SH.11 along with the fee. There shall be declaration with the return filed with the Registrar in Form No. SH.11, signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.

15. **Completion of verification of offers:** The company shall complete the verifications of the offers received within fifteen days from the date of closure of the offer and the shares or other securities lodged shall be deemed to be accepted unless a communication of rejection is made within twenty-one days from the date of closure of the offer.

16. **Opening of Bank Account:** The company shall immediately after the date of closure of the offer, open a separate bank account and deposit therein, such sum, as would make up the entire sum due and payable as consideration for the shares tendered for buy-back in terms of these rules. The company shall within seven days of the time specified in sub-rule (7)-

    (a) make payment of consideration in cash to those shareholders or security holders whose securities have been accepted; or

    (b) return the share certificates to the shareholders or security holders whose securities have not been accepted at all or the balance of securities in case of part acceptance.

17. **Other Points to be considered:**

    In case the number of shares or other specified securities offered by the shareholders or security holders is more than the total number of shares or securities to be bought back by the company, the acceptance per shareholder shall be on proportionate basis out of the total shares offered for being bought back.

Penalty

If a company makes any default in complying with the provisions of Section 68 or any regulation made by the Securities and Exchange Board, in case of listed companies, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

Explanatory statement to contain certain disclosures [Rule 17(1) of the Companies (Share Capital and Debentures) Rules, 2014]

Explanatory statement to the special resolution authorising buy-back to be annexed to the notice of the general meeting pursuant to section 102 shall contain the following disclosures:

(a) the date of the Board meeting at which the proposal for buy-back was approved by the Board of Directors of the company;

(b) the objective of the buy-back;

(c) the class of shares or other securities intended to be purchased under the buy-back;

(d) the number of securities that the company proposes to buy-back;

(e) the method to be adopted for the buy-back;

(f) the price at which the buy-back of shares or other securities shall be made;

(g) the basis of arriving at the buy-back price;

(h) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;

(i) the time-limit for the completion of buy-back;

(j) the aggregate share holding of the promoters and of the directors of the promoter, where the promoter is a company and of the directors and key managerial personnel as on the date of the notice convening the general meeting;

  (i) the aggregate number of equity shares purchased or sold by persons mentioned in (i) above during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;

  (ii) the maximum and minimum price at which purchases and sales referred to in (ii) above were made along with the relevant date.

(k) if the persons mentioned in sub-clause (i) of clause (j) intend to tender their shares for buy-back–

  (i) the quantum of shares proposed to be tendered;

  (ii) the details of their transactions and their holdings for the last twelve months prior to the date of the Board meeting at which the buy-back was approved including in formation of number of shares acquired, the price and the date of acquisition.

(l) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon or redemption of preference shares or payment of dividend due to any shareholder, or repayment of any term loans or interest payable thereon to any financial institution or banking company;

(m) a confirmation that the Board of Directors have made a full enquiry in to the affairs and prospects of the company and that they have formed the opinion –

  (i) that immediately following the date on which the general meeting is convened there will be no grounds on which the company could be found unable to pay its debts;

  (ii) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to meet its liabilities as and when they fall due and will not be rendered insolvent within a period of one year from that date; and

  (iii) informing their opinion for the above purposes, the directors have taken in to account the liabilities (including prospective and contingent liabilities); as if the company were being wound-up under the provisions of the Companies Act, 2013.

(n) a report addressed to the Board of Directors by the company's auditors stating that:

(i) they have inquired into the company's state of affairs;

(ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;

(iii) that the audited accounts on the basis of which calculation with reference to buy-back is done is not more than six months old from the date of offer document; and

However, where the audited accounts are more than six months old, the calculations with reference to buy-back shall be on the basis of un-audited accounts not older than six months from the date of offer document which are subjected to limited review by the auditors of the company;

(iv) the Board of Directors have formed the opinion as specified in clause (m) on reasonable grounds and that the company, having regard to its state of affairs, will not be rendered insolvent within a period of one year from that date.

Transfer to and application of Capital Redemption Reserve Account [Section 69]

When a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet. The capital redemption reserve account may be applied by the company, in paying up unissued shares of the company to be issued to member so the company as fully paid bonus shares.

Circumstances prohibiting buy-back [Section 70]

No company shall directly or indirectly purchase its own shares or other specified securities-

- through any subsidiary company including its own subsidiary companies;
- through any investment company or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company: However, the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist. [Proviso to Section 70(1)]

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of sections 92 (Annual Return), section 123 (Declaration of Dividend), section 127 (punishment for failure to distribute dividend) and section 129 (Financial Statement).

Why the Company choose Buy Back?

The following are the benefits of share buy-back for the companies as under:

1. It is an alternative mode of reduction in capital without requiring approval of the Court/NCLT;
2. to improve the earnings per share;
3. to improve return on capital, return on net worth and to enhance the long-term shareholders value;
4. to provide an additional exit route to shareholders when shares are under valued or thinly traded;
5. to enhance consolidation of stake in the company;
6. to prevent unwelcome takeover bids;

7. to return surplus cash to shareholders;
8. to achieve optimum capital structure;
9. to support share price during periods of sluggish market condition;
10. to serve the equity more efficiently.

Illustration:

PQR Limited has the following:

Equity Share Capital: Rs. 800 crore of Rs. 10 each

General Reserve: Rs. 500 crore

Security Premium Account: Rs. 200 crore

Secured Loans: Rs. 100 Crores

Advise the maximum quantum upto the company can buy back its shares with Board Approval and Shareholders' approval.

*Solution: Maximum Quantum with Board Approval: (800 +500)*10 % = 130 crore i.e. 13 crore shares can be bought back with Board Approval*

*Maximum Quantum with Shareholders' Approval: (800 +500)*25 % = 325 crore i.e. 32.5 crore shares can be bought back with Shareholders' Approval*

In exercise of the powers conferred by sub-section (3) of section 23 read with section 469 of the Companies Act, 2013 the Central Government have notified Companies (Listing of equity shares in permissible jurisdictions) Rules, 2024 vide MCA notification dated 24th January 2024

The provisions of these rules shall apply to –

(a) unlisted public companies;

(b) listed public companies, so far as they are in accordance with regulations framed or directions issued in this regard by the Securities and Exchange Board or the Authority, which issue their securities for the purposes of listing on permitted stock exchanges in permissible jurisdictions

Listing on permitted stock exchanges in permissible jurisdictions. -

(1) An unlisted public company, which does not fall under rule 5 and which has no partly paid-up shares, may issue equity shares for the purposes of listing on a stock exchange in a permissible jurisdiction.

Explanation. – For the purposes of this sub-rule, issue of equity shares shall include, offer for sale of equity shares by existing shareholders of the unlisted public company for listing on a stock exchange in a permissible jurisdiction.

(2) The unlisted public company or its existing shareholders referred to in sub-rule (1) shall also comply with the requirements of the Scheme.

(3) Listing of equity shares on permitted stock exchanges in permissible jurisdiction by an unlisted public company which also intends to get its equity shares listed with any recognised stock exchange as defined under clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 shall also be in compliance with such conditions as may be specified by the Securities and Exchange Board of India.

(4) The unlisted public company shall file the prospectus in e-Form **LEAP-1** specified in the Second Schedule along with the fees within a period of seven days after the same has been finalised and filed in the permitted exchange.

(5) After the listing of the equity shares of a company on any of the stock exchanges in a permissible jurisdiction, the company shall comply with Indian Accounting Standards as specified in the Annexure to the Companies (Indian Accounting Standards) Rules, 2015 in preparation of their financial statements, in addition to any other accounting standard, which they may be required to comply for the preparation of the financial statements filed before the securities regulator concerned, or with the stock exchange concerned, as the case may be.

Certain companies not eligible. - A company shall not be eligible for issuing its equity shares for listing in accordance with these rules, in case it –

(a) has been registered under section 8 or declared as Nidhi under section 406 of the Act;

(b) is a company limited by guarantee and also having share capital;

(c) has any outstanding deposits accepted from the public as per Chapter V of the Act and rules made thereunder;

(d) has a negative net worth;

Explanation. – For the purposes of this clause, the expression "net worth" shall have the same meaning as assigned to it under clause (57) of section 2 of the Act;

(e) has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holder or any other secured creditor:

Provided that this clause shall not apply if the company had made good the default and a period of two years had lapsed since the date of making good the default;

(f) has made any application for winding-up under the Act or for resolution or winding-up under the Insolvency and Bankruptcy Code, 2016 and in case any proceedings against the company for winding-up under the Act or for resolution or winding-up under the Insolvency and Bankruptcy Code, 2016 is pending;

(g) has defaulted in filing of an annual return under section 92 or financial statement under section 137 of the Act within the specified period.

The First Schedule states that Permissible Jurisdiction-International Financial Services Centre in India and Permitted Stock Exchange refers to India International Exchange, NSE. International Exchange.

REDUCTION OF SHARE CAPITAL (SECTION 66)

The need of reducing share capital may arise in various circumstances such as follows:

- Returning of surplus to shareholders;
- Eliminating losses, which may be preventing the payment of dividends;
- As a part of scheme of compromise or arrangements; simplify capital structure;
- When the company is making losses, the financial position does not present a true and fair view of the company. In order to reduction of capital will write-off that portion of capital which is already lost and will make the balance sheet look healthy.

Conditions for reduction of share capital

1. **Approval of members by passing Special Resolution**: It is required to get the matter for reduction in share capital to get it approved with member's approval by special resolution.
2. **Filing of Form MGT-14 with ROC:** Special resolution passed for reduction of share capital is required to be filed with ROC within 30 days.

3. **Confirmation by Tribunal**: Subject to confirmation by the Tribunal on an application by the company, a company limited by shares or limited by guarantee and having a share capital may, by a special resolution, reduce the share capital in any manner and in particular.

4. **Methods for reduction of share capital:**

(a) extinguish or reduce the liability on any of its shares in respect of the share capital not paid-up; or

Example: Where the shares are of face value of ₹100 each with ₹65 has been paid, the company may reduce them to ₹65 fully paid-up shares and thus relieve the shareholders from liability on the uncalled capital of ₹35 per share.

(b) either with or without extinguishing or reducing liability on any of its shares,–

(i) cancel any paid-up share capital which is lost or is unrepresented by available assets; or

Example: Where the shares of face value of ₹100 each fully paid-up is represented by ₹65 worth of assets. In such a case, reduction of share capital may be effected by cancelling ₹35 per share and writing off similar amount of assets.

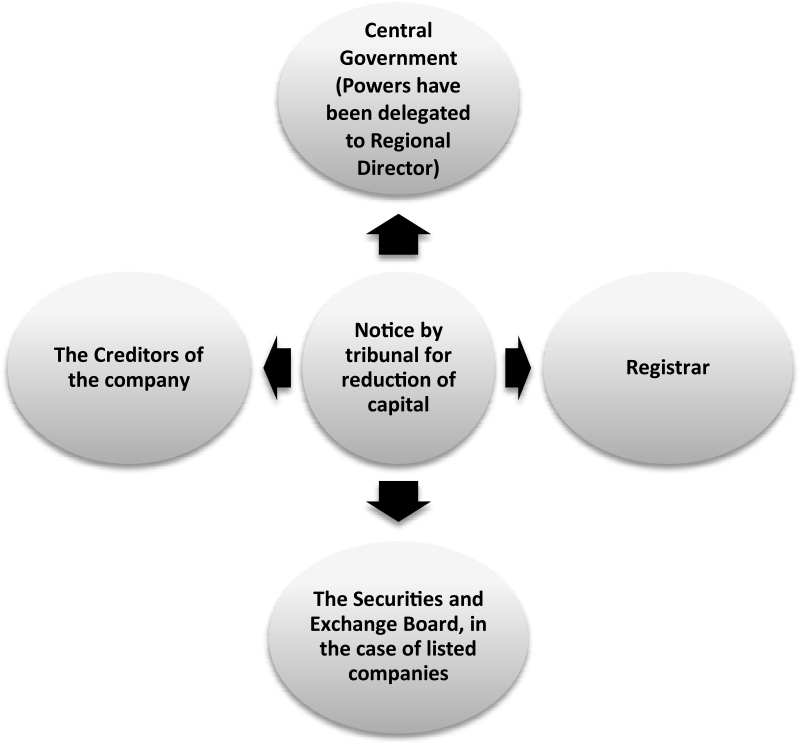
(ii) pay off any paid-up share capital which is in excess of the wants of the company, alter its memorandum by reducing the amount of its share capital and of its shares accordingly:

Example: Shares of face value of ₹100 each fully paid-up can be reduced to face value of ₹75 each by paying back ₹25 per share.

No Reduction of Capital would be allowed in case of Arrears in the Repayment of Deposits and Interest there on.

5. **Notice by Tribunal:**

The Tribunal shall give notice of every application made to it under sub-section (1) to:



It shall take into consideration there presentations, if any, made to it by that Central Government, Registrar, the Securities and Exchange Board and the creditors within a period of three months from the date of receipt of the notice.

If no representation has been received from the Central Government, Registrar, the SEBI or the creditors within the said period, it shall be presumed that they have no objection to the reduction. [Proviso to Section 66(2)]

Consent affidavits from the creditors is mandatory for reduction of share capital

In case of the case of *Brillio Technologies Pvt. Ltd vs Registrar Of Companies, The NCLAT, New Delhi,* while giving its judgment held that "Consent affidavits from the creditors is mandatory for reduction of share capital, SPA cannot be utilized for making payment to non- promoter shareholders, selective capital reduction is allowed if the non-promoter shareholders are paid fair and true value of their respective shares and that section 66 of that Act makes such a provision for reduction without it coming under any arrangement or compromise."

6. **The claims of every creditor of the company must be discharged**:

   The Tribunal may, if it is satisfied that the debt or claim of every creditor of the company has been discharged or determined or has been secured or his consent is obtained, make an order confirming the reduction of share capital on such terms and conditions as it deems fit.

7. **The Accounting Treatment for the company must be in compliance with accounting standards:**

   Proviso to Section 66(3) provides that no application for reduction of share capital shall be sanctioned by the Tribunal unless the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act and a certificate to that effect by the company's auditor has been filed with the Tribunal.

8. **Filing of the certificate by company's auditor with Tribunal:** A certificate to that fact that the accounting treatment, proposed by the company for such reduction is in conformity with the accounting standards specified in section 133 or any other provision of this Act by the company's auditor has been filed with the Tribunal.

9. **Publication of the order of the Tribunal:** The order of confirmation of the reduction of share capital by the Tribunal under Section 66(3) shall be published by the company in such manner as the Tribunal may direct.

10. **Deliver a copy of the Tribunal to Registrar:** The company shall deliver a certified copy of the order of the Tribunal under sub-section (3) and of a minute (which means document submitted to Tribunal detailing the reduction and approved by the tribunal. Here the word minute has different meaning from the word minutes used for proceedings) approved by the Tribunal showing -

    (i) the amount of share capital;

    (ii) the number of shares into which it is to be divided;

    (iii) the amount of each share; and

    (iv) the amount, if any, at the date of registration deemed to be paid-up on each share, to the Registrar within thirty days of the receipt of the copy of the order, who shall register the same and issue a certificate to that effect.

No liability of member

A member of the company, past or present, shall not be liable to any call or contribution in respect of any share held by him exceeding the amount of difference, if any, between the amount paid on the share, or reduced amount, if any, which is to be deemed to have been paid thereon, as the case may be, and the amount of the share as fixed by the order of reduction.

Action under Section 447 i.e. Punishment for Fraud

If any officer of the company:

- knowingly conceals the name of any creditor entitled to object to the reduction;
- knowingly misrepresents the nature or amount of the debt or claim of any creditor; or
- abets or is privy to any such concealment or misrepresentation as aforesaid; He shall be liable under section 447.

CASE LAWS

1) Birla Global Finance Ltd. Company Petition No. 228 of 2002 Connected With C.A. No. 149 of 2002, in re: In this case the court held that the redemption of preference shares is nothing but repayment of the preference capital and amounts to reduction of share capital.

2) Sandvik Asia Ltd. v. Bharat Kumar Padamsi (2009 (3) Bom CR 57): Here the court held that once it is established that non-promoter shareholders are being paid fair value of their shares, and an overwhelming majority of them have voted in favour of resolution for reduction of share capital, the court will not be justified in withholding the sanction to the resolution.

3) Elpro International Ltd. (2009 4 Comp LJ 406 (Bom): The Bombay High Court while dealing with a special resolution passed in favour of reduction of capital, held that a company can reduce the share capital of any shareholder in any way so long as the procedure is fair and gets the approval of the majority shareholders.

4) Indian National Press (Indore) Ltd., In re, (1989) 66 Com Cases 387, 392 (MP)- The need for reducing capital may arise in various ways, for example, trading losses, heavy capital expenses, and assets of reduced or doubtful value. As a result, the original capital may either have become lost or a company may find that it has more resources than it can profitably employ. In either case, the need may arise to adjust the relation between capital and assets.

In the matter of *Josco Jewellers Private Limited Vs. RoC, Kerala CP/06/KOB/2020*: The Petitioner Company had filed a petition under Section 66 of the Companies Act, 2013 against the Registrar of Companies, Kerela seeking reduction of its share capital from Rs. 120 crores to Rs. 1 crore. After a review of the capital structure, the Board of Directors of the Petitioner Company observed that the company's paid up capital was more than the required amount for the existing business of the company and that it would be beneficial for the company to remit back its excess capital by way of reduction of share capital. The NCLT, Kochi Bench held that since all the requisite statutory procedures have been fulfilled and no objections has been received from any shareholders, the company petition filed for reduction of its share capital is hereby allowed.

DIMINUTION OF SHARE CAPITAL IS NOT A REDUCTION OF CAPITAL

As per section 61(1)(e) of the Companies Act, 2013, diminution of capital is the cancellation of the unsubscribed part of the issued capital. It can be effected by an ordinary resolution provided articles of the company authorises to do so. According to section 61(2), cancellation of shares under section 61(1) shall not be deemed to be reduction of share capital. It does not need any confirmation of the Tribunal under section 66.

Reduction of share capital by following methods also do not need any sanction/approval of the Tribunal:

(a) Redemption of redeemable preference shares.

(b) Purchase of shares of a member by the Company on order of the Tribunal under Section 242 of the Companies Act, 2013.

(c) Buy-back of its own securities under Section 68.

In the following cases, the diminution of share capital is not to be treated as reduction of the capital:

(i) Where the company cancels shares which have not been taken or agreed to be taken by any person [Section 61(1)(e) Companies Act, 2013];

(ii) Where redeemable preference shares are redeemed in accordance with the provisions of Section 55 [Explanation to section 55(3) of the Companies Act, 2013];

(iii) Where any shares are forfeited for non-payment of calls and such forfeiture amounts to reduction of capital;

(iv) Where the company buys-back its own shares under Section 68 of the Act [Section 66(6)];

(v) Where the reduction of share capital is effected in pursuance of the order of the Tribunal sanctioning any compromise or arrangement under section 230.

Points to remember:

The above cases do not require the approval or sanction of Tribunal as well as the procedure for reduction of capital as laid down in Section 66 is not attracted.

CASE LAWS

(A) *SIEL Ltd., Inre. [(2008)144 Com Cases 469 (Del)]*, the view was that reduction of the share capital of a company is a domestic concern of the company and the decision of the majority would prevail. If the majority by special resolution decides to reduce the share capital of the company, it has the right to decide to reduce the share capital of the company and it has the right to decide how this should be effected. While reducing the share capital, the company can decide to extinguish some of its shares without dealing in the same manner with all other shares of the same class. A selective reduction is permissible within the frame work of law for any company limited by shares.

(B) *British and American Trustee and Finance Corpn. vs. Couper, (1894) AC 399, 403: (1991-4),* the Act does not prescribe the manner in which the reduction of capital is to be effected. Nor is there any limitation of the power of the Court to confirm the reduction except that it satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured.

(C) *British and American Trustee Corpn. vs. Couper, (1894) (ibid),* when exercising its discretion, the Court must ensure that the reduction is fair and equitable. In short the Court shall consider the following, while sanctioning the reduction:

(i) The interests of creditors must be safeguarded;

(ii) The interests of shareholders must be considered; and

(iii) Lastly, the public interest must be considered as well.

(D) *Borough Commercial and Bldg. Society, (1893),* Reduction in shares capital of an unlimited company: An unlimited company to which Section 100 (corresponds to section 66 of the Companies Act, 2013) does not apply, can reduce its capital in any manner that its Memorandum and Articles of Association allow. It is not governed by Sections 61 and 66 of the Act (corresponds to section 27 and 30 of the Companies Act, 2013). Section 13 (corresponds to section 4 of the Companies Act, 2013) does not provide that its capital shall be stated in the Memorandum. However, even if its capital is stated in the Memorandum, the Companies Act impliedly gives power to the member to alter it.

(E) *Great Universal Stores Ltd., Re (1960),* Reduction of capital when company is defunct: The Registrar of Companies has been empowered under Section 560 (corresponds to section 248 of the Companies Act, 2013) to strike off the name of the company from register on the ground of non-working. Therefore, where the company has ceased to trade and Registrar exercises his power under Section 560 (corresponds to section 248 of the Companies Act, 2013) a reduction of capital cannot be prevented.

(F) *Marwari Stores Ltd. vs. Gouri Shanker Goenka, (1936),* Equal Reduction of Shares of One Class: Where there is only one class of shares, *prima facie*, the same percentage should be paid off or cancelled or reduced in respect of each share, but where different amounts are paid-up on shares of the same class, the reduction can be effected by equalising the amount so paid-up. The same principle is to be followed where there are different classes of shares *[Bannatyne v. Direct Spanish Telegraph Co.*, (1886) 34 Ch D 287].

(G) *Asian Investments Ltd. Re, (1992),* It is, however, not necessary that extinguishment of shares in all cases should necessarily result in reduction of share capital. Accordingly where reduction is not involved Section 100 (corresponds to section 66 of the Companies Act, 2013) would not be attracted.

REDUCTION OF SHARE CAPITAL WITHOUT SANCTION OF THE TRIBUNAL

The following are cases which amount to reduction of share capital and where no confirmation by the Tribunal is necessary:

(a) **Surrender of shares** — "Surrender of shares" means the surrender to the company on the part of the registered holder of shares already issued. Where shares are surrendered to the company, whether by way of settlement of a dispute or for any other reason, it will have the same effect as a transfer in favour of the company and amount to a reduction of capital. But if, under any arrangement, such shares, instead of being surrendered to the company, are transferred to a nominee of the company then there will be no reduction of capital [*Collector of Moradabad vs. Equity Insurance Co. Ltd.*, (1948)]. Surrender may be accepted by the company under the same circumstances where forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from further liability on shares.

The Companies Act contains no provision for surrender of shares. Thus, surrender of shares is valid only when Articles of Association provide for the same and:

(a) Where forfeiture of such shares is justified; or

(b) When shares are surrendered in exchange for new shares of same nominal value.

Both forfeiture and surrender lead to termination of membership. But in the former case, it is at the initiative of company and in the latter case at the initiative of member or shareholder.

(b) **Forfeiture of shares** — A company may if authorised by its articles, forfeit shares for non-payment of calls and the same will not require confirmation of the Tribunal.

Where power is given in the articles, it must be exercised strictly in accordance with the regulations regarding notice, procedure and manner stated therein, otherwise the forfeiture will be void. Forfeiture will be effected by means of Board resolution. The power of forfeiture must be exercised bonafide and in the interest of the company.

In Re *Jubilant Clinsys Ltd. CA No. 94/ALD/2016, NCLT-Allahabad Bench*

In this case, the Court held that where proposed reduction of share capital did not prejudicially affect interest of any shareholder nor it had any adverse effect on public at large and all requisite statutory requirements in respect to said reduction had been complied, reduction of share capital was to be allowed.

In Re *Economy Hotels India Services Private Limited Vs. Registrar of Companies & Anr. (NCLAT) Company Appeal (AT) No. 97 of 2020, NCLAT Delhi*

The Appellant Company had filed a petition under Section 66 of the Companies Act praying for confirming the reduction of share capital. In the extract of the minutes submitted to NCLT, it was written that the 'unanimous ordinary resolution' required for reduction has been obtained. The NCLT rejected the application for reduction. Hence the company has filed and appeal with NCLAT pleading that it was a mere typographical error in the minutes characterising the 'special resolution' as 'unanimous ordinary resolution' and the Appellant had filed the special resolution with ROC and fulfilled all the statutory requirements prescribed in the Companies Act, 2013, hence the order of the Tribunal is liable to set aside.

The court held that merely a 'typographical error' in the extract of 'Minutes', characterising the 'special resolution' as 'unanimous ordinary resolution' will not render a special resolution as invalid. The special resolution passed is very well valid. NCLAT has allowed the reduction.

Effect of Forfeiture

When the shares have been forfeited, the defaulting shareholder ceases to be member of the company and he loses all rights or interests in his shares. But notwithstanding the forfeiture he remains liable to pay to the company all monies which at the date of forfeiture were payable by him to the company in respect of the shares.

Re-issue of forfeited shares

The Company may re-issue the forfeited shares to any willing buyer after having specific powers to that effect in the Articles. The shares are generally issued at a price at par with other shares as reduced by amounts already received in respect of the said shares.

Reissue of forfeited shares is a sale of shares and it does not amount to an allotment. The company should duly record the particulars of the members who acquire those shares as if it were a transfer of shares.

The directors would fix a price for the forfeited share that should not be lower than the amount of the call(s) due and unpaid on the share at the time of forfeiture.

In the case of a company whose shares are listed in a recognized stock exchange, re-issue of forfeited shares shall be as per Guidelines for Preferential Issue of the Securities and Exchange Board of India and the listing agreement.

Conclusiveness of certificate for reduction of capital

Where the Registrar had issued his certificate confirming the reduction, the same was held to be conclusive although it was discovered later that the company had no authority under its articles to reduce capital [*Re Walkar & Smith Ltd., (1903) 88 LT 792 (Ch D)*]. Similarly, in a case the special resolution for reduction was an invalid one, but the company had gone through with the reduction. It was held that the reduction was not allowed to be upset [*Ladies's Dress Assn. v. Pulbrook, (1900) 2 QB 376*].

PART E: TRANSFERABILITY OF SHARES

What is transfer of shares?

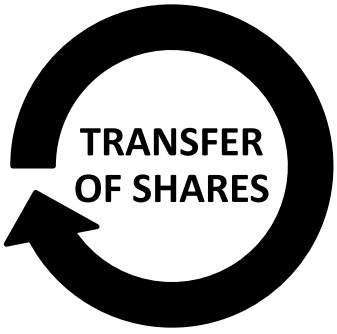
When the owner of shares transfers his ownership of shares to another person is called as transfer of shares. The person who transfers is known as 'Transferor' and the person to whom shares are transferred is known as 'Transferee'.

TRANSFER OR TRANSMISSION OF SECURITIES

Transferability of securities

One of the most important characteristics of a company is that its shares are transferable. Section 44 of the Companies Act, 2013 states that the shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company. Therefore, there cannot be an absolute prohibition on the right to transfer shares. The right to transfer may be subjected to restrictions contained in the articles and there cannot be total prohibition or ban on transferability of shares. However, only permissible restriction on transferability may be contained Articles of association

Governing Provisions of Companies Act 2013: Section 56 of the Companies Act deals with transfer and transmission of securities.



- **PUBLIC COMPANY:** Freely Transferable
- **PRIVATE COMPANY:** Restricted to Transfer

PRIVATE COMPANIES

Shares of a private company are not marketable securities due to restriction on right to transfer. Such shares by their very nature are not freely transferable in the market. The objective behind the right of restriction on the transfer of shares is to preserve the composition of the shareholding.

- The section 2(68) of the Companies Act, 2013 restricts the right to transfer shares but does not prohibit the right to transfer shares. In case of transfer of shares of a private company, the provisions or restrictions contained in the Articles of Association should be duly complied with by the transferor and transferee.
- Restrictions upon transfer of shares in private companies are not applicable in following cases:-
  - (a) On the right of a member to transfer his/her shares in a case where the shares are to be transferred to his/her representative(s).
  - (b) In the event of death of a shareholder, legal representatives may require the registration of shares in the names of heirs, on whom the shares have been devolved.
  - (c) In respect of shares which are proposed to be issued on a right basis, existing members would have a right to renounce shares likely to be allotted to them. If the existing shareholders renounce

their shares then these shares will be allotted to the renounces for the first time and therefore no transfer of shares will take place.

- Restriction on right to transfer shares is generally placed by using following two methods:

  (a) **Right of pre-emption:** If a member wishes to sell some or all of his shares, such shares shall first be offered to other existing members of the company at a price determined by the directors or by the auditor of the company or by the use of formula set out in the articles. If no existing member is determined to acquire shares, then shares can be transferred by the transferor to the proposed transferee. A member is not bound to sell his shares to other members under pre-emption clause unless any other member or members agree to buy all the shares proposed to be sold. The transfer between the members is outside the purview of pre-emption clause. The pre-emption clause cannot place a complete ban on right to transfer; they cannot completely prohibit the transfer.

  (b) **Valuation of Shares under Preemption clause:** Articles of Association of private company provide that the shares are to be sold under pre-emption clause at a fair price determined by the directors or the auditor of the company. It may also be provided that the fair price would be certified by the auditor of the company. If the pre-emption clause requires that the shares are required to be offered to other members at a price certified by the directors or auditor(s), the Court is not in a position to enquire into the correctness of valuation, unless there is evidence that valuation was not correctly made. If the person who made the valuation has acted negligently and failed to take into account all the necessary factors for arriving at the value of share, in such case the transferor may sue for the damages to the person who made the valuation for difference between the value of the share as computed by the valuer, and the real value of shares.

  In *Nanalal Zaver v. Bombay Life Assurance Co. Ltd,* the Supreme court held that the existing shareholders must be given the first option by the company.

(c) **Powers of directors to refuse registration of transfer of shares:** The Powers of directors to refuse registration of transfer of shares are specified in the articles of association of the company. This power is to be exercised by the Board of Directors in good faith.

PUBLIC COMPANY

As per section 58(2), the securities or other interest of any member in a public company shall be freely transferable. The Board of Directors of a company or the concerned depository has no discretion to refuse or withhold transfer of any security. The transfer has to be effected by the company/depository automatically and immediately.

However, proviso to section 58(2) provides that any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. It is now possible to contractually agree on terms such as right of first refusal, right of first offer, tag along, call option, put option, etc. in the shareholder agreements/ investment agreements, in the case of a public company as well. These terms would now be binding on the investors. Therefore, private arrangements or contracts between two or more persons would be enforceable contracts.

- ***Instruments of transfer to be presented to the company (Form SH-4)***

According to Section 56(1) a company, shall not register a transfer of securities of, the company, unless a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered to the company by the transferor or transferee within a period of 60 days (irrespective

of the nature of the company, whether listed or unlisted) from the date of execution along with the certificate relating to the securities, or if no such certificate is in existence, then along with the related certificate or letter of allotment of securities. In case of loss of the instrument, the company may register the transfer on terms as to indemnity.

Such instrument of transfer of securities held in physical form shall be in **Form No**. **SH.4.** Where a company not having share capital, the instrument of transfer herein should also be in **Form No. SH.4** and other conditions be complied where the references therein to securities were references instead to the interest of the member in the company.

However, nothing in section 56(1) shall prejudice any power of the company to register, on receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted [Section56(2)].

- ***Registration of partly paid up shares – Notice to the transferee (Form No. SH.5)***

According to section 56(3), where an application is made by the transferor alone and relates to partly paid shares, the transfer shall not be registered, unless the company gives the notice in **Form No. SH.5** to the transferee and the transferee gives 'no objection' to the transfer within two weeks from the receipt of the notice.

- ***Time Limit for Delivery of certificates: One Month***

Every company, unless prohibited by any provision of law or any order of Court, Tribunal or other authority, deliver the certificates fall securities transferred or transmitted within a period of one month in case of transfer or transmission of securities.

- ***Intimation to depository***

Proviso to Section 56(4) states that where the securities are dealt with in a depository, the company shall intimate the details of allotment of securities to depository immediately on allotment of such securities. No transfer deed is required for transfer of shares, where the shares are held in dematerialized form.

- ***Transfer of securities by legal representative***

Section 56(5) of the Act provides that in case of death of holder of any security, the transfer of such security by the legal representative of the deceased shall be valid-

- Even though the legal representative is not the holder of such security;
- As if the legal representatives were the holder of such security.

Notice to ROC: No such Notice or intimation is required to be given to ROC. The Share Transfer details shall be given to ROC in Annual Return of the company in Form MGT-7

- ***Penalties***

According to 56(6) , where any default is made in complying with the provisions of sub-sections (1) to (5) of Section 56, the company and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

- ***Transfer of shares by depository with an intent to defraud, is liable under Section 447 for fraud***

As per section 56(7), without prejudice to any liability under the Depositories Act, 1996, where any depository or depository participant, with an intention to defraud a person, has transferred shares, it shall be liable under section 447 for fraud.

- ***Stamp duty payable and affixation/ cancellation of stamps at the time of transfer of shares***

Before the transfer is lodged with the company, it should be duly stamped. The transfer of securities attracts prescribed stamp duty under the Indian Stamp Act, 1899.

The amount of consideration is required to be mentioned in the share transfer deed as otherwise the companies cannot verify whether share transfer stamp duty has been correctly charged thereby attracting the penal provisions of the Stamp Act in case of a default.

Under Section 56(1), a company cannot register the transfer of securities unless a instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee has been delivered to the company along with the certificate relating to the securities in question.

Meaning of 'Duly stamped': The expression 'duly stamped' has not been defined in the Companies Act. Under Section 2(11) of the Indian Stamp Act, 1899, 'duly stamped' as applied to an instrument, means that the instrument bears an adhesive or impressed stamp of not less than the proper amount and that such stamp has been affixed or used in accordance with the law for the time being in force in India.

Stamp must be cancelled: Under Section 12(1) of the Indian Stamp Act, 1899, whoever affixes an adhesive stamp to an instrument which has been executed by any person shall, when affixing such stamp, cancel the same so that it cannot be used again. Sub-section (2) thereof makes it clear that any instrument bearing an adhesive stamp which has not been cancelled so that it cannot be used again, shall, so far as such stamp is concerned, be deemed to be unstamped. Sub-section (3) thereof provides the manner in which the adhesive stamp can be cancelled and provides that the stamp be cancelled by writing on or a cross the stamp his name or initials or the name or initials of his firm. Section 17 of the Indian Stamp Act, 1899 makes it clear that all instruments chargeable with duty and executed shall be stamped before, or at the time of execution. Therefore, the legal requirement is that the stamp must be cancelled either before or at the time of execution.

It is necessary that the value of the consideration paid for a transfer must be determined as a part of the agreement because in the absence of such valuation it would not be possible to know whether stamp duty has been paid according to the value or not. A transfer form which does not indicate the value of the shares purposes of transfer would be void and not capable of being accepted.

The "value of the shares" means the price which the shares would fetch at the time of the transfer and not the face value of the shares. The consideration actually paid or agreed to be paid is the value of the shares. So long as there is nothing to indicate that the consideration was not truly stated in the transfer, the one mentioned therein should be accepted as the consideration that was paid [*Union of India vs. Kulu Valley Transport Ltd. (1958).*

Stamp Duty Rates w.e.f. 1st July 2020 as per Amended Indian Stamp Act

S.No.	*Type of transfer*	*Rate of Stamp Duty*
1.	Transfer and Re-issue of debenture	0.0001%.
2.	Transfer of security other than debenture on delivery basis	0.015%
3	Transfer of security other than debenture on non-delivery basis	0.003%

CASE LAWS

A company cannot register transfer of shares unless the instrument of transfer is duly stamped and is delivered to the company. The expression "duly stamped" has to be construed with reference to the provisions of Section 2(11) of the Indian Stamp Act, 1899 and the document in question would be an invalid one if the stamp affixed there on has not been cancelled. Under Section 108(1) of the Companies Act, 1956 [Corresponds to section 56(1) of the Companies Act, 2013] it is mandatory that the company shall not register the transfer of shares unless a properly executed instrument of transfer duly stamped has been delivered to the company. [*Shri Parveen Sharda vs. Chopsani Ice Aerated Water and Oils Mills Ltd., Appeal No. 1 of 1982 decided on 10.1.1983 (CLB*)].

In *Vardhaman Publishers Ltd. vs. Mathrubhumi Printing & Publishing Co. Ltd.* (1990), the Kerala High Court held that affixing stamps on a separate sheet of paper and attaching it to the transfer application or cancellation of stamps by drawing a line across the stamp was not improper and would not invalidate the said application. On the question of whether a newly added Article empowering the Board to reject transfer of shares would affect transactions of sale of shares entered into before the insertion of the Article, the Court held that the property in the shares passes on the date of transfer and the right to have the shares registered in the transferee's name becomes crystallised on that day itself. Any alteration of articles will not affect concluded transactions and in respect of such transactions, the existing articles would prevail. So, if the original (unaltered) Articles as on the date of transfer permit free transfer of shares, the Board cannot refuse registration of the transfer.

The Share Transfer details shall be given to ROC in Annual Return of the company in Form MGT-7.

STATUTORY REMEDY IN CASE BOARD REFUSES REGISTRATION OF TRANSFER/TRANSMISSION OF SHARES

Section 58 of the Companies Act, 2013, deals with process of the company to be followed by on refusal to register the transfer of securities.

PRIVATE COMPANY

(i) If a private company limited by shares refuses (whether in pursuance of any power of the company under its articles or otherwise) to register the transfer of, or the transmission of the right to any securities or interest of a member in the company, then the company shall send notice of the refusal to the transferor and the transferee or to the person giving intimation of such transfer, within a period of thirty days from the date on which the instrument of transfer, or the intimation of such transmission, was delivered to the company. Notice shall contain the reasons for refusal to register the transfer or transmission.

(ii) The transferee may appeal to the Tribunal against the refusal within a period of thirty days from the date of receipt of the notice or in case no notice has been sent by the company, within a period of sixty days from the date on which the instrument of transfer or the intimation of transmission, was delivered to the company [Section 58(3)].

PUBLIC COMPANY

(i) If a public company without sufficient cause refuses to register the transfer of securities within a period of thirty days from the date on which the instrument of transfer or the intimation of transmission, is delivered to the company, the transferee may, within a period of sixty days of such refusal or where no intimation has been received from the company, within ninety days of the delivery of the instrument of transfer or intimation of transmission, appeal to the Tribunal [Section 58(4)].

(ii) The Tribunal, while dealing with an appeal may, after hearing the parties, either dismiss the appeal, or by order-

(a) direct that the transfer or transmission shall be registered by the company and the company shall comply with such order within a period of ten days of the receipt of the order; or

(b) direct rectification of the register and also direct the company to pay damages, if any, sustained by any party aggrieved [Section 58(5)].

(iii) If a person contravenes the order of the Tribunal he shall be punishable with imprisonment for a term not less than one year but may extend to three years and with fine not less than one lakh rupee may extend to five lakh rupees [Section 58(6)].

CASE LAWS

(A) Refusal to register share transfer on suspicion that the employee if admitted as a member will attend general meetings of the company and may create nuisance by raising irrelevant issues and also obtain access to the records to the company as a shareholder is not a valid reason. *[Appeal to the CLB No. 27, of 1975 dated 17th August, 1976, Shri Nirmal Kumar vs. Jaipur Metal and Electrical Limited];*

(B) The mere attempts of a person to wind up a company more than once cannot be a ground for refusing to register transfer by the directors *[Rangpur Tea Association Ltd. vs. Makkan Lal Samaddar (1979)];*

(C) The power to refuse registration of shares which is conferred on the directors by the articles, is a discretionary power and must be exercised reasonably, and in good faith for the benefit of the company. Unless the contrary is proved, the power is deemed to have been exercised properly. *[Berry & Stewart vs. Tottenham Hostpur Football and Athletic Co. Ltd., 1936];*

(D) Where the appellant transferee and respondent company were in the same line of business and were rivals, the refusal on the ground of rivalry will be justified in terms of the decision rendered by the Supreme Court in the Bajaj Auto Case. Under these circumstances, the investment cannot be considered to have been made bona fide with the intention of making profits. The respondent company is entitled to refuse the registration even in the absence of an enabling provision in articles in view of the provisions of Section 111(2)[Corresponds to section 58(3) and 58(4) of the Companies Act, 2013] [*Modi Carpets Ltd. v. Trans- Asia Carpets Ltd.*, *Appeal No. 2 of 1980 decided on 26.12.1981(CLB)*];

(E) In *Shri T.N. Kuriakos vs. Premier Tyres Ltd.,* decided on 13.6.1983 (CLB), the appeal against the refusal by the respondent company to register transfer of shares was allowed by the Company Law Board (Now Tribunal) on the ground that the refusal of the respondent to register transfer of shares in favour of the appellant was based on the decision of the Transfer Committee, a sub-committee of the Board of Directors and not that of the Board of Directors as such, and, therefore, the said decision was not a valid and legal decision;

(F) The Supreme Court of India in *Mackintosh Burn Limited v. Sarkar and Chowdhury Enterprises Private Limited*, (2018) 5 SCC 575 held that the registration of a share transfer may not only be refused on the ground of it resulting in a violation of any law but also for any other sufficient cause.

RECTIFICATION OF REGISTER OF MEMBERS (SECTION 59)

Section 59 of the Companies Act, 2013 provides the procedure for the rectification of register of members after the transfer of securities. The provision states that –

1. **Remedy to the aggrieved for not carrying the changes in the register of members: Grounds of appeal:** If, without sufficient cause –

   (i) The name of any person is entered in the register of members; or

   (ii) The name of any person having entered in the register of members is without sufficient reason omitted there from; or

   (iii) Default or unnecessary delay is being made in entering in the register, the fact of any person having become a member; or

   (iv) Default or unnecessary delay is being made in entering in the register, the fact of any person having ceased to be a member; or

   (v) The person aggrieved, or any member of the company, or the company may appeal in such form as may be prescribed, to the Tribunal. In case of foreign members or debenture holders residing outside India, the appeal shall be filed in a competent Court outside India as may be specified by the Central Government by notification.

2. **Order of the Tribunal:** The Tribunal may, after hearing the parties to the appeal by order, either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within a period of ten days of the receipt of the order, or direct rectification of the records of the depository or the register and in the latter case, direct the company to pay damages, if any, sustained by the party aggrieved.

3. **Right to transfer not restricted:** Section 59 of the Act shall not restrict the right of a holder of securities, to transfer such securities. Any person acquiring such securities shall been titled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

4. **Contravention of provisions of the law**: Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned.

5. **Specific instances of rectification:**

   Rectification has been held to be permissible in the following cases:

   (a) Applicant induced to take shares by misrepresentation;

   (b) Shareholders' name removed under unlawful surrender of his shares;

   (c) Irregular allotment;

   (d) Name of nominee entered in register without his knowledge or consent;

   (e) Allotment of shares to a non-resident without taking necessary permission for foreign exchange;

   (f) Allotment in violation of memorandum of association of the company.

6. **Mutation of name in other Company's register of members:** The Company which has changed its name would been titled to ask those companies in which it is holding shares to substitute a company's new name in their register of members in the place of old name. [*Sulphur Dyes v. Hicks on & Dadajee Ltd. (1995) 83 Com Cases 533(Bom)]*

LOST TRANSFER DEEDS

- It is sometimes found that the transfer documents sent to companies are lost, say, in transit. In such a case, the provision to section 56(1) of the Act provides that where the instrument of transfer has been lost or the instrument of transfer has not been delivered within the prescribed period (within 60 days from the date of execution of the instrument of transfer), the company may register the transfer on such terms as to indemnity as the Board may think fit.
- The Board of Directors of the company should be satisfied that the instrument of transfer signed by or on behalf of the transferor and by or on behalf of the transferee has been lost. The proof may be in the form of an affidavit from the transferor or the transferee and supported by the purchase or sale note of the broker and the registration receipt issued by the postal authorities.
- In addition, the Board can take an indemnity on such terms as it may think fit to safeguard its position and after that company may register the transfer.

DELEGATION OF POWERS FOR TRANSFER

It is the articles of the company which authorise the Board of Directors to accept or refuse transfer of securities, at their discretion. The Board further have the power to delegate all or any of their powers to any of the company or any person even not in the employment of the company. Therefore, the articles of association should authorise the Board of Directors to delegate the powers suitably. Only in the case of refusal to register a transfer, the directors are required to exercise their discretion.

TRANSFER OF DEBENTURES

In case of transfer of debentures, a proper instrument of transfer duly stamped, dated and executed by or on behalf of the transferor and the transferee should be delivered to the company by the transferor or transferee with in a period of 60 days from the date of execution along with the certificate relating to the debentures or if no such certificate is in existence with the letter of allotment of debentures.

After registering the transfer, the particulars thereof have to be recorded in the Debenture Transfer Register and should be initialed by the appropriate authority. After making appropriate endorsements, the debenture certificate may be sent to the party concerned.

TRANSFER OF SHARES TO MINOR

In India, a minor is not competent to enter into any contract, as under Section 11 of the Indian Contract Act, 1872, a person who has attained the age of majority is only competent to contract. Since a minor cannot enter into a contract or agreement except through a guardian, and since as per Section 153, no notice can be taken of the fact that the guardian holds a share in trust for a minor, it follows that his name cannot be entered in the Register of Members and therefore, he cannot become a member of a company. There is, however, no objection in law to the guardian of a minor entering into a contract on behalf of a minor, by virtue of the statutory right conferred on the guardian of a minor under Section 8 read with Section 4 to 6 of the Hindu Minority and Guardianship Act,1956. Since Section 56 of the Companies Act, 2013 enables execution of transfer deed by or on behalf of the transferor or the transferee, the transfer deed can be executed by a minor through his natural guardian as transferee, and the contract so entered into by a minor through his natural guardian is a binding and valid contract under Section 8 of the Hindu Minority and Guardianship Act, 1956.

The articles of association of a company cannot impose a blanket ban prohibiting transfer of shares in favour of a minor, as such a restriction is unreasonable and not sustainable. Section 44 of the Companies Act, 2013 provides that shares in a company are movable property and are transferable in the manner provided by the Articles. The expression 'in the manner provided by the articles of association of the company' can only be interpreted to mean the procedure to be adopted for transfer and impose restrictions, which are meaningful and reasonable. In case, the restriction imposed on transfer to a minor is accepted, it would mean that the shares of a deceased member can never be inherited by the legal heir who might be a minor. This would lead to a highly unjust situation and cannot be accepted as tenable. Accordingly, if the shares can be transmitted in favour of a minor, there is no reason why the shares which are fully paid-up and in respect of which no financial liability devolves on the minor are to be held as not transferable merely because of the ban imposed in the articles of association [*Saroj* v. *Britannia Industries Ltd.,* Appeal No.5/80 decided on 14.12.81 by CLB].

TRANSFER OF SHARES TO PARTNERSHIP FIRM

A firm is not a person and as such is not entitled to apply for membership. The Department of Company Affairs (Now, Ministry of Corporate Affairs) has in its Circular No. 4/72 dated 9.2.1972 stated that a firm not being a person cannot be registered as a member of a company except where the company is licensed under Section 25 (Corresponds to section 8 of the Companies Act, 2013).

TRANSFER OF SECURITIES TO A BODY CORPORATE

An incorporated body being a legal person can acquire securities in its own name. Where a company is a transferee, the following documents are required to be submitted to the company:

(a) A certified true copy of the Board resolution and/or power of attorney authorizing the signatory of the instrument of transfer to execute the instruments;

(b) A certified true copy of a Board resolution passed under Section 179(3)(e) of the Companies Act; and

(c) A certified true copy of Memorandum and Articles of Association of a company.

Transfer of shares without Authority of Owner is void:

transfer of shares by the husband of a lady owner without her authority was void and the transferee obtained no rights.

WHEN TRANSFEROR ACT AS TRUSTEE

When a transferor makes a transfer, he makes an implied representation that the transfer will be registered by the company in the name of the transferee in the place of transferor. If the company refuses to register the transfer for no fault or default of the transferee, the transferor, by reason of the shares continuing to stand in his name, will, in cases where he has received consideration for the transfer, be treated as trustee for the transferee and bound to act in accordance with his direction and for his benefit in respect of the shares, unless the transferee rescinds the contract and seeks to recover his money on consideration which has failed.

However, after the transfer form has been executed the transferor cannot be compelled to undertake any financial burden in respect of the shares at the instance of transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor.

TRANSFER IN VIOLATION OF ARTICLES

Where the article of a private company requires that transfers of the company shares should be made with the previous sanction of the company's Board of Directors, the Supreme Court held that any transfer without such

approval would be invalid. *John Tinson & co. P. Ltd. v. Surjeet Malhan (Mrs.) (1997) 88 Com Cases 750: AIR 1997 SC 1411.*

Where a transfer was made in violation of a private company's articles requiring that shares must be first offered to existing members, it was held that the transferor was not the proper person to object.

TRANSMISSION OF SECURITIES

Transmission of securities has not been defined by the Companies Act, 2013. 'Transmission by operation flaw' is not a transfer. It refers to those cases where a person acquires an interest in property by operation of any provision of law, such as by right of inheritance or succession or by reason of the insolvency or lunacy of the holder of securities or by purchase in a Court-sale.

Thus, transmission of securities takes place when the registered holder of securities dies or is adjudicated as an insolvent, or if the holder of securities is a company, it goes into liquidation. Because a deceased person cannot own anything, the ownership of all his property passes, after his death, to those who legally represent him. Similarly, when a person is declared insolvent, his entire property vests in the Official Assignee or Official Receiver. Upon the death of a sole registered holder of security, so far as the company is concerned, the legal representatives of the deceased holder of securities are the only persons having title to the securities unless securities-holder had appointed a nominee, in which case he would been titled to the exclusion of all others.

Transmission of shares do not require the execution through instrument of transfer in Form SH-4

Transmission in Case of Sole Owner

On the death of a sole owner of shares, vesting of rights and liabilities goes in favor of the legal heirs. They are entitled to be registered as the holders of shares. [*Scott v. Scott (London) Ltd., (1940) Ch. 794*; *Safeguard Industrial Investments Ltd. vs. National West minister Bank Ltd., (1980) 3 All ER 849*.] But the legal heirs do not by itself become members of the company. The company cannot register them as members without the consent. [*Re, Cheshire Banking Co. Duff's Executor's case, (1886) 32 Ch D 301*.] A company cannot compel them to become member nor it is a duty to do so.[*State of Kerala vs. West Coast Planters Agencies Ltd.,(1958) 28 Com Cases 13 (Ker)*.] The company can justifiably register them as members when they apply for it.

Transmission of shares to widow

If a widow applies for transmission of the shares standing in the name of her deceased husband without producing a succession certificate and if the articles of association of the company so authorises, the directors may dispense with the production of succession certificate, probate or letter of administration upon such terms as to indemnity as the directors may consider necessary, and transmit the shares to the widow of the deceased by obtaining an indemnity bond.

Transmission of joint holdings

In case some shares are registered in joint names and the articles of the company provide that the survivor shall be the only person to be recognised by the company as having any title to the shares, the company is justified in refusing to register the transmission of title by operation of law in favour of the son of the deceased holder even though he may obtain succession certificate from the Court.

Section 56(1) of the Companies Act, 2013 states that the transfer of securities must be effected by a proper instrument of transfer and that a provision in the articles of an automatic transfer of securities of a deceased securities-holder is illegal and void. Such transfer does not amount to transmission which takes place by operation of law. Section 56(2) of the Act provides that nothing in the sub-section (1) shall prejudice the powers of the company to register, on

receipt of an intimation of transmission of any right to securities by operation of law from any person to whom such right has been transmitted. It follows that, for such transmission, instrument of transfer is not required, and, merely an application addressed to the company by the legal representative is sufficient.

Articles of companies generally provide for formalities to be observed for transmission of shares. In the absence of such provision in the articles of the company, Regulations 23 to 27 of Table F of Schedule I to the Act will govern the procedure for transmission. According to these regulations, the legal representatives are entitled to the shares held by deceased member and the company must accept the evidence of succession e.g., a succession certificate or letter of administrations or probate or any other evidence properly required by the Board of Directors. He is, however, not a member of the company by reason only of being the legal owner of the shares. But he may apply to be registered as a member. On the contrary, instead of being registered himself as a member, he may make such transfer of the shares as the deceased or insolvent member could have made. The Board of directors also have the same right to decline registration as they would have had in the case of transfer of shares before death. But if the company unduly refuses to accept a transmission, the same remedies are available to the legal representative as in the case of a transfer namely, an appeal to the Tribunal under Section 58.

Distinction between Transfer and Transmission

S. No.	*Basis*	*Transfer of Securities*	*Transmission of Securities*
1.	**Nature**	Transfer takes place by a voluntary or deliberate act of the parties by way of a contract.	Transmission is the result of the operation of law. For example, due to death, insolvency or lunacy of a member.
2.	**Instrument**	An instrument of transfer is required in case of transfer.	No instrument of transfer is required in case of transmission.
3.	**Circumstance**	Transfer is a normal course of transferring property.	Transmission takes place on death or insolvency of a holder of securities.
4	**Consideration**	Transfer of securities is generally made for some consideration.	Transmission of securities is generally made without any consideration.
5	**Stamp Duty**	Stamp duty is payable on transfer of securities by a holder of securities.	No stamp duty is payable on transmission of securities.
6	**Liability**	As soon as transfer is complete, the liability of the transferor ceases.	Shares continue to be subject to the original liabilities.

The Board of Directors of a company or the concerned depository has no discretion to refuse or withhold transfer of any security.

Rejected Documents

Documents which are not duly stamped or where stamps are not cancelled should be returned to the person lodging them pointing out the errors so as to enable them to rectify *the error. In Feder. vs. Smt. Sarla Devi Rathi (1997)*, the company had not registered 100 shares that Smt. Sarla Devi Rathi, the respondent, had purchased and neither they returned the share certificates to her. The company urged that since the respondent had not become a shareholder of the company, no cognizance of the complaint could be taken. The High Court held that there was a *prima-facie* case against the company.

The CLB had pointed out that the company on not registering the transfer should have returned the documents to the party who lodged them (the transferee in this case) and not the transferor as the transferor loses his right in the shares as soon as he executes the transfer in blank.

Time for pointing out Insufficiency of Stamps

Where a company by mistake or otherwise registers a transfer which should have been refused because of insufficient or uncancelled stamps, or because of the instrument being unstamped, it should point out the error to the transferee within such time (within one year from the date of execution) that the transferee can have the matters rectified through the orders of the Collector. Afterwards it would be too late. [*Kothari Industrial Corpn. Ltd. vs. Lazor Detergents P. Ltd. (1994) 1 Comp LJ 178 (CLB – Mad)]*.

Impounding of Documents Relating to Share Transfer

The Board of directors are not persons to impound or regularise an instrument of transfer which is not duly stamped, *Mathrubhumi Co. Ltd. vs. Vardhaman Publishers Ltd.*, *(1992) 73 Com Cases 8093 (Ker)* as they have no authority under Sections 33 and 42 of the Stamp Act.

CASE LAWS

Related to Transfer of Shares

(A) *Hindustan Mercantile Bank Ltd. vs. D.N. Choudhury Cotton Mills Ltd. (2008) 83 SCL 399 (CLB–KOL.)*, the legal opinion on which the transferor company had relied upon was on the basis that the transferee company along with a few other companies was acting in concert to acquire shares in violation of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 [Replaced by SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011]. To come to the conclusion that the transferee along with others was acting in concert, reliance had been placed on commonality of directors both in the transferee-company and other companies. Since the company was not a listed company, the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997, were not applicable. Further, it was found that neither the transferee company nor other companies had acquired shares of the transferor company. Accordingly, the company was to be directed to register the transfer of shares in favour of the transferee.

(B) *Sham Sunder Kukreja vs. Hindustan Lever Ltd. (2001) 44 CLA 38 (CLB)*, if, by virtue of Section 111A(3) of the Companies Act, 1956 [Corresponds to section 59(1) of the Companies Act, 2013], the petition should have been filed within 2 months of the registration of the securities submitted for transfer, and where on the basis of facts and circumstances of the case, the transfer was effected in a fraudulent manner, the period of limitation (2 months) shall not apply.

(C) *Dr. Rajiv Das v. The United Press Ltd. (2001) (CLB)*, in the case, where the shares of a company were held in joint names and one of these joint holders requested the company to split the shares equally between the joint holders by issuing fresh certificates, the company shall not be legally bound to do so unless the share transfer deeds executed by both the joint holders duly completed and stamped were lodged with the company together with the relevant share certificates, in terms of the provisions of Section 108 of the Companies Act, 1956 [Corresponds to section 56 of the Companies Act, 2013].

(D) *T.S. Premkumar vs. Tamil Nadu Mercantile Bank Ltd. 2001 (CLB).* there shall be no justification, if a company/ bank asks for information on Income Tax Returns (including that of the nominees of the transferee), the sources of the consideration paid for the purchase of share, the details of the group to which the transferee is attached, for the purposes of registration of transfer of shares, if the number of the shares which are subject matter of transfer, is insignificant, and after the registration of which the controlling of interest in the company/bank is not changing.

(E) Transferor Holds Bonus Shares Only as a Trustee for the Transferee. *Charanjiv Lal vs. ITC Ltd. and Another (2005) 5 COMP LJ 138 (CLB)*, the petitioner-transferee purchased 100 equity shares of ITC limited of bearing and lodged the same through post, which were received by the company on 10th December, 1991. However, the company did not take any action to register the shares in name of the petitioner and informed him that it had not received the share certificates and the transfer instrument. To prevent any unauthorized transfer of the shares, he obtained a status quo order from Senior Civil Judge, Delhi.

In theme an while, the company declared 60 bonus shares on two occasions against the impugned 100 shares of which the certificate relating to first 60 bonus shares had been sent to the transferor. The suit filed by the transferee-petitioner was dismissed for want of jurisdiction and hence the petitioner-transferee approached the Company Law Board. The Petition was allowed. The view expressed by the Judge was that the bonus shares always go with the original shares and the transferor holds bonus shares only as a trustee for the transferee. Considering that the original shares have been sold before the record date, in the absence of denial by the transferor nearly a month before the record date, it is the petitioner transferee who is entitled to the bonus shares and not the transferor.

Transfer of Shares in Depository Mode

Depository system maintains the ownership records of securities in the book entry form while in physical mode every share transfer is required to be accompanied by physical movement of share certificates to, and registration with the company concerned. The process of physical movement of share certificates often involves long delays and a significant portion of transactions end up as bad deliveries due to the faulty completion of paperwork, or signature differences with the specimens on record with the companies, or for other procedural lapses. Investors also face problems on account of loss of share certificates, forgery and mutilation. The significant time involved in effecting ownership changes also impounds a substantial volume of shares at any given time leading to lower trading volumes.

FORGED TRANSFER

It may happen that a forged instrument of transfer is presented to the company for registration. In order to avoid the consequences which will follow a forged transfer, companies normally write to the transferor about the lodgement of the transfer instrument so that he can object if he wishes. The company informs him that if no objection is made by him before a day specified in the notice, it would register the transfer.

The consequences of a forged transfer are detailed here under:

(a) A forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder and the company is bound to restore his name on the register of members *[People's Ins. Co. vs. Wood and Co., 1961]*. A forged document never has any legal effect. It can never move ownership from one person to another, however, genuine it may appear. Thus, a forged instrument of transfer leaves the ownership of the shares exactly where it always was in the so-called transferor. It follows that if a company registers a forged transfer, the true owner can apply so as to be replaced on the register and his name will be restored. But the company does not incur any liability in damages by putting the name on the register.

(b) However, if the company issues a share certificate to the transferee and he sells the shares to an innocent purchaser, the company is liable to compensate such a purchaser, if it refuses to register him as a member, or if his name has to be removed on the application of the true owner.

(c) If the company is put to loss by reason of the forged transfer, as it may have paid damages to an innocent purchaser, it may recover the same independently from the person who lodged the forged transfer.

The fact that the transferee was a bona fide purchaser for valued id not make any difference and the transferee was bound to return the scrips to the person to whom the same rightfully belong. [*Kaushalya Devi* vs. *National Insulated Cable Company of India 1977 Tax LR 1928(Del)]*

In case of joint share holdings, a transfer to be effective must be executed by all and if the signature of any one be forged, the transfer will be void.

A person acting in good faith, sends in and procures registration of the transfer and the issue of a fresh certificate on the basis of a forged deed is bound to indemnify the company against the untoward consequences. This happens when a stock broker, trusting his clients innocently forwards forged document to the company. [*Yeung vs. Hongkong and Shanghai Banking Corpn.*, *(1980)]*.

Further Section 57 states that if any person deceitfully personates as an owner of any security or interest in a company, or of any share warrant or coupon issued in pursuance of this Act, and thereby obtains or attempts to obtain any such security or interest or any such share warrant or coupon, or receives or attempts to receive any money due to any such owner, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to three years and with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

A forged transfer cannot pass any title and is a nullity.

DEATH OF A JOINT SHAREHOLDER

Where shares are held in joint names, and one of the joint shareholder dies, the survivor alone will be recognized as the holder of the said shares. It would be sufficient for the company to delete the name of the deceased shareholder after obtaining satisfactory evidence of his death. This of course does not prevent a third person from calling on the company to register his name as holder of the shares after obtaining evidence such as probate of a will for the purpose of proving his title to the shares as against the surviving joint holders.

TRANSPOSITION OF NAME

In the case of joint-shareholders, one or more of them may require the company to alter or rearrange order of their names in the register of members of the company. In this process, there will be need for effecting consequential changes in the share certificates issued to them. If the company provides in its articles that the senior-most among the joint- holders will be recognised for all purposes like service of notice, a copy of balance sheet, profit and loss account, voting at a meeting etc., the request of transposition may be duly considered and approved by the Board or other authorised officer of the company. Since no transfer of any interest in the shares take place on such transposition, the question of insisting on filling transfer deed with the company, may not arise. Transposition also does not require stamp duty.

Transposition of names of shareholders in the register of members do not require the execution through instrument of transfer in Form SH-4.

The Stock Exchange Division of the Department of Economic Affairs has clarified that there is no need of execution of transfer deed for transposition of names if there quest for change in the order of names was made in writing, by all the joint-holders. If transposition is required in respect of a part of the holding, execution of transfer deed will be required.

DEATH OF TRANSFEROR OR TRANSFEREE BEFORE REGISTRATION OF TRANSFER

Where the transferor dies and the company has no notice of his death the company would obviously register the transfer. But if the company has notice of his death, the proper course is not to register until the legal representative of the transferor has been referred to.

Where the transferee dies and company has notice of his death, a transfer of shares cannot be registered in the name of the deceased. With the consent of the transferor and the legal representatives of the transferee, the transfer may be registered in the names of the later. But if there is a dispute, an order of Court will have to be insisted upon.

In *KillickNixon Ltd. vs. Dhanraj Mills Ltd*., it was held that the company is not bound to enquire into the capability of the transferee to enter into a contract. The company has to act on the basis of what is presented in the transfer deed.

Proof in a transfer by representative

Where a transfer is executed by a person in a representative capacity such as an officer of a body corporate or by an attorney, proof of the authority and the Board resolution authorizing the representative to execute the transfer on behalf of body corporate must be produced, before the transfer can be registered.

Relationship between Transferor and Transferee

Pending registration, the transferee has only an equitable right to the shares transferred to him. He does not become the legal owner until his name is entered on the Register of Members in respect of the shares. But as between the transferor and the transferee, immediately after the transfer is made, the contract of transfer will subsist and the transferee becomes the beneficial owner of the shares so transferred to him. A relation of trustee (transferor) and beneficiary (transferee) is thereby established between them. The transferor is under obligation to comply with all reasonable directions of the transferee. The transferee should, however, take prompt steps to get himself registered as a member.

Section 126 of the Companies Act, 2013 provides that where the transferor gives a mandate to pay the dividend to the transferee pending registration of transfer, the same should be paid to the transferee, otherwise the dividend in relation to such shares should be transferred to the Unpaid Dividend Account mentioned in Section 124. It is further provided that in the case of offer of rights shares or fully paid bonus shares, the same should be kept in abeyance till the title to the shares is decided.

RIGHTS OF TRANSFEROR

Transferor's right to indemnity for calls - Where a transferor has paid for calls to the company after the shares are transferred, there arises an implied promise by the transferee to indemnify the transferor. Such a promise to indemnify can be implied even in the case of blank transfers [*Ashworth Partington & Co.,(1925)1K]*.

Transferee's right to Dividends, Bonus and Rights Shares - Where the transferor, by reason of the shares standing in his name, has received after the transfer, any dividend on shares, bonus or other benefit accruing in respect thereof, the transferee being the person lawfully entitled thereto, can recover the same from the transferor, provided that he has not allowed his claim to become time barred under the provisions of the Limitation Act. [*Chunnilal Khushaldas Patel vs. H.K. Adhyaru, (1956) 26 Com Cases 168 : AIR 1956 SC 655]*.

Dividend to transferee after transfer - In one case the transfer was registered and dividends paid to the transferee. Later, the register was rectified by removing the transferee's name from the register on the ground of a technical nature, like inadequacy of stamps, it was held that the transferee was not bound to hand over the dividend amount to the transferor. [*Kothari Industrial Corpn. L*td. *vs. Lazor Detergents P. Ltd., (1994)1 Comp LJ 178 (CLB-Mad)]*. However the Madras High Court held that the company should not be allowed to rectify the register on a technical ground after transferring the shares.

Position under the Securities Contracts (Regulation) Act, 1956 - As regards the position of a transferor after transfer, Section 27 of the Securities Contracts (Regulation) Act, 1956 may also be noted. It provides as follows:

Title to dividends -

1. It shall be lawful for the holder of any security whose name appears on the books of the company issuing the said security to receive and retain any dividend declared by the company in respect thereof for any year, notwithstanding that the said security has already been transferred by him for consideration, unless the transferee, who claims the dividend from the transferor has lodged the security and all other documents relating to the transfer which may be required by the company with the company for being registered in his name within fifteen days of the date on which the dividend became due.

   Explanation: The period specified in this section shall be extended -

   (i) in case of death of the transferee, by the actual period taken by his legal representative to establish his claim to the dividend;

   (ii) in case of loss of transfer deed by theft or any other cause beyond the control of the transferee, by the actual period taken for the replacement thereof; and

   (iii) in case of delay in the lodging of any security and other documents relating to the transfer due to causes connected with the post, by the actual period of the delay.

2. Nothing contained in Sub-section (1) shall affect -

   (a) the right of a company to pay any dividend which has become due to any person whose name is for the time being registered in the books of the company as the holder of the security in respect of which the dividend has become due; or

   (b) the right of the transferee of any security to enforce against the transferor or any other person his rights, if any, in relation to the transfer in any case where the company has refused to register the transfer of the security in the name of the transferee.

EFFECTS OF TRANSFER

Once a transfer form has been executed, the transfer is complete as between the transferor and the transferee and the transferee acquires the right to have his name entered in the register of members. No further application is necessary for having the name of the transferee entered in the register of members and the transferee perfects his title to the share after the entry in the Register of Members. Once the transferee becomes a member of the company, a contractual relationship arises with the company, [*Killick Nixon Ltd. vs. Dhanraj Mills Pvt. Ltd.*, *(1983) 54 Com Cases 432 (DB)(Bom)]*.

A company cannot refuse to register a transfer on the ground that the transfer was without consideration or that there was a collusion and connivance between the transferor and transferee. Any objection about inadequate consideration can be raised only by the transferor himself and not by the company particularly where the shares are fully paid.

Where the transfer is in a spot delivery contract, Section 108 [Corresponds to section 56 of the Companies Act, 2013] is not applicable. [*Sanatan Investment Co. Pvt. Ltd. vs. Prem Chand Jute Mills Ltd. (1983) 54 Com Cases 186(Cal)]*.

CASE LAW

The National Company Law Appellate Tribunal (NCLAT) held that the Company has to register the transfer of 60,000 shares in the name of legal heirs of one of its deceased shareholders which were due to him on right basis as Letter of Administration for succession has been submitted by legal heirs, so company could not insist for production of affidavit and indemnity bond in the matter of *DLF Ltd. & Anr. vs. Satya Bhushan Kaura & Anr.*, *dated January 13, 2020.*

Priority among Transferees

It was held in *Society General De Paris vs. Jonet Walker and other (1886),* that where a share holder has fraudulently sold his shares to two different transferees, the first purchaser will, on the ground of time alone, be entitled to the shares in priority to the second.

For example, a person as signed his property, including some shares, for the benefit of his creditor. The assignee failed to get the share certificates registered in his name, but gave notice of assignment to the company. The assignor sold the shares to an other who applied for registration. It was held that the assignee's claim was prior in time and therefore, entitled to registration. [*Peat vs. Clayton, (1906) 1 Ch.659*].

Pledging of Shares

Shares of a company can be a subject matter of a valid pledge. Section 2(7) of the Sale of Goods Act, 1930, defines the term 'goods' as meaning every kind of moveable property other than actionable claim and money and includes stocks and shares. Shares are goods under the Sale of Goods Act, 1930 and therefore can be a subject matter of pledge under the Indian Contract Act, 1872. In *Kanhaiyalal Jhanwar vs. Pandit Shirali And Co. And Ors [AIR 1953 Cal 526]*, the Calcutta High Court held that the deposit of share certificates themselves is sufficient to create a pledge thereon.

On the death of a sole owner of shares, the rights and liabilities goes in favour of the legal heirs. They are entitled to be registered as the holder of the shares. But the company can register them as members with only their consent and when they apply for *it. Re Cheshire Banking Co.,Duff's executor's case* (1886) 32 Ch D 301.

LEGAL FRAMEWORK FOR DEPOSITORY SYSTEMS

The legal framework for depository system in the Depositories Act provides for the establishment of single or multiple depositories.

Two depositories in India

In the depository system, share certificates belonging to the investors are dematerialised and their names are entered in the records of depository as beneficial owners. Consequent to these changes, the investors' names in the companies register are replaced by the name of depository as the registered owner of the securities. The depository however, does not have any voting rights or other economic rights in respect of the shares as a registered owner. The beneficial owner continues to enjoy all the rights and benefits and be subject to all the liabilities in respect of the securities held by a depository. Shares in the depository mode are fungible and do not have distinctive numbers. The ownership changes in the depository are done automatically on the basis of *delivery payment*.

The companies which enter into an agreement with the depository will give an option to the holders of eligible securities to avail the services of the depository through participants. The investors desiring to join the depository are required to surrender the certificates of securities to the issuer company in the specified manner and on receipt of information about dematerialisation of securities by the issuer company, the depository enters in its records the names of the investors as beneficial owners. Similarly, the beneficial owner has right to opt out of a

depository in respect of any security and claim the share certificates and get his name substituted in the register of members as the registered owner in place of the depository.

There has to be regular, mandatory flow of information about the details of ownership in the depository record to the company concerned. In case of any reservation about the acquisition of securities on the ground that the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, SEBI Act, 1992 or Companies Act, 2013 or any other law for the time being in force, the depository, company, depository participants, the holder of securities or SEBI shall have a right to make an application to the Tribunal for rectification of register or records concerned. Pending decision of the Tribunal, the holder of securities can transfer such securities and the transferee concerned shall be entitled to voting rights unless voting rights have been suspended by an order of the Tribunal.

The Act provides for detailed regulations to be framed by SEBI and detailed bye-laws to be framed by depositories with the approval of SEBI.

How does an investor avail services of a depository?

(a) In the case of existing securities:

An investor before availing the services of a depository, shall enter into an agreement with the depository through a participant and then shall surrender security certificates to the issuer. The issuer on receipt of security certificate shall cancel them and substitute in its records the name of the depository as the registered owner in respect of that security and inform the depository accordingly. The depository shall there after enter the name of the investor in its records as beneficial owner.

(b) In the case of fresh issue:

At the time of initial offer the investor would indicate his choice in the application form. If the investor opts to hold a security in the depository mode, the issuer shall intimate the concerned depository about the details of allotment of a security made in the favour of investors and records the depository as registered owner of the securities. On receipt of such information, the depository shall enter in its records the names of allottees as beneficial owners. In such case a prior agreement by the investor with the depository as well as an agreement between the issuer company and depository may be necessary.

(c) In the case of exit from the depository:

If a beneficial owner or a transferee of a security desires to take a way a security from depository, he shall inform the depository of his intention. The depository in turn shall make appropriate entries in its records and inform the issuer. The issuer shall make arrangements for the issue of certificate of securities to the investor within 30 days of the receipt of intimation from the depository.

(d) In the case of transfer within the depository:

The depository shall record all transfers of securities made among the beneficial owners on receipt of suitable intimation to the effect that a genuine purchase transaction has been settled.

(e) In the case of pledge:

Before creation of any pledge or hypothecation in respect of a security, the beneficial owner is required to obtain prior approval of the depository and on creation of pledge or hypothecation; the beneficial owner shall give intimation of such pledge or hypothecation to the depository. The depository shall make appropriate entries in its records which will be admissible as evidence.

DEMATERIALISATION AND REMATERIALISATION OF SHARES

Dematerialisation of Shares

Dematerialisation of securities means holding of securities in electronic form in lieu of physical certificates. Dematerialisation is comparable to keeping your money in a bank account. In demat form, physical share certificates are replaced by electronic book entries; purchase of shares are reflected as credits in demat account and sales are reflected as debits. The risk associated with physical share certificates such as loss, replacement, theft, damage, etc. are overcome in the share certificates held in Dematerialisation form which are totally risk free.

- Dematerialisation of shares of a company is regulated by the Depositories Act, 1996.
- According to the Depositories Act, 1996, an investor has the option to hold securities either in physical or electronic form. Part of holding can be in physical form and part in demat form. However, SEBI has notified that settlement of market trades in listed securities should take place only in the demat mode.
- Section 29 of the Companies Act, 2013 provides that every company making public offer; and such other prescribed companies shall issue the securities only in dematerialised form by complying with the provisions of the Depositories Act, 1996 and the regulations made there under. In case of such class or classes of unlisted companies as may be prescribed, the securities shall be held or transferred only in dematerialised form in the manner laid down in the Depositories Act, 1996 and the regulations made thereunder.

Any company, other than a company mentioned above, may convert its securities into dematerialised form or issue its securities in physical form in accordance with the provisions of this Act or in dematerialised form in accordance with the provisions of the Depositories Act, 1996 and the regulations made there under.

As per Rule 9(1) of the Companies (Prospectus & Allotment of Securities) Rules, 2014 the promoters of every public company making a public offer of any convertible securities may hold such securities on in dematerialised form:

Provided that the entire holding of convertible securities of the company by the promoters held in physical form up to the date of the initial public offer shall be converted into dematerialised form before such offer is made and thereafter such promoter shareholding shall be held in dematerialised form only.

The Ministry of Corporate Affairs vide issuing the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 dated 27th October, 2023 has inserted rule 9(2) stating- every public company which issued share warrants prior to commencement of the Companies Act, 2013 and not converted into shares shall, -

(a) within a period of three months of the commencement of the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 inform the Registrar about the details of such share warrants in Form PAS-7; and

(b) within a period of six months of the commencement of the Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023, require the bearers of the share warrants to surrender such warrants to the company and get the shares dematerialised in their account and for this purpose the company shall place a notice for the bearers of share warrants in Form PAS-8 on the website of the company, if any and shall also publish the same in a newspaper in the vernacular language which is in circulation in the district and in English language in an English newspaper, widely circulated in the State in which the registered office of the company is situated.

In case any bearer of share warrant does not surrender the share warrants within the period referred to in sub-rule (2), the company shall convert the such share warrants into dematerialised form and transfer the same to the Investor Education and Protection Fund established under section 125 of the Act.

As per Rule 9A of the Companies (Prospectus & Allotment of Securities) Rules, 2014 i.e. Issue of securities in dematerialised form by unlisted public companies.

1. Every unlisted public company shall -

   (a) Issue the securities only in dematerialised form; and

   (b) Facilitate dematerialisation of all its existing securities

   in accordance with provisions of the Depositories Act, 1996 and regulations made there under.

2. Every unlisted public company making any offer for issue of any securities or buy-back of securities or issue of bonus shares or rights offer shall ensure that before making such offer, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

3. Every holder of securities of an unlisted public company:

   (a) who intends to transfer such securities on or after 2nd October, 2018, shall get such securities dematerialised before the transfer; or

   (a) who subscribes to any securities of an unlisted public company (whether by way of private placement or bonus shares or rights offer) on or after 2nd October, 2018 shall ensure that all his existing securities are held in dematerialised form before such subscription.

4. Every unlisted public company shall facilitate dematerialisation of all its existing securities by making necessary application to a depository as defined in clause (e)of sub-section(1) of section 2 of the Depositories Act, 1996 and shall secure International Security Identification Number (ISIN) for each type of security and shall inform all its existing security holders about such facility.

5. Every unlisted public company shall ensure that–

   (a) it makes timely payment of fees (admission as well as annual) to the depository and registrar to an issue and share transfer agent in accordance with the agreement executed between the parties;

   (b) it maintains security deposit at all times, of not less than two years, fees with the depository and registrar to an issue and share transfer agent in such form as may be agreed between the parties; and

   (c) it complies with the regulations or directions or guidelines or circulars, if any, issued by the Securities and Exchange Board or Depository from time to time with respect to dematerialisation of shares of unlisted public companies and matters incidental or related thereto.

6. No unlisted public company which has defaulted in sub-rule (5) of Rule 9A of the Companies (Prospectus & Allotment of Securities) Rules, 2014 shall make offer of any securities or buy-back its securities or issue any bonus or right shares till the payments to depositories or registrar to an issue and share transfer agent are made.

7. Except as provided in sub-rule (8) of Rule 9A of the Companies (Prospectus & Allotment of Securities) Rules, 2014, the provisions of the Depositories Act, 1996, the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 and the Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 shall apply *mutatis mutandis* to dematerialisation of securities of unlisted public companies.

8. Every unlisted public company governed by this rule shall submit **Form PAS-6** to the Registrar with such fee as provided in Companies (Registration Offices and Fees) Rules, 2014 within sixty days from the conclusion of each half year duly certified by a Company Secretary in practice or Chartered Accountant in practice.

8A. The company shall immediately bring to the notice of the depositories any difference observed in its issued capital and the capital held in dematerialised form.

9. The grievances, if any, of security holders of unlisted public companies under this rule filed before the Investor Education and protection Fund Authority.

10. The Investor Education and protection Fund Authority shall initiate any action against a depository or participant or Registrar to an issue and share transfer agent after prior consultation with the securities and Exchange Board of India.

11. The Companies (Prospectus & Allotment of Securities) Rules, 2014 shall not apply to an unlisted public company which is:-

A Nidhi;
A Government company;
A wholly owned subsidiary.

As per Rule 9B of the Companies (Prospectus & Allotment of Securities) Rules, 2014 i.e. Issue of securities in dematerialised form by private companies

(1) Every private company, other than a small company, shall within the period referred to in sub-rule (2) -

(a) issue the securities only in dematerialised form; and

(b) facilitate dematerialisation of all its securities, in accordance with provisions of the Depositories Act, 1996 and regulations made thereunder.

(2) A private company, which as on last day of a financial year, ending on or after 31st March, 2023, is not a small company as per audited financial statements for such financial year, shall, within eighteen months of closure of such financial year, comply with the provisions of this rule.

(3) Every private company referred to in sub-rule (2) making any offer for issue of any securities or buyback of securities or issue of bonus shares or rights offer, after the date when it is required to comply with this rule, shall ensure that before making such offer, entire holding of securities of its promoters, directors, key managerial personnel has been dematerialised in accordance with the provisions of the Depositories Act,1996 and regulations made thereunder.

(4) Every holder of securities of the private company referred to in sub-rule (2),-

(a) who intends to transfer such securities on or after the date when the company is required to comply with this rule, shall get such securities dematerialised before the transfer; or

(b) who subscribes to any securities of the concerned private company whether by way of private placement or bonus shares or rights offer on or after the date when the company is required to comply with this rule shall ensure that all his securities are held in dematerialised form before such subscription.

(5) The provisions of sub-rules (4) to (10) of rule 9A shall, mutatis mutandis, apply to the dematerialisation of securities under this rule.

(6) The provisions of this rule shall not apply in case of a Government company.

- As per SEBI (ICDR) Regulations, 2018, in case of a public issue or rights issue, the specified securities issued shall be issued only in dematerialized form in compliance with the Companies Act, 2013, statement that furnishing the details of depository account is mandatory and applications without depository account shall be treated as incomplete and rejected. Investors will not have the option

of getting the allotment of specified securities in physical form. However, they may get the specified securities rematerialised subsequent to allotment.

- Currently, there are two depositories registered with SEBI and are licensed to operate in India:

  NSDL (National Securities Depository Ltd.)

  CDSL [Central Depository Services (India) Ltd.]

- Section 8 of the Depositories Act, 1996 provides that every person subscribing to shares offered by a company shall have the option either to receive the share certificates or hold shares with a depository in electronic form. Where a person opts to hold his shares with, the company shall intimate such depository the details of allotment of the shares and on receipt of such information the depository shall enter in its records the name of the allottee as the beneficial owner of the shares[Sub-section(2) of Section 8].
- Section 9 of the Depositories Act, 1996 clarifies that all the securities held by a depository shall be dematerialised and shall be in a fungible form that is, they do not bear any notable feature like distinctive number, folio number or certificate number. Once shares get dematerialised, they lose their identity in terms of share certificate, distinctive numbers and folio numbers.
- According to Section 10 of the Depositories Act, 1996, a depository shall be deemed to be the registered owner of the shares for the purposes of effecting transfer of ownership of the security on behalf of a beneficial owner and the depository as a registered owner shall not have any voting rights or any rights in respect of the shares held by it. It is only the beneficial owner of the shares who shall be entitled to all the rights and benefits and be subject to all the liabilities in respect of his shares held by a depository.
- Every depository shall maintain a register and an index of beneficial owners in the manner provided in Section 88 of the Companies Act, 2013. *[Section 11]*

SEBI has amended relevant provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to disallow listed companies from accepting request for transfer of securities which are held in physical form, with effect from April 1, 2019. The shareholders who continue to hold shares and other types of listed companies in physical form even after this date, will not be able to lodge the shares with company/its RTA for further transfer. They will need to convert them to demat form compulsorily if they wish to effect any transfer. Only the requests for transmission and transposition of securities in physical form, will be accepted by the listed companies/their RTAs.

As per SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, the listed entity shall ensure that hundred percent of share holding of promoter and promoter group is in dematerialised form and the same is maintained on a continuous basis in the manner as specified by the SEBI.

TRANSFER OF DEMATERIALISED SHARES

Transfer of shares in dematerialised form do not require execution of instrument of transfer in ***Form SH-4****.*

However, the stamp duty is payable as per new Amended Stamp Act w.e.f. 1st July 2020.

Section 7 of the Depositories Act, 1996 lays down that every depository shall, on receipt of intimation from a participant, register the transfer of shares in the name of the transferee and where the beneficial owner or a transferee of any shares seeks to have custody of such shares, the depository shall inform the issuer accordingly.

The Stamp Duty is also to be paid on the transfer of securities in dematerialised form w.e.f. 01/07/2020 which was earlier exempted. Any number of securities can be transferred/ delivered with one delivery instruction. Therefore, the paperwork and signing of multiple transfer forms is done away with.

REMATERIALISATION OF SECURITIES

An investor may opt to rematerialise his shares even after Dematerialisation. Rematerialisation is conversion of electronic securities into physical certificates of such securities.

This can be done in the following manner:

(1) Beneficial owner sends request to DP.

(2) DP intimates Depository (NSDL or CDSL) of such request electronically.

(3) Depository confirms rematerialisation request to the company's Share Transfer Agents.

(4) Share Transfer Agent updates accounts, prints certificates and confirms the Depository.

(5) Depository updates accounts and downloads the details to the DP.

(6) Share Transfer Agent dispatches certificates to holder thereof.

(7) The DP also sends intimation about rematerialisation to its client.

SPECIMEN RESOLUTIONS

Specimen of the Board Resolution Approving Private Placement of Shares

"RESOLVED THAT pursuant to the provisions of Section 42, 62(1)(c) and other provisions, applicable, if any, of the Companies Act, 2013 read with the Companies (Prospectus and allotment of Securities) Rules, 2014 and the Companies (Share Capital and Debentures) Rules, 2014, the consent of the Board of Directors of the Company be and is hereby accorded for an allotment of _____(_____) Equity Shares of Rs. _____(Rupees_____ _____) each of the Company at par, distinctively numbered from _____ to _____ (both inclusive), to_____ from whom the Company has received share application money aggregating to Rs. _____/- (Rupees _____).

RESOLVED FURTHER THAT the said Equity Shares shall rank *pari-passu* with existing Equity Shares in all respects.

RESOLVED FURTHER THAT any of the Director of the Company be and is hereby authorized to file Return on Allotment of aforesaid shares in E-Form No. PAS-3 or such other applicable form from time to time with the Registrar of Companies by affixing Digital Signature thereto.

RESOLVED FURTHER THAT the Share Certificate for the shares allotted as aforesaid be issued to abovementioned allottee under the signatures of any two Directors and Mr. _____ as Authorised signatory of the Company and the Common Seal (if any) of the company be affixed on the share certificate as per the Articles of Association of the Company.

RESOLVED FURTHER THAT necessary entries in respect of issue and allotment of aforesaid shares be made in the Register of Members.

RESOLVED FURTHER THAT any of the Director of the Company be and is hereby authorized to intimate above allotment to Depositories and/or R&T agents by submitting necessary documents and to do all such acts, deeds, matters and things which may deem necessary, pertinent, desirable, incidental in this regard."

Specimen of the Board Resolution Approving the Registration of Transfer of Shares

"RESOLVED THAT Registration of transfer of _____ fully paid equity shares of the company as per details in the register of share transfers of the company entered on page _____ to _____, entries Nos. _____ to

_____ (both inclusive), which was placed before the meeting and each page was initialed by the chairman of the meeting as a mark of identification, be and is hereby approved."

"RESOLVED FURTHER THAT Shri _____,Company Secretary be and is hereby authorized to endorse the relevant share certificates under his signature, arrange for their dispatch to the transferees of the shares and make appropriate entries in the register of members and other records of the company."

Specimen of Board Resolution Approving Registration of Transmission of Shares

"RESOLVED THAT Transmission of _____ nos. of fully paid equity shares of the company bearing distinctive numbers _____ to _____ (both numbers inclusive) presently registered in the name of Shri _____ who has been reported as deceased on _____ in the district of _____ which is situated in the state of _____, in the name of Shri _____ son of Shri _____ resident of _____ be and is hereby approved."

"RESOLVED FURTHER THAT since the company has received a letter from the said Shri _____, intimating to the company that he has decided to have the said shares registered in his name, the said shares be registered in his name;" and

"RESOLVED FURTHER THAT Shri _____,Company Secretary, be and is here by authorized to enter the name of the said Shri _____ in the register of members of the company and send the relevant share certificates to him after appropriately endorsing them in his name."

LESSON ROUND-UP

- Share capital of a company can be classified as: nominal, authorized or registered capital; issued and subscribed capital; called up and uncalled capital; paid-up capital.
- A share is defined as a share in the share capital of a company and includes stock.
- The Companies Act, 2013 permits a company limited by shares to issue two classes of shares, namely equity share capital and preference share capital.
- A preference share or preference share capital is that part of share capital which carries a preferential right with respect to both dividend and capital.
- Preference shares may be of various types, namely participating and non-participating, cumulative and non-cumulative shares, redeemable preference shares.
- Equity share capital means all share capital which is not preference share capital.
- Where a company allots or agrees to allot any securities of the company with a view to all or any of those securities being offered for sale to the public, any document by which the offer for sale to the public is made shall, for all purposes, be deemed to be a prospectus issued by the company.
- A share certificate is prima facie evidence to the title of the person whose name is entered on it.
- A company may issue fully paid-up bonus shares to its members, in any manner whatsoever, out of (i) its free reserves; (ii) the securities premium account; or (iii) the capital redemption reserve account.
- Sweat equity shares means equity shares issued by a company to its employees or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

- A company may if authorised by its articles, forfeit shares for non-payment of calls and the same. The power of forfeiture must be exercised bona fide and in the interest of the company.
- In general parlance, "transfer" takes place when title to the property is transferred from one person to another whereas "transmission" refers to devaluation of title by operation of law.
- Transmission may takes place either by succession or by testamentary transfer.
- According to Section 44 of the Companies Act, 2013, shares, debentures or other interest of a company are movable property, transferable in the manner provided by the articles of association of the company.
- Section 56 of the Companies Act requires that where share transfer form is delivered to the company should be adequately stamped.
- Shares of a private company are not marketable securities due to restriction on right to transfer. Such shares by their very nature are not freely transferable in the market.
- The securities of a public company are freely transferable, subject to the provisions that any contractor arrangement between two or more persons in respect of transfer of securities shall be enforceable as contract.

GLOSSARY

Explanatory Statement: To enable shareholders to take apt and a well informed decision, it is necessary to provide them with requisite information. It covers all the information and facts that may enable members to understand the meaning, scope and implication of the proposed resolution. (Section 102 of Companies Act, 2013)

Special Resolution: A resolution is a Special Resolution when it is intended to be passed as a special resolution. The votes cast in favour of such resolution by members who, are required to be not less than three times the number of the votes, if any, cast against the resolution by members so entitled and voting. (Section 114 of Companies Act, 2013)

General Meeting: Meeting of the members of the company with the Board of Directors. This may be Extra ordinary General Meeting or Annual General Meeting.

Share Capital: Funds raised by issuing shares in return for cash or other considerations. The amount of share capital a company can change over time because each time a business sells new shares to the public in exchange for cash, the amount of share capital will increase. Share capital can be composed of both common and preferred shares.

Red herring Prospectus: A prospectus which does not include complete particulars of the quantum or price of the securities included there in.

Shelf Prospectus: A prospectus in respect of which the securities or class of securities included therein are issued for subscription in one or more issues over a certain period without the issue of a further prospectus.

Abridged Prospectus: "Abridged Prospectus" means a memorandum containing such salient features of a prospectus as may be specified by the Securities and Exchange Board by making regulations in this behalf.

Redemption of shares: Where a company issues shares on terms stating that they can be bought back by the company. Not all shares can be redeemed, only those stated to be redeemable when they were issued. The payment for the shares must generally come from reserves of profit so that the capital of the company is preserved.

Employee Stock Option: As defined under sub-section (37) of Section 2 of the Companies Act, (ESOP) 2013, "employees' stock option" means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price.

Sweat Equity Shares: Sweat equity shares mean equity shares issued by a company to or directors at a discount or for consideration, other than cash for providing know-how or making available rights in the nature of intellectual property or value additions, by whatever name called.

Rights Issue: Rights issue is an issue of capital to be offered to the existing shareholders of the company through a letter of offer.

Bonus Shares: When a company is prosperous and accumulates large distributable, it converts these accumulated profits into capital and divides the capital among the existing members in proportion to their entitlements. Members do not have to pay any amount for such shares. A company may, if its Articles provide, capitalize its profits by issuing fully-paid bonus shares.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. Discuss the various kinds of share capital. How is preference share capital distinguished from equity share capital?
2. Define and explain the term "share". What are the different classes of shares which a company may issue?
3. What are the various modes through which a public and private company may issue securities and the governing laws for issue of securities?
4. Define Prospectus and its types. What is Offer for Sale?
5. What is a Share Certificate and its legal effects? When can a company issue duplicate share certificate?
6. State the provisions of the Companies Act, 2013 relating to issue of shares at premium and at discount.
7. Discuss the procedure for issue of further shares to existing shareholders under Section 62 (1) of the Companies Act, 2013.
8. Jacob, who is Managing Director in 'Z' Limited has been issued 5000 Sweat Equity Shares in consideration of providing know-how without cost to 'Z' Limited last year. Jacob now wants to transfer half of these shares in the name of his brother. Can he do so? if not, why?
9. XYZ Limited wants to alter capital clause of its Memorandum of Association. What are the ways in which said clause may be altered under provisions of the Companies Act, 2013.

10. Sitcom Limited has completed buy back 8% of its shares in November 2019. Now the Board of Directors want to further buy back 15% in January 2020 and asks CS to call EGM for passing special resolution. Advise the Board of Directors in the matter.

11. The paid-up capital of ARC Limited is Rs. 50,00,000/- divided into 5,00,000 Equity Shares of Rs. 10/- each. The Board of Directors want to return a part of the paid-up the share capital as it feels that it is in excess of the needs of the Company. Can the Company do so? What procedure is to be followed?

12. Parag has submitted the duly executed and stamped transfer deed in prescribed form for transfer of shares of Reliable Ltd. from Parag to the Company. What steps the CS should take after receiving the same?

13. The Capital of ABC Ltd is Rs. 50 lacs, consisting equity share capital of Rs. 40 Lacs and redeemable preference share capital of Rs. 10Lacs. The company is running in losses and its accumulated loses aggregated to Rs. 15 Lacs, the company wants to borrow Rs. 20 lacs from financial institutions to improve its working and also to redeem the preference share capital. Choose the correct option:

    (a) The borrowing from financial institution for redemption of preference shares shall not be permissible

    (b) The company can raise funds from financial institution for redemption of preference shares

    (c) The company shall after seeking approval from members of the company can raise funds from financial institution for redemption of preference shares

    (d) None of the above.

14. Ram lal is a shareholder of a company holding 100 shares. Ram Lal dies in a road accident leaving Mohan as his legal representative. Mohan is not a member of the company. Mohan transfers all 100 shares of the deceased member to Anil. Is the transfer is valid?

    (a) No, Mohan can effect a valid transfer only after the succession in his favour is duly registered

    (b) Yes, the transfer done is valid

    (c) Mohan can effect a valid transfer only after intimating the company about the demise

    (d) None of the above.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- *https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==*

Members and Shareholders

Lesson 5

KEY CONCEPTS

■ Subscribers ■ Members ■ Shareholders ■ Debenture holders ■ Significant Beneficial Owners ■ Beneficial Interest ■ Veto Power

Learning Objectives

To understand:

- The term 'Member'
- Modes of Acquiring Membership
- Who is eligible to become member in Company?
- What are the situations where a person cease to be a member of a company
- Maintaining the Register of Members
- Modalities of Maintaining the Resister of Members
- Who can inspect the Register of Members?
- Foreign Register of Members
- Significant Beneficial Owner
- What are the Rights and Liability of Members?
- Concept of Shareholder's Democracy
- Shareholder's Agreement
- The term "Veto Power"

Lesson Outline

- Introduction
- How to become a Member?
- Register of Members
- Declaration of Beneficial Interest
- Significant Business Owner
- Rectification of Register of Members
- Rights of members
- Variation of shareholder's rights
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 88-95)
- The Companies (Management and Administration) Rules, 2014
- The Companies (Significant Beneficial Owners) Rules, 2018

THE TERM - "MEMBERS"

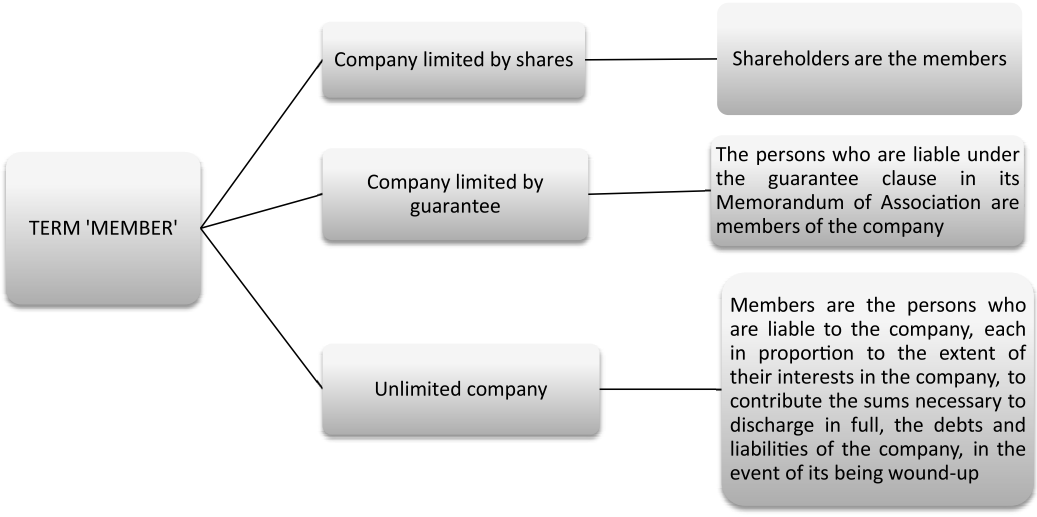
Members defined under the Companies Act, 2013

According to Section 2(55) of the Companies Act, 2013, member, in relation to a company, means,

1. The subscribers to the memorandum of a company who shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members;
2. Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall, be a member of the company;
3. Every person holding shares of a company and whose name is entered as a beneficial owner in the records of a depository shall be deemed to be a member of the concerned company.

A company is composed of members, though it has its own separate legal entity. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity.

Definition-"Members" in different kinds of the company



Essential Elements for Membership of the Company

There are two important elements which must be present before a person can acquire membership of a company *viz*., –

- An agreement to become a member; and
- Entry of the name of the person so agreeing, in the register of members of the company.

In Herdilia Unimers Ltd. v. Renu Jain [1995] 4 Comp. LJ. 45 (Raj.), it was held that the moment the shares were allotted and share certificate signed and the name entered in the register of members, the allottee became the shareholder, irrespective of whether the allottee received the shares or not.

Member -Competency to Contract under Indian Contract Act, 1872

The person desirous of becoming a member of a company must have the legal capacity of entering into an agreement in accordance with the provisions of the Indian Contract Act, 1872. Section 11 of the Indian Contract Act lays down that:

Every person is competent to contract who:-

(i) is of the age of majority according to the law to which he is subject.

(ii) is of sound mind.

(iii) is not disqualified from contracting by any law to which he is subject.

WAYS TO ACQUIRE MEMBERSHIP OF THE COMPANY

As per Section 2(55) of the Companies Act, 2013, a person may acquire the membership of a company:

- **Subscribers to MOA:** by subscribing to the Memorandum of Association (deemed agreement); or
- **Entering an Agreement**: by agreeing in writing to become a member:
  - **(i) Allotment**: by making an application to the company for allotment of shares; or
  - **(ii) Transfer**: by executing an instrument of transfer of shares as transferee; or
  - **(iii) Transmission**: by consenting to the transfer of share of a deceased member in his name; or
  - **(iv) Estoppel:** by acquiescence or estoppel.
- **Beneficial Owner in Depository's Records**: by holding shares of a company and whose name is entered as beneficial owner in the records of a depository (Under the Depositories Act, 1996).
- **Entering the name in Register of Members:** On his name being entered in the register of members of company.

(a) Subscribers to the Memorandum

In the case of a subscriber, no application or allotment is necessary to become a member. By virtue of his subscribing to the memorandum, he is deemed to have agreed to become a member and he becomes *ipso facto* member on the incorporation of the company and is liable for the shares he has subscribed.

In accordance with the provisions of Section 10(2) of the Companies Act, 2013 all monies payable by any member to the company under the memorandum or articles shall be debt due from him to the company.

A subscriber to the memorandum cannot rescind the contract for the purchase of shares even on the ground of fraud by the promoters. [*In Re. Metal Constituents Co., (1902) 1.Ch. 707.*]

Further, a subscriber to the memorandum must pay for his shares in cash even if the promoters have promised him the shares for services rendered in connection with the promotion of the company. Again, he must take the shares directly from the company, and not through transfer from other member(s).

When a person signs a memorandum for any number of shares he becomes absolutely bound to take those shares and no delay will relieve him from that liability unless he fulfills the obligation. His liability remains right up to the time when the company goes into liquidation and he is bound to bring the money for which he is liable to pay to the creditors of the company.

(b) Agreement in Writing

(i) By an application and allotment

A person who applies for shares becomes a member when shares are allotted to him, a notice of allotment is issued to him and his name is entered on the register of members. The general law of contract applies to this transaction. There is an offer to take shares and acceptance of this offer when the shares are allotted.

An application for shares may be absolute or conditional. If it is absolute, an allotment and its notice to the applicant will be sufficient acceptance. On the other hand, if the offer is conditional, the allotment must be made according to be condition as contained in the application. If there is conditional application and unconditional allotment, there is no contract.

(ii) By transfer of shares

Shares in a company are movable property as provided in Section 44 of the Act and are transferable in the manner as provided in the articles of the company and as provided in Section 56 of the Companies Act, 2013. A person can become a member by acquiring shares from an existing member and by having the transfer of shares registered in the books of the company, i.e. by getting his name entered in the register of members of the company.

(ii) By transmission of shares

A person may become a member of a company by operation of law i.e. if he succeeds to the estate of a deceased member. Membership by this method is a legal consequence. On the death of a member, his executor or the person who is entitled under the law to succeed to his estate, gets the right to have the shares transmitted and registered in his name in the company's register of members. No instrument of transfer is necessary in this case.

If the legal representative of deceased member desires to be registered as a member in place of the deceased member, the company shall do so or in the alternative he may request the company to transfer the shares in the name of another person of his choice. The Official Assignee or Official Receiver is likewise entitled to be a member in place of the shareholder, who has been adjudged insolvent.

(iii) By acquiescence or estoppels

A person is deemed to be a member of a company if he allows his name, without sufficient cause, to be on the register of members of the company or otherwise holds himself out or allows himself to be held out as a member. In such a case, he is estopped from denying his membership. He can, however, escape his liability by taking prompt action for having his name removed from the register of members on permissible grounds.

(c) Holding Shares as Beneficial Owner in the Records of Depository

Every person holding shares of the company and whose name is entered as a beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

Differences between Members and Shareholders

Every company must have members as specified under the law. The fact that a person owning shares in the company does not make him a member of the company.

The following are the differences between members and shareholders:

MEMBER	***SHAREHOLDER***
Section 2(55) of the Companies Act, 2013 specifies the meaning of 'member'	On the other hand, the meaning of 'shareholder' is not defined under the Companies Act, 2013
A shareholder becomes a member of a company, once his name is entered into the company's register of members or if he is a subscriber to the incorporation of the company	The person who has ownership of shares of a company is known as shareholder Further, in case of companies limited by guarantee do not have a share capital, and consequently, their members are not shareholders
The person who signs the memorandum of association with the company becomes a member	After signing the memorandum, a person may become shareholder only when the shares are allotted to him
The bearer of a share warrant is not a member	Whereas, the holder of a share warrant is a shareholder

WHO MAY BECOME A MEMBER

Subject to the Memorandum and Articles, any *sui juris* (a person who is competent to contract) except the company itself, can become a member of a company. However, it is important to note the following points in relation to certain organizations and persons:

S. No.	Entities	Eligible to become Member or not
1.	Company	Can become a member of another company
2.	Subsidiary Company	Can't become member of a Holding Company
3.	Partnership firm	Can't become member until registered
4.	Limited Liability Partnership	Can become a member
5.	Section 8 Company	Can become a member if authorized by MOA
6.	Foreigners	Can become a member
7.	Minors	Can't become member
8.	Society	Can become a member

(a) ***Company as a member of another company:*** A company is a legal person and so is competent to contract. Therefore, it can become a member of any other company. However, it must be authorised by its Memorandum of Association to invest in the shares of that company or any other company. Also a company cannot become a member of itself.

> ***As per section 19 of the Companies Act, 2013, a subsidiary company cannot become a member of its holding company.***
>
> ***EXCEPTIONS:***
>
> *However, a subsidiary can hold shares in its holding company only under the following exceptional circumstances–*
>
> - *where the subsidiary company holds such shares as the legal representative of a deceased member of the holding company; or*
> - *where the subsidiary company holds such shares as a trustee; or*
> - *where the subsidiary company is a shareholder even before it became a subsidiary company of the holding company.*

(b) ***Partnership firm as a member of the company:*** A partnership firm is not a legal person and as such it cannot, in its own name, become a member of a company except in company registered u/s 8 of Act.

(c) ***Limited Liability Partnership as a member of the company,*** being an incorporated body under Limited Liability Partnership Act, 2008 can become a member of a company.

(d) ***Section 8 Company as a member of the company:*** A non-profit making company licensed under Section 8 of the Act, can become a member of another company if it is authorised by its Memorandum of Association to invest into shares of the other company.

(e) ***Foreigners as members:*** A foreigner may take shares in an Indian company and become a member subject to the provisions of the Foreign Exchange Management Act, 1999, but in the event of war with his country, he becomes an alien enemy and his power of voting and his rights to receive notices are suspended.

(f) ***Minor as member:*** A member who is not a *sui juris* e.g., a minor, is wholly incompetent to enter into a contract and as such cannot become a member of a company. Consequently, an agreement by a minor to take shares is void *ab-initio*.

It has been held by the Company Law Board (replaced by the Tribunal under the Companies Act, 2013) that an agreement in writing for a minor to become a member may be signed on behalf of the minor by his lawful guardian and the registration of transfer of shares in the name of the minor, acting through his or her guardian, especially where the shares are fully paid cannot be refused on the ground of the transferee being a minor [*Miss Nandita Jain* v. *Benett Coleman and Co. Ltd.*, *Appeal No. 27 of 1972 dated 17.2.78]*.

After attaining majority, the minor, if he does not want to be a member, must repudiate his liability on the shares on ground of minority, and if he does so, the company can not plead estoppel on the ground of his having received dividends during his minority or that he had fraudulently misrepresented his age in his application for shares [*Sadiq Ali* v. *Jai Kishori*, *(1928) 30 Bom. L.R. 1346]*.

If shares are transferred to a minor, the transferor will remain liable for all future calls on such shares so long as they are held by the minor even if the transferor was ignorant of his minority. If the company knows of his minority it may refuse to register the transfer, unless the transfer was made through the guardian.

(g) ***Insolvent as member:*** An insolvent may be a member of a company as long as he is on the register of members. He is entitled to vote, but he loses all beneficial interest in the shares and company will pay dividend on his shares to the Official Assignee or Receiver [*Morgan* v. *Gray*, *(1953) All E.R. 213]*.

(h) ***Person of unsound mind or lunatic:*** A person of unsound mind is not eligible to exercise his voting rights when he has been declared as person of unsound mind by a court. The voting rights on these shares may be excercised by the person designated by the competent court.

(i) ***HUF as member****:* HUF is not a juristic person, although it is a person for purposes of the Income-tax Act, 1961. HUF is represented by its Karta. There is no legal bar on HUF to invest its money in shares and securities and the Companies Act does not prohibit membership of HUF. In case of an HUF, the shares can be registered in the name of 'A' as Karta of HUF as held in [*Vickers Systems International Limited v. Mahesh P. Keshwani [(1992) 13 Com Cases 317 (CLB)]*.

(j) ***Pawnee:*** A pawnee has no right of foreclosure since he never had the absolute ownership at law and his equitable title cannot exceed what is specifically granted by law. In this sense, a pledge differs from a mortgage. In view of the above, a pawnee cannot be treated as the holder of the shares pledged in his favour, and the pawner continues to be a member and can exercise the rights of a member [*Balakrishna Gupta* v. *Swadeshi Polytex Ltd.*, *(1985) 58 Com Cases 563 (S.C.)]*.

(k) ***Receiver:*** A receiver whose name is not entered in the register of members cannot exercise any of the membership rights attached to a share unless in a proceeding to which company is a party and an order is made therein. Mere appointment of a receiver in respect of certain shares of a company without more rights cannot, deprive the holder of the shares whose name is entered in the register of members of the company, the right to vote at the meeting of the company [*Balakrishna Gupta* v. *Swadeshi Polytex Ltd.*, *(1985) 58 Com Cases 563 (S.C.)]*.

(l) ***Society as a member:*** Department's Clarification dated 24.11.1962 has clarified that "a society registered under the Societies Registration Act, 1860 should not be deemed to be a 'body corporate' within the meaning of the aforesaid provisions [Refer to Section 2(7) (i) of the Companies Act, 1956 (currently refer section sub clause (i) of clause 11 of section 2 of the Companies Act ,2013) although such a society

can be treated as a 'person' having separate legal entity apart from the members constituting it and thereby capable of becoming a member of a company under section 41(2) of the erstwhile Companies Act, 1956."

(m) ***Persons taking shares in fictitious names:*** A person who takes shares in the name of a fictious person, becomes liable as a member besides incurring criminal liability under Section 38 of the Act, wherein punishment is provided for commission of fraud.

Penalty under Companies Act, 2013: As per section 447 of the Companies Act, 2013, without prejudice to any liability including repayment of any debt under this Act or any other law for the time being in force, any person who is found to be guilty of fraud involving an amount of at least 10 lakh rupees or 1% of the turnover of the company, whichever is lower shall be punishable with imprisonment for a term which shall not be less than 6 months but which may extend to 10 years and shall also be liable to fine which shall not be less than the amount involved in the fraud, but which may extend to three times the amount involved in the fraud.

Provided that where the fraud in question involves public interest, the term of imprisonment shall not be less than 3 years.

Provided further that where the fraud involves an amount less than 10 lakh rupees or 1% of the turnover of the company, whichever is lower, and does not involve public interest, any person guilty of such fraud shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to 50 lakh rupees or with both.

(n) ***Trade Union as member:*** A trade union registered under the Trade Union Act, can be registered as a member and can hold shares in a company in its own corporate name [*All India Bank Officers Confederation* v. *Dhanlakshmi Bank Ltd.*, *(1997) 90 Com Cases 225].*

Joint Members

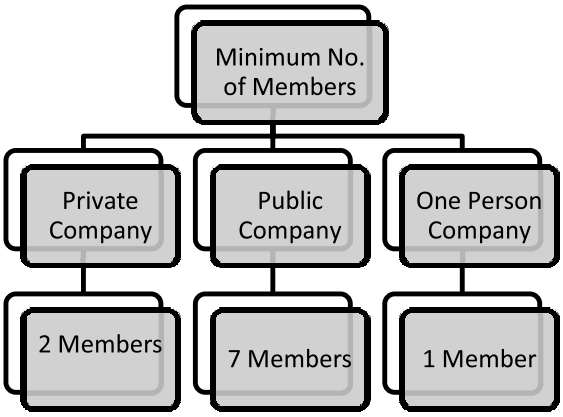
If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member (*Narandas* v. *India Mfg. Co.*, *A.I.R. 1953 Bom. 433]*. Unless the Articles of the company otherwise provide, joint members can insist on having their names registered in any order they may require. They may also have their holding split into several joint holdings with their names in different orders so that all of them may have a right to vote as first named holding in one or the other joint holdings. *Burns* v. *Siemens Brothers Dynamo Works Ltd.* (1919) 1 Ch. 225.

Nominee joint members

Where the shares of a company were registered in the joint name of the company and one of the directors, it was held that the director was a nominee of the company for that purpose. He could act jointly with the company and not individually. He had no rights of his own in respect of the shares and was not entitled to bring proceedings on the basis of being one of the registered holders as held in *Exchange Travel (Holdings) Ltd., Re [(1991) BCLC 728 (Ch D)].*

Minimum Number of Members

Section 3(1) of the Companies Act, 2013 provides that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is to be a public company; or two or more persons, where the company to be formed is to be a private company; or one person, where the company to be formed is to be One Person Company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.



Restriction on Membership

By virtue of Section 2(68)(ii) of the Companies Act, 2013, the maximum number of members of a private company except in the case of One Person Company is limited to two hundred excluding the present and past employees of the company who continue to be members of the company.

There is no restriction with regard to the maximum number of members of a public company

CESSATION OF MEMBERSHIP

Cessation of membership of the company means discontinuation of membership. A person ceases to be a member of a company when his name is removed from its register of members, which may occur in any of the following situations:

Cessation of membership means removal of name of member from Register of members of the company.

(a) **Transfer:** He transfers his shares to another person, the transfer is registered by the company and his name is removed from the register of members;

(b) **Forfeiture:** His shares are forfeited;

(c) **Sale:** His shares are sold by the company to enforce a lien;

(d) **Death:** He dies (his estate, however, remains liable for calls);

(e) **Insolvency:** He is adjudged insolvent and the Official Assignee disclaims his shares;

(f) **Redemption**: His redeemable preference shares are redeemed;

(g) **Cancellation**: He rescinds the contract of membership on the ground of fraud or misrepresentation or a genuine mistake;

(h) **Purchase by another member/ by company itself:** His shares are purchased either by another member or by the company itself under an order of the Tribunal under Section 242 of the Companies Act, 2013;

(i) **Winding up**: The member is a company which is being wound-up in India, and the liquidator disclaims the shares;

(j) The company is wound up.

Though one ceases to be a member, he remains liable as a contributory and is also entitled to share in the surplus, if any.

Expulsion of a Member

A controversy had arisen as to whether a public limited company had powers to insert an article in its Articles of Association relating to expulsion of a member by the Board of Directors of the company where the directors were of the view that the activities or conduct of such a member was detrimental to the interests of the company.

The Department of Company Affairs (now, Ministry of Corporate Affairs) clarified that an article for expulsion of a member is opposed to the fundamental principles of the Company Jurisprudence and is *ultra vires* the company, the reason being that such a provision against the provisions of the Companies Act relating to the rights of a member in a company, the powers of the Central Government as an appellate authority under Section 111 of the Act and the powers of the Court under Sections 107, 395 and 397 of the Companies Act, 1956. *[These sections correspond to sections 58, 48, 235 and 241 of the Companies Act, 2013 respectively.]*

According to Section 6 of the Companies Act, 2013, the Act overrides the Memorandum and Articles of Association and any provision contained in these documents repugnant to the provisions of the Companies Act, is void.

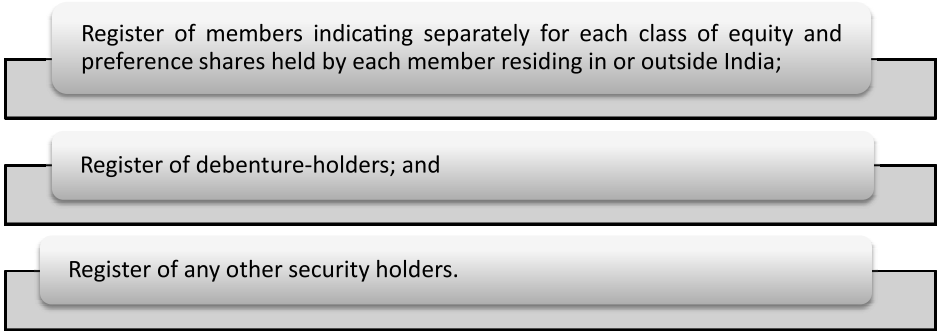
The Department of Company Affairs (now MCA) has, therefore, clarified that any assumption of the powers by the Board of Directors to expel a member by alteration of Articles of Association shall be illegal and void.

As, under Article 141 of the Constitution, the law declared by the Supreme Court is binding on all courts within the territory of India, any provision pertaining to the expulsion of a member by the management of a company which is against the law as laid down by the Supreme Court will be illegal and ultra vires. In the light of the aforesaid position, it is clarified that assumption by the Board of Directors of a company of any power to expel a member by amending its articles of association is illegal and void *[Circular: Letter No. 32/75, dated 1.11.1975]*.

REGISTER OF MEMBERS

Section 88 of the Companies Act, 2013 lays down:

1. Every company shall keep and maintain the following registers in such form and in such manner as may be prescribed, namely :–



2. **Inclusion of index:** Every register maintained under sub-section (1) of section 88 of the Act shall include an index of the names included therein.

3. The register and index of beneficial owners maintained by a depository under section 11 of the Depositories Act, 1996, shall be deemed to be the corresponding register and index for the purposes of this Act.

4. A company may, if so authorised by its articles, keep in any country outside India, in such manner as may be prescribed, a part of the register referred to in sub-section (1) of section 88 of the Act, called

"foreign register" containing the names and particulars of the members, debenture-holders, other security holders or beneficial owners residing outside India.

5. **Penalty:** If a company does not maintain a register of members or debenture-holders or other security holders or fails to maintain them in accordance with the provisions of sub-section (*1*) or sub-section (2) of Section 88 of the Companies Act, 2013, the company shall be liable to a penalty of three lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

CONTENTS OF REGISTER OF MEMBERS IN CASE COMPANY NOT HAVING SHARE CAPITAL

In the case of a company not having share capital, the register of members shall contain the following particulars, in respect of each member, namely:-

(a) name of the member; address (registered office address in case the member is a body corporate); e-mail address; Permanent Account Number or CIN; Unique Identification Number, if any; Father's/ Mother's/ Spouse's name; Occupation; Status; Nationality; in case member is a minor, name of the guardian and the date of birth of the member; name and address of nominee;

(b) date of becoming member;

(c) date of cessation;

(d) amount of guarantee, if any;

(e) any other interest if any; and

(f) Instructions, if any, given by the member with regard to sending of notices etc.

Rule 3 & 5 of the Companies (Management and Administration) Rules, 2014 deal with maintenance of Register under section 88. It is provided that every company limited by shares shall from the date of its registration maintain a register of its members in **Form No. MGT-1.**

MAINTAINING REGISTER OF MEMBERS

- **Time period to make entries in Register of members: 7 DAYS**

  a**)** The entries in the registers maintained under section 88 of the Companies Act, 2013, shall be made within 7 days after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

  Every company which issues or allots debentures or any other security shall maintain a separate register of debenture holders or security holders, as the case may be, for each type of debentures or other securities in Form No.MGT.2.

  b) Consequent upon any forfeiture, buy-back, reduction, sub-division, consolidation or cancellation of shares, issue of sweat equity shares, transmission of shares, shares issued under any scheme of arrangements, mergers, reconstitution or employees stock option scheme or any of such scheme provided under this Act or by issue of duplicate or new share certificates or new debenture or other security certificates, entry shall be made within seven days after approval by the Board or committee, in the register of members or in the respective registers, as the case may be.

- **Maintaining Register of Members at RO:** The registers shall be maintained at the registered office of the company unless a special resolution is passed in a general meeting authorizing the keeping of the register at any other place within the city, town or village in which the registered office is situated or any other place in India in which more than one- tenth of the total members entered in the register of members reside.

- **Explanation to changes in register on account of death, insolvency, etc. of the member:** If any change occurs in the status of a member or debenture holder or any other security holder whether due to death or insolvency or change of name or due to transfer to Investor Education Protection Fund or due to any other reason, entries thereof explaining the change shall be made in the respective register.
- **Rectification in Register pursuant to order of authority:**
  a) If any rectification is made in the register by the company pursuant to any order passed by the competent authority under the Act, the necessary reference of such order shall be indicated in the respective register.
  b) If any order is passed by any judicial or revenue authority or by Security and Exchange Board of India (SEBI) or Tribunal attaching the shares, debentures or other securities and giving directions for remittance of dividend or interest, the necessary reference of such order shall be indicated in the respective register.

CASE LAW

Where the facts of the case do not warrant any directions for rectification of register of members, the petition fails on the ground of maintainability. *(Held in case of Rubicon Real Enterprises (P) Ltd. v. Premium Acres Infratech (P.) Ltd. (2017) NCLT- New Delhi.*

- **Particulars of Pledge, charge, lien or hypothecation within 15 days:**
  a) In case of companies whose securities are listed on a stock exchange in or outside India, the particulars of any pledge, charge, lien or hypothecation created by the promoters in respect of any securities of the company held by the promoter including the names of pledgee/pawnee and any revocation therein shall be entered in the register within fifteen days from such an event.
  b) If promoters of any listed company, which has formed a joint venture company with another company have pledged or hypothecated or created charge or lien in respect of any security of the listed company in connection with such joint venture company, the particulars of such pledge, hypothecation, charge and lien shall be entered in the register members of the listed company within fifteen days from such an event.

AUTHENTICATION OF ENTRIES OF REGISTER OF MEMBERS

The entries in the registers maintained under section 88 and index included therein shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose, and the date of the board resolution authorising the same shall be mentioned.

The entries in the foreign register shall be authenticated by the company secretary of the company or person authorised by the Board by appending his signature to each entry.

CASE LAW

Related to Register of Members

1. A person who claims to have purchased the shares of a member will be entitled to have his name entered in the register by satisfying the requirement of either Section 108 or 109 [Corresponds to section 56 of the Companies Act, 2013]. *[Lalithamba Bai v. Harrisons Malayalam Ltd., (1988) 2 Comp LJ 41 (Ker)]*.
2. No company should enter in the register a statement that has a lien on the shares of a member, *[W.Key & Son Ltd., (1902) 1 Ch 467]*.

3. A company cannot insist upon putting in the register anything except that which is required by the section to be inserted in it. *[T.H. Saunders & Co. Ltd. Re, (1908) 1 Ch 415].*
4. In a voluntary winding up, the liquidator may accept share transfers and alter the register accordingly.

   [*Taylor, Phillips and Richard's Case, (1897) 1 Ch 298*].
5. A firm in its own name cannot be registered as a member, as a firm is not a legal person like a company incorporated under the Act. Only the partners can be recognised and registered as joint holders. *[See Re Vagliano & Anthracite Collieries Ltd., (1910) 79 LJ Ch 769].*

Index of Members

Section 88(2) of the Companies Act, 2013 read with Rule 6 of Companies (Management and Administration) Rules, 2014 requires that every register maintained under section 88(1) of the Act, shall include an index of the names included therein.

Every register maintained under sub-section (1) of section 88 of the Act, shall include an index of the names entered in the respective registers and the index shall, in respect of each folio, contain sufficient indication to enable the entries relating to that folio in the register to be readily found.

The company shall make the necessary entries in the index simultaneously with the entry for allotment or transfer of any security in such Register.

Inspection must be allowed of the Index in the same manner as applicable to the register of members.

Note: No requirement in case the no. of members is less than 50.

Place of keeping and inspection of the Registers

Section 94 of the Companies Act, 2013 fixes the place for maintaining a company's registers returns etc. and for allowing their inspection.

- **Maintaining at Registered Office:** According to Section 94(1), the registers required to be kept and maintained by a company under section 88 and copies of the annual return filed under section 92 shall be kept at the registered office of the company.
- **Maintaining at a place other than Registered Office:** Such registers or copies of return may also be kept at any other place in India in which more than one-tenth of the total number of members entered in the register of members reside, if approved by a special resolution passed at a general meeting of the company.

Inspection of Registers

According to section 94(2) read with Rule 14 of the Companies (Management & Administration) Rules, 2014 the registers and their indices, except when they are closed under the provisions of this Act, and the copies of all the returns shall be open for inspection by any member, debenture-holder, other security holder or beneficial owner, during business hours without payment of any fees and by any other person on payment of such fees as may be specified in the articles of association of the company but not exceeding Rs. 50 for each inspection.

CASE LAW

The non-shareholder of the company/companies who has no commercial interest in the company/companies, is not entitled to file petition seeking inspection and supply of copies of statutory documents claiming as "any other person" under section 163. [*Held in Anlikumar Poddar v. Darshan Securities (P.) Ltd. (2017) NCLT-Mumbai.*]

- **Copies of Registers and Annual Return:** As per Section 94(3) any such member, debenture-holder, other security holder or beneficial owner or any other person may–

  (a) Take extracts from any register, or index or return without payment of any fee; or

  (a) Require a copy of any such register or entries therein or return on payment of such fees as may be specified in the Articles of Association of the company but not exceeding Rs 10 for each page.

  Such particulars of the register or index or return as may be prescribed shall not be available for inspection under section 94(2) or for taking extracts or copies under section 94(3).

  Explanation*:* For the purposes of this sub-rule, reasonable time of not less than two hours on every working day shall be considered by the company.

  Such copy or entries or return shall be supplied within seven days of deposit of such fee.

- **Penalty:** If any inspection or the making of any extract or copy required under this section is refused, the company and every officer of the company who is in default shall be liable, for each such default, to a penalty of one thousand rupees for every day subject to a maximum of one lakh rupees during which the refusal or default continues.

The Ministry of Corporate Affairs (MCA) vide its notification dated April, 06, 2022 has notified "the Companies (Management and Administration) Amendment Rules, 2022" which has inserted a new sub rule (3) in rule 14, to restrict the inspection of register or index or return in respect of the members of the company. As per this amendment, particulars of register or index or return in respect of the members of the company related to address or registered address (in case of a body corporate), e-mail ID, Unique Identification Number, PAN, shall not be made available for any inspection or for taking extracts or copies.

Register - An evidence

Section 95 of the Companies Act, 2013 provides that the registers, their indices and copies of annual returns maintained under sections 88 and 94 shall be *prima facie* evidence of any matter directed or authorised to be inserted therein by or under this Act.

A register of members is *prima facie* evidence of the truth of its contents. Accordingly, if a person's name, to his knowledge, is there in the register of members of a company, he shall be deemed to be a member and onus lies on him to prove that he is not a member. He must promptly appeal to the Tribunal or a competent Court outside India specified by the Central Government by notification, in respect of foreign members or debenture holder residing outside India for rectification of the register under Section 59 of the Act to take his name off the register, failing which the doctrine of holding out will apply.

In *Re. M.F.R.D.* Cruz, *A.I.R. 1939 Madras 803,* the plaintiff applied for 4,000 shares in a company but no allotment was made to him. Subsequently 4,000 shares were transferred to him without his request and his name was entered in the register of members. The plaintiff knew it but took no steps for rectification of the register of members. The company went into liquidation and he was held liable as a contributory. The Court held "when a person knows that his name is included in the register of shareholders and he stands by and allows his name to remain, he is holding out to the public that he is a shareholder and thereby he loses his right to have his name removed".

Foreign Register

Section 88(4) of the Companies Act, 2013 empowers companies to keep foreign registers of members or debenture- holders, other security holders or beneficial owners residing outside India. It states:

"A company may, if so authorised by its articles, keep in any country outside India, in such manner as may be prescribed, a part of the register referred to in sub-section (1), called "foreign register" containing the names and particulars of the members, debenture-holders, other security holders or beneficial owners residing outside India."

A foreign register is deemed to be a part of the company's principal register and it should be kept in the same manner as the principal register and be likewise open to inspection.

A duplicate of such register should be maintained at the registered office in India and all entries made in the foreign register should be made in the duplicate register at the registered office as soon as possible.

A company may discontinue a foreign register at any time but all the entries made in it must be transferred to the principal register.The decision of a competent Court in the State or Country in which a foreign register is kept, with regard to its rectification, shall be as effective as if it were a decision of a competent Court in India, if the Central Government, by notification in the *Official Gazette*, so directs.

Maintenance of Foreign Register

Rule 7 of the Companies (Management and Administration) Rules, 2014 deals with maintenance of foreign register, it is provided that a company which has share capital or which has issued debentures or any other security may, if so authorised by its articles, keep in any country outside India, a part of the register of members or as the case may be, of debenture holders or of any other security holders or of beneficial owners, resident in that country (hereafter in this rule referred to as the "foreign register").

Filing form with Registrar : The company shall, within 30 days from the date of the opening of any foreign register, file with the Registrar notice of the situation of the office in **Form No.MGT.3** along with the fee where such register is kept; and in the event of any change in the situation of such office or of its discontinuance, shall, within 30 days from the date of such change or discontinuance, as the case may be, file notice in **Form No.MGT.3** with the Registrar of such change or discontinuance.

A foreign register shall be deemed to be part of the company's register (hereafter in this rule referred to as the "principal register") of members or of debenture holders or of any other security holders or beneficial owners, as the case may be.

The foreign register shall be maintained in the same format as the principal register.

A foreign register shall be open to inspection and may be closed, and extracts may be taken there from and copies thereof may be required, in the same manner, *mutatis mutandis*, as is applicable to the principal register, except that the advertisement before closing the register shall be inserted in at least two newspapers circulating in the place wherein the foreign register is kept.

If a foreign register is kept by a company in any country outside India, the decision of the appropriate competent authority in regard to the rectification of the register shall be binding.

Entries in the foreign register maintained under sub-section (4) of section 88 shall be made simultaneously after the Board of Directors or its duly constituted committee approves the allotment or transfer of shares, debentures or any other securities, as the case may be.

The company shall-

(a) transmit to its registered office in India a copy of every entry in any foreign register within fifteen days after the entry is made; and

(b) Keep at such office a duplicate register of every foreign register duly entered from time to time.

Every such duplicate register shall, for all the purposes of this Act, be deemed to be part of the principal register.

Subject to the provisions of section 88 of the Act and the rules made thereunder, with respect to duplicate registers, the shares or as the case may be, debentures or any other security, registered in any foreign register shall be distinguished from the shares or as the case may be, debentures or any other security, registered in the principal register and in every other foreign register; and no transaction with respect to any shares or as the case may be, debentures or any other security, registered in a foreign register shall, during the continuance of that registration, be registered in any other register.

The company may discontinue the keeping of any foreign register; and thereupon all entries in that register shall be transferred to some other foreign register kept by the company outside India or to the principal register.

Closing of Register of Members

Section 91 of the Companies Act, 2013 contains guidelines for closing the register of members. It lays down:

- **Time Limit for Register of Members:** A company may close the register of members or the register of debenture-holders or the register of other security holders for any period or periods not exceeding in the aggregate 45 days in each year, but not exceeding 30 days at any one time, subject to giving of previous notice of at least 7 days or such lesser period as may be specified by Securities and Exchange Board for listed companies or the companies which intend to get their securities listed, in the prescribed manner.
- **Penalty:** If the register of members or of debenture-holders or of other security holders is closed without giving the notice as provided above, or after giving shorter notice than that so provided, or for a continuous or an aggregate period in excess of the limits specified in that sub-section, the company and every officer of the company who is in default shall be liable to a penalty of 5000 rupees for every day subject to a maximum of 1 lakh rupees during which the register is kept closed.

In a decided case law it was held that the provisions contained in Section 154 of the Companies Act, 1956 (Corresponds to section 91 of the Companies Act, 2013) are permissive and not mandatory. The section has application only when a company desires to close its register of members and in such a situation, the requirements of the section are to be complied with. *[Talyar Tea Co.* v. *Union of India*, *(1991) 71 Com Cases 95].*

The power in this section is intended for the convenience of the company in order to enable the register of members to be brought up to date for the purpose of calculating dividend and bonus, etc. However, even if the register of members is closed, the company is obliged to make certain entries during the period of closure, such as entries relating to registration and probates and letters of administration, notices of change of name and address and court orders, such as changing orders, etc. [*Killick Nixon Ltd.* v. *Dhanraj Mill Pvt. Ltd.*, *(1983) 54 Com Cases 432 (DB) (Bom)].*

The closure of the register is cloaked with the right to refuse the transfer of shares/debentures. Record date is an alternate for closing the registers. The purpose of closing the registers is to get the registers updated and to fix a cut-off date for the purpose of payment of dividend or issue of rights and bonus shares. This purpose can also be achieved by fixing a record date for a day.

Further Rule 10 of the Companies (Management and Administration) Rules, 2014 in relation to Closure of register of members or debenture holders or other security holders provides that a company closing the register of members or the register of debenture holders or the register of other security holders shall give at least seven days previous notice and in such manner, as may be specified by Securities and Exchange Board of India(SEBI), if such company is a listed company or intends to get its securities listed, by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English

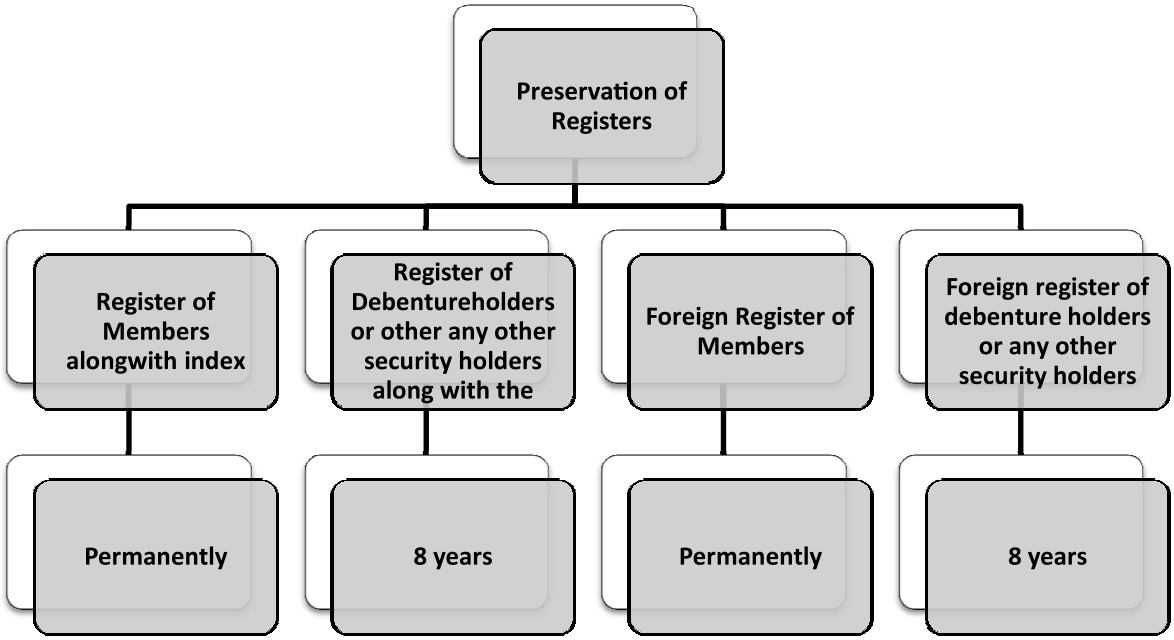
newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company.

The above mentioned provisions shall not be applicable to a private company provided that the notice has been served on all members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders.

Preservation of Registers

Rule 15 of the Companies (Management and Administration) Rules, 2014 provides that the register of members along with the index shall be preserved permanently and shall be kept in the custody of the Company Secretary of the company or any other person authorized by the Board for such purpose and the register of debenture holders or any other security holders along with the index shall be preserved for a period of 8 years from the date of redemption of debentures or securities, as the case may be, and shall be kept in the custody of the company secretary of the company or any other person authorized by the Board for such purpose.

The foreign register of members shall be preserved permanently, unless it is discontinued and all the entries are transferred to any other foreign register or to the principal register. Foreign register of debenture holders or any other security holders shall be preserved for a period of 8 years from the date of redemption of such debentures or securities. The foreign register shall be kept in the custody of the company secretary or person authorised by the Board.



Power of the Central Government to Investigate into the Ownership of Company

Sometimes, the registered holder of shares in a company may be a nominee for some other person, who really owns the shares. This enables persons, who in fact control a company, to conceal their real status from the shareholders and from the public and practice fraud with regard to the management of the company. To check such a practice, Sections 216 of the Act, empowers the Central Government to appoint an inspector to investigate into and report on the ownership of a company.

DECLARATION BY PERSONS NOT HOLDING BENEFICIAL INTEREST IN ANY SHARE

Key Terminology:

- **Registered Owner:** It means the person whose name is entered in the Register of Members but do not hold any beneficial interest in the share.
- **Beneficial Owner:** It means the person who holds the beneficial interest in the shares of the company but his name is not entered in the Register of Members.
- **Registered Owner:** Section 89(1) of the Companies Act, 2013 read with the Companies (Management and Administration) Rules, 2014 makes it obligatory on the part of a person, whose name is entered in the register of members of a company as the holder of a shares in that company but who does not hold beneficial interest in such shares, a declaration to the company specifying the name and other particulars of the person who holds the to make beneficial interest in such shares.
- **Beneficial Owner:** Section 89(2) of the Act, makes it obligatory for any person who, holds or acquires beneficial interest in a share of a company to make a declaration to the company specifying the nature of his interest, the particulars of the person in whose name the shares stand registered in the books of the company and such other particulars as may be prescribed.
- **Changes in Beneficial Interest:** Section 89(3) of the Act, states that where any change occurs in the beneficial interest in such shares, the person referred in sub-section (1) and the beneficial owner specified under sub-section (2) of Section 89 of the Act, shall make a declaration within thirty days, from the date of such change to the company in the prescribed Form containing the prescribed particulars.

  Section 89(4) of the Act, states that the Central Government may make rules to provide for the manner of holding and disclosing beneficial interest and beneficial ownership under this section.
- **Penalty in failure to make declarations:** Section 89(5) of the Act, provides that if any person fails to make a declaration as required under sub-section (1) or sub-section (2) or sub-section (3) of Section 89, he shall be liable to a penalty of fifty thousand rupees and in case of continuing failure, with a further penalty of two hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees.
- **Filing return with Registrar of Companies:** Section 89(6) of the Act, makes it obligatory on the part of the company to make a note of such a declaration in the register concerned and to file within thirty days from the date of receipt of declaration by it, with the Registrar of Companies, a return in the prescribed form with regard to such a declaration with such fees or additional fees as may be prescribed.

  In case of Specified IFSC Public Company/ Specified IFSC Private Company, in Section 89(6) the word "30 days" is substituted as "60 days". Notification dated 4th January, 2017.
- **Penalty in failure to file return:** Section 89(7) of the Act, says if a company, required to file a return under sub-section (6), fails to do so before the expiry of the time specified therein, the company and every officer of the company who is in default shall be liable to a penalty of one thousand rupees for each day during which such failure continues, subject to a maximum of five lakh rupees in the case of a company and two lakh rupees in case of an officer who is in default.

Section 89(8) of the Act, says no right in relation to any share in respect of which a declaration is required to be made under this section but not made by the beneficial owner, shall be enforceable by him or by any person claiming through him.

Section 89(9) of the Act, says that nothing in this section shall be deemed to prejudice the obligation of a

company to pay dividend to its members under this Act and the said obligation shall, on such payment, stand discharged.

Section 89(10) of the Act, provides that for the purposes of this section and section 90, beneficial interest in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to:

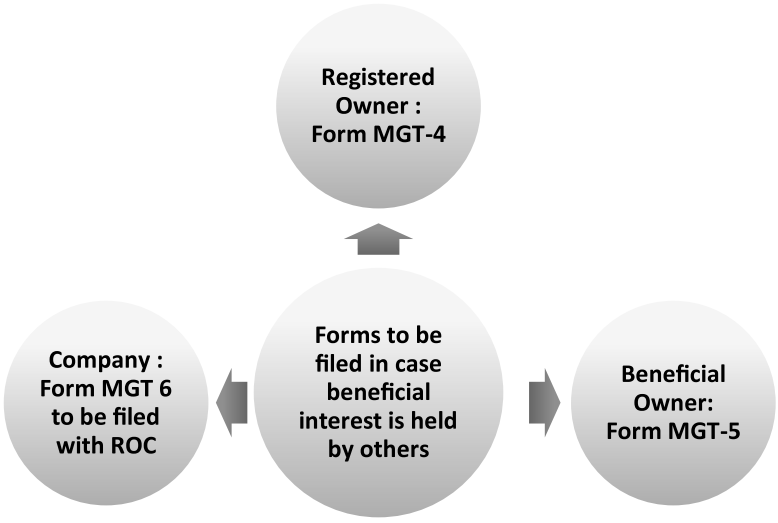
(i) exercise or cause to be exercised any or all of the rights attached to such share; or

(ii) receive or participate in any dividend or other distribution in respect of such share.

Section 89(11) of the Act, provides that the Central Government may, by notification, exempt any class or classes of persons from complying with any of the requirements of this section, except sub-section (10), if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

In case of Government Company - Section 89 shall not apply - Notification dated 5th June, 2015.

Step for declaration of beneficial interest in any shares [Rule 9 of the Companies (Management and Administration) Rules, 2014]



(1) A person whose name is entered in the register of members of a company as the holder of shares in that company but who does not hold the beneficial interest in such shares (hereinafter referred to as "the registered owner"), shall file with the company, a declaration to that effect in **Form No. MGT 4**, within a period of 30 days from the date on which his name is entered in the register of members of such company:

When any change occurs in the beneficial interest in such shares, the registered owner shall, within a period of 30 days from the date of such change, make a declaration of such change to the company in **Form No. MGT 4**.

(2) Every person holding and exempted from furnishing declaration or acquiring a beneficial interest in shares of a company not registered in his name (hereinafter referred to as "the beneficial owner") shall file with the company, a declaration disclosing such interest in **Form No. MGT 5**, within 30 days after acquiring such beneficial interest in the shares of the company:

Provided that where any change occurs in the beneficial interest in such shares, the beneficial owner shall, within a period of thirty days from the date of such change, make a declaration of such change to the company in **Form No. MGT 5**.

(3) Where any declaration under section 89 of the Act, is received by the company, the company shall make a note of such declaration in the register of members and shall file, within a period of 30 days from the date of receipt of declaration by it, a return in **Form No. MGT. 6** with the Registrar in respect of such declaration with fee.

(4) Every company shall designate a person who shall be responsible for furnishing, and extending co-operation for providing, information to the Registrar or any other authorised officer with respect to beneficial interest in shares of the company.

(5) For the purpose of sub-rule(4), the company may designate-

(i) a company secretary, if there is a requirement of appointment of such company secretary under the Act and the rules made thereunder; or

(ii) a key managerial personnel, other than the company secretary; or

(iii) every director, if there is no company secretary or key managerial personnel.

(6) Until a person is designated as referred under sub-rule (4), the following persons shall be deemed to have been designated person;

(i) company secretary, if there is a requirement of appointment of such company secretary under the Act and the rules made thereunder; or

(ii) every Managing Director or Manager, in case a company secretary has not been appointed; or

(iii) every director, if there is no company secretary or a Managing Director or Manager.

(7) Every company shall inform the details of the designated person in Annual return.

(8) If the company changes the designated person at any time, it shall intimate the same to the Registrar in e-form GNL-2 specified under the Companies (Registration Offices and Fees) Rules, 2014.

Provided that nothing contained in this rule shall apply in relation to a trust which is created, to set up a Mutual Fund or Venture Capital Fund or such other fund as may be approved by SEBI.

SIGNIFICANT BENEFICIAL OWNERS IN A COMPANY [SECTION 90 R/W THE COMPANIES (SIGNIFICANT BENEFICIAL OWNERS) RULES, 2018]

Section 90(1) of the Act provides that every individual, who acting alone or together, or through one or more persons or trust, including a trust and persons resident outside India, holds beneficial interests, of not less than 25% or such other percentage as may be prescribed, in shares of a company or the right to exercise, or the actual exercising of significant influence or control as defined in clause (27) of section 2 of the Act, over the company (herein referred to as "significant beneficial owner"), shall make a declaration to the company, specifying the nature of his interest and other particulars, in such manner and within such period of acquisition of the beneficial interest or rights and any change thereof, as may be prescribed.

Provided the Central Government may prescribe a class or classes of persons who shall not be required to make declaration as stated above.

In case of Government company - Section 90 shall not apply. - Notification dated 5th June, 2015.

KEY CONCEPT

Rule 2 of the Companies (Significant Beneficial Owners) Rules, 2018 as amended by the Companies (Significant Beneficial Owners) Amendment Rules, 2019

As per the definition provided in Section 90(1) of the Companies Act, 2013 the Government is empowered to prescribe other threshold limit for the determination of the Significant Beneficial Owner. Accordingly, the revised Rule 2 of the Companies (Significant Beneficial Owners) Rules, 2018 as amended by the Companies (Significant Beneficial Owners) Amendment Rules, 2019 provides the following definition :-

As per Rule 2(h) of the Companies (Significant Beneficial Owners) Rules, 2018:

"Significant beneficial owner" in relation to a reporting company means an individual referred to in sub-section (1) of section 90, who acting alone or together, or through one or more persons or trust, possesses one or more of the following rights or entitlements in such reporting company, namely:

(i) holds indirectly, or together with any direct holdings, not less than 10% of the shares;

(ii) holds indirectly, or together with any direct holdings, not less than 10% of the voting rights in the shares;

(iii) has right to receive or participate in not less than 10% of the total distributable dividend, or any other distribution, in a financial year through indirect holding alone, or together with any direct holdings;

(iv) has right to exercise, or actually exercises, significant influence or control, in any manner other than through direct holdings alone.

I) Explanation I: If an individual does not hold any right or entitlement indirectly under sub-clauses (i), (ii) or (iii) as mentioned above, he shall not be considered to be a significant beneficial owner.

II) Explanation II: Direct Holding of Right and Entitlement

An individual shall be considered to hold a right or entitlement directly in the reporting company, if he satisfies any of the following criteria, namely:

(i) the shares in the reporting company representing such right or entitlement are held in the name of the individual;

(ii) the individual holds or acquires a beneficial interest in the share of the reporting company under Section 89(2), and has made a declaration in this regard to the reporting company.

III) Explanation III: Indirect Holding of Right and Entitlement

An individual shall be considered to hold a right or entitlement indirectly in the reporting company, if he satisfies any of the following criteria, in respect of a member of the reporting company, namely:

A. BODY CORPORATE: Where the member of the reporting company is a body corporate (whether incorporated or registered in India or abroad), other than a limited liability partnership, and the individual,-

a) holds majority stake in that member; or

b) holds majority stake in the ultimate holding company (whether incorporated or registered in India or abroad) of that member.

B. HUF Member: Where the member of the reporting company is a Hindu Undivided Family (HUF) (through karta), and the individual is the karta of the HUF.

C. **PARTNERSHIP ENTITY MEMBER:** Where the member of the reporting company is a Partnership Entity (through itself or a partner), and the individual,-

- is a partner; or
- holds majority stake in the body corporate which is a partner of the partnership entity; or
- holds majority stake in the ultimate holding company of the body corporate which is a partner of the partnership entity.

D. **TRUST MEMBER:** Where the member of the reporting company is a trust (through trustee), and the individual-

- is a trustee in case of a discretionary trust or a charitable trust;
- is a beneficiary in case of a specific trust;
- is the author or settlor in case of a revocable trust.

E. **POOL INVESTEMENT VEHICLE MEMBER:** Where the member of the reporting company is,-

- a pooled investment vehicle; or
- entity controlled by the pooled investment vehicle; based in member State of the Financial Action Task Force on Money Laundering and the regulator of the securities market in such member State is a member of the International Organization of Securities Commissions, and the individual in relation to the pooled investment vehicle;
- is a general partner; or
- is an investment manager; or
- is a Chief Executive Officer where the investment manager of such pooled vehicle is a body corporate or a partnership entity.

IV) Explanation IV – Where the member of a reporting company is,

(i) a pooled investment vehicle; or

(ii) an entity controlled by the pooled investment vehicle,

based in a jurisdiction which does not fulfil the requirements referred to in clause (v) of Explanation III, the provisions of clause (i) or clause (ii) or clause (iii) or clause (iv) of Explanation III, as the case may be, shall apply.

DEFINITIONS:

- **Acting together means**- For the purpose of the aforesaid clause meaning of "Acting together" is given by Explanation V as under:

  If any individual, or individuals acting through any person or trust, act with a common intent or purpose of exercising any rights or entitlements, or exercising control or significant influence, over a reporting company, pursuant to an agreement or understanding, formal or informal, such individual, or individuals, acting through any person or trust, as the case may be, shall be deemed to be 'acting together'.

- **Shares:** For the purpose of the aforesaid clause meaning of "Shares" is given by Explanation VI as under:

  As per Explanation VI of Rule 2 (h) of SBO Rules, For the purpose of calculation of 10% of beneficial interest in shares, **Shares** includes instrument in form of:

- Global Depository Receipts,
- Compulsorily Convertible Preference Shares, or
- Compulsory convertible debentures.

- **Reporting Company** - As per Rule 2(f) of SBO Rules, 2018, Reporting Company means a company as defined in clause (20) of section 2 of the Companies Act, 2013 required to comply with the requirements of section 90 of the Companies Act, 2013.
- **Partnership entity** means a partnership firm registered under the Indian Partnership Act, 1932 or a limited liability partnership registered under the Limited Liability Partnership Act, 2008.
- **Majority stake means:-**
  - (i) holding more than one-half of the equity share capital in the body corporate; or
  - (ii) holding more than one-half of the voting rights in the body corporate; or
  - (iii) having the right to receive or participate in more than one-half of the distributable dividend or any other distribution by the body corporate.
- **Significant Influence** means the power to participate, directly or indirectly, in the financial and operating policy decisions of the reporting company but is not control or joint control of those policies.

Illustration 1: Capital Structure of Company ABC limited is as following: Equity Share Capital of Rs. 2,000 CCD's of Rs. 3000 CCP's of Rs. 1000 TOTAL Rs. 6,000 Mr. A beneficially holds Rs. 520 equity shares in the Company. Whether Mr. A beneficially required to give disclosure under SBO?

Solution: *For the purpose of SBO Rules share capital includes (CCD's and CCP's). Therefore total share capital of the Company is Rs. 6,000/-. Mr. A beneficially holds Share capital of Rs. 520/-. His percentage of holding is 520/6000= 8.667%. As holding of Mr. A beneficially is less than 10% therefore no need to give disclosures u/s 90 of SBO Provisions.*

Illustration 2: If an Individual ('A') holding shares in any Company (Exp. Mr. A Holding 60% shareholding of ABC Pvt. Ltd. and his name entered into register of member) Whether provisions of SBO shall be applicable on Mr. A or Not?

Solution *"Significant Beneficial Owner": means beneficial owner holding ultimate beneficial interest not less than 10% and whose name not entered in the register of members of a Company. Therefore, one can opine that SBO provision applicable on person who is holding beneficial interest and whose name not entered into register of members. In above mentioned example individual holding shares directly in the company in his name therefore provision of SBO not applicable on such individual.*

Illustration 3: If an Individual ("A") holding shares in any Company, (Exp. Mr. A Holding 7% shareholding of ABC Pvt. Ltd. and his name not entered into register of member). On behalf of Mr. A name of Mr. B entered into register of Members. Whether provisions of SBO shall be applicable on Mr. A or Not?

Solution: *Significant Beneficial Owner means beneficial owner holding ultimate beneficial interest not less than 10% and whose name not entered in the register of members of a Company. In the above mentioned question, shareholding is less than 10% therefore question of SBO doesn't arise. No need to made compliances as per SBO.*

Illustration 4: If in the question B; Mr. A Holding 18% shareholding of ABC Pvt. Ltd. and his name not entered into register of member). On behalf of Mr. A name of Mr. B entered into register of Members. Whether provisions of SBO shall be applicable on Mr. A or Not?

***Solution**: Mr. A is beneficial owner and Mr. B is registered owner. Mr. B holding shares on behalf of Mr. A which is more than 10%. As per SBO provisions, Mr. A fall under conditions of Section 90. Therefore, have to comply with the provisions of Section 90.*

Some more practical scenarios for determining SBOs:

(i) S holds directly 10% of equity in A Ltd. and he holds 55% of equity in H Ltd. which holds 1% equity in A Ltd.

S holds directly 10% of equity in A Ltd. and he holds 55% of equity in H Ltd. which holds 1% equity in A Ltd. - S is a Significant Beneficial Owner since he holds 11% totally through indirect and direct holdings.

(ii) S holds 8% of equity while M holds 7% of equity in A Ltd. and they are deemed to act together.

S holds 8% of equity while Mr. M holds 7% of equity in A Ltd. and they are deemed to act together - S and M are not Significant Beneficial Owner, as there is no indirect holding and their acting together is irrelevant.

(iii) S holds 8% of equity in A Ltd. directly. S is also the Karta of a HUF that holds 7% equity in A Ltd.

S holds 8% of equity in A Ltd. directly. Mr. S is also the Karta of a HUF that holds 7% of equity in A Ltd. S is a Significant Beneficial Owner since he holds total 15% equity through indirect and direct holdings.

(iv) S holds 8% of equity in A Ltd. directly. S is also the trustee of a discretionary trust that holds 3% equity in A Ltd.

S holds 8% of equity in A Ltd. directly. Mr S is also the trustee of a discretionary trust that holds 3% equity in A Ltd. He is a Significant Beneficial Owner since he holds total 11% equity in A Ltd. through indirect and direct holdings. Holding by way of being a trustee of a discretionary trust is considered to be indirect holding.

Declarations to be made by Significant Beneficial Owner

- **Initial Disclosure:** On the date of commencement of the Companies (Significant Beneficial Owners) Amendment Rules, 2019, every individual who is a significant beneficial owner in a reporting company, was required to file a declaration in **Form No. BEN-1** to the reporting company within ninety days from such commencement i.e., February 08, 2019.
- **Continual Disclosure:** Every individual, who subsequently becomes a SBO/ or where his significant beneficial ownership undergoes any change shall file a declaration in **Form No. BEN-1** to the reporting company, within 30 days of acquiring such significant beneficial ownership or any change therein.

Obligations of the Reporting Company

- **Filing of Returns with ROC:**

  Upon receipt of a declaration from the Significant Beneficial Owner of the company and changes therein, the reporting company shall file a return in **Form No. BEN-2** with the Registrar in respect of

such declaration, within a period of 30 days from the date of receipt of such declaration, along with the prescribed fees.

- **Notice to the Significant Beneficial Owner**

  It should be noted that, the obligation of the individual to self-declare his significant beneficial holdings, and the obligation of the company to send notice seeking information from members in terms of Rule 2A of the Companies (Significant Beneficial Owners) Rules, 2018, are independent obligations.

  As per Rule 2A(1) of the Companies (Significant Beneficial Owners) Rules, 2018, every reporting company shall take necessary steps to find out if there is any individual who is a significant beneficial owner, as defined in rule 2(h) of the Companies (Significant Beneficial Owners) Rules, 2018, in relation to that reporting company, and if so, identify him and cause such individual to make a declaration in **Form No. BEN-1**.

Further, according to Section 90(5) a company shall give notice, in the prescribed manner, to any person (whether or not a member of the company) whom the company knows or has reasonable cause to believe-

(a) to be a significant beneficial owner of the company;

(b) to be having knowledge of the identity of a significant beneficial owner or another person likely to have such knowledge; or

(c) to have been a significant beneficial owner of the company at any time during the three years immediately preceding the date on which the notice is issued, and who is not registered as a significant beneficial owner with the company as required under this section.

As per Rule 2A(2) of SBO Rules whereby, the reporting company has members (other than individual) holding 10% or more of participating interest [either of shares, voting rights, or right to receive or participate in the dividend or any other distribution payable in a financial year], shall give notice to such member seeking information in accordance with Section 90(5) about the individual who is significant beneficial owner in the reporting company **in Form BEN-4.**

The abovementioned particulars should be submitted in writing to the registered address of the company by concerned person not later than 30 days of the date of this notice.

Consequences of Non-Reporting under Section 90 (5)

As per Rule 7 of The Companies (Significant Beneficial Owners) Rules, 2018, the reporting company shall apply to the Tribunal within a period of 15 days of the expiry of the period specified in BEN-4,

(i) where any person fails to give the information required by the notice in Form No. BEN-4, within the time specified therein; or

(ii) where the information given is not satisfactory.

In accordance with section 90(7) of the Companies Act, 2013, for order directing that the shares in question be subject to restrictions, including:

(a) restrictions on the transfer of interest attached to the shares in question;

(b) suspension of the right to receive dividend or any other distribution in relation to the shares in question;

(c) suspension of voting rights in relation to the shares in question;

(d) any other restriction on all or any of the rights attached with the shares in question.

Order of Tribunal

NCLT on application moved by a company is not under a binding obligation to pass any restrictive order and the concerned person or member shall have the opportunity to explain why he or she is not a significant beneficial owner and retract the contentions made by the company.

As per Section 90(8) of the Companies Act, 2013 the Tribunal may:

- After giving an opportunity of being heard to the parties concerned, make such order restricting the rights attached with the shares.
- Within a period of 60 days of receipt of application or such other period as may be prescribed.

As per Section 90(9) of the Companies Act, 2013, the company or the person aggrieved by the order of the Tribunal may make an application to the Tribunal for relaxation or lifting of the restrictions placed by the Tribunal within a period of one year from the date of such order.

However, if no such application has been filed within a period of one year from the date of the order, such shares shall be transferred, without any restrictions, to the authority constituted under sub-section section 125(5) i.e., Investor Education and Protection Fund , in such manner as prescribed.

The MCA vide notification dated June 09, 2021 has notified Rule 6A of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 pertaining to the Manner of transfer of shares under sub-section (9) of Section 90 of the Companies Act, 2013 to the Investor Education and Protection Fund (IEPF).

Register of Significant Beneficial Owners

According to Rule 5 of the Companies (Significant Beneficial Owners) Rules, 2018, the company shall maintain a register of significant beneficial owners in Form No. BEN-3 which includes :

- the name of individual;
- his date of birth;
- address and e-mail ID;
- details of ownership in the company; and
- Such other details.

The register shall be open for inspection during business hours, at such reasonable time of not less than two hours, on every working day as the board may decide, by any member of the company on payment of such fee as may be specified by the company but not exceeding fifty rupees for each inspection.

Non-Applicability

As per Rule 8 of the Companies (Significant Beneficial Owners) Rules, 2018 shall not be made applicable to the extent the share of the reporting company is held by:

- IEPF Authority;
- It's holding reporting company; however, the details of such holding reporting company shall be reported in Form No. BEN-2;
- The Central Government, State Government or any local Authority;

- Reporting company or a body corporate an entity, controlled by the Central Government or by any State Government or partially by the Central Government and partly by one or more State Governments;
- SEBI registered Investment Vehicles such as mutual funds, alternative investment funds (AIF), Real Estate Investment Trusts (REITs), Infrastructure Investment Trust (InVITs) regulated by SEBI; and
- Investment Vehicles regulated by RBI, or IRDA, or Pension Fund Regulatory and Development Authority.

Penal Provisions

Section	*Nature of Violation*	*Person Responsible*	*Penalty*
Section 90(10)	Failure to make a declaration	SBO	penalty of Rs.50,000 and in case of continuing failure, with a further penalty of Rs.1000 for each day after the first during which such failure continues, subject to a maximum of Rs.2 Lakhs
Section 90(11)	Failure to maintain register U/S 90(2) & file information U/S 90(4) or required to take necessary steps under sub-section 90(4A) and denial of inspection	• Company • Officer of the company who is in default	• liable to a penalty of Rs.1Lakh and in case of continuing failure, with a further penalty of Rs.500 for each day, after the first during which such failure continues, subject to a maximum of Rs.5 Lakhs • a penalty of Rs.25000 and in case of continuing failure, with a further penalty of Rs.200 for each day, after the first during which such failure continues, subject to a maximum of Rs.1 Lakh
Section 90(12)	Furnishing of false and incorrect information or suppressing any material information	Person declaring Beneficial interest	Liable to action under Section 447 of the Companies Act, 2013 (Fraud)

Rectification of a Register of Members

The register of members of a company contains names, addresses, occupations, if any etc. only of members of the company. Any person, whose name is entered in the register of members of a company, considered to be its member, although he may not own the shares which are shown in his name in the register of members. On the contrary, a person, whose name is not entered in the register of members is not considered as member of the company even though he may have done everything to entitle him to be put on the register of members. Injustice may, therefore, result from such omission or commission.

CASE LAW

Where the petitioners failed to produce their share certificates, it could not be said that they had not transferred their shares in favour of respondents and thus, petitioners were not entitled to the relief for rectification of Register of Members of respondent company. [***Held in the case of M/s Bhupendra Patel v. Hotel Satyaketu (P.) Ltd. (2017) NLT – Ahmedabad.***]

Section 59 of the Companies Act, 2013 confers powers on the Tribunal or a competent court outside India specified by the Central Government by notification in respect of foreign members or debenture-holders residing outside India to order rectification of register of members of a company if an appeal is made by the aggrieved person or by any member of the company or the company on any of the following grounds:

(a) where the name of a person is without sufficient cause, entered in the register of members of a company;

(b) where his name, after having been entered in the register, is omitted without sufficient cause; or

(c) where default is made or unnecessary delay takes place in entering in the register of members the fact of any person having become, or ceased to be, a member of the company.

This may happen where a person has transferred his shares according to law and the company either refuses or delays registration of transfer in the transferee's name.

The Tribunal may, after hearing the parties to the appeal for rectification of register of members either dismiss the appeal or direct that the transfer or transmission shall be registered by the company within ten days of the receipt of the order or direct for rectification of records of the depository or the register and in the latter case also direct the company to pay damages if any, sustained by the party aggrieved.

The provisions of this section shall not restrict the right of a holder of securities, to transfer such securities and any person acquiring such securities shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal [Section 59(3)].

It is pertinent to note that though the time limit for filing an application for rectification of register of members has not been specified in the Act, the provisions of Article 137 of the Limitation Act would apply and in consequence, the application for rectification must be made within three years from the date on which the right occurs [Ref. *Anil Gupta v. Delhi Cloth & General Mills Co. Ltd.,* (1983) 54 Com Cases 301 (Delhi)].

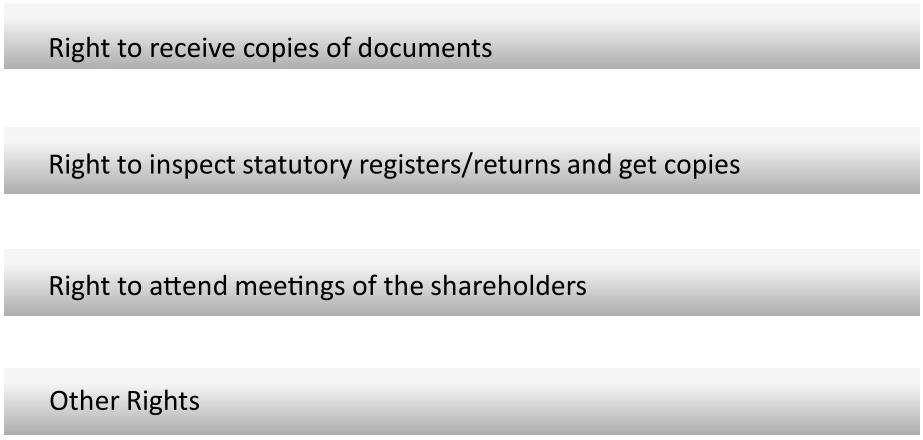
Where the transfer of securities is in contravention of any of the provisions of the Securities Contracts (Regulation) Act, 1956, the Securities and Exchange Board of India Act, 1992 or this Act or any other law for the time being in force, the Tribunal may, on an application made by the depository, company, depository participant, the holder of the securities or the Securities and Exchange Board, direct any company or a depository to set right the contravention and rectify its register or records concerned. [Section 59(4)]

RIGHTS OF MEMBERS

When once a person becomes a member he is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Act. The appointment of a receiver, the attachment of the shares, the pledge of the shares or taking over of the management of a company which is holding shares in another company will not alter the position. So long a person's name stands registered in the books as a member, even if he has sold the share and has given the share certificates and the blank transfer deed duly signed, he alone is entitled to exercise the rights of membership [*Balakrishna Gupta & Others* v. *Swadeshi Polytex Ltd. and Others (1985) 58 Com Cases 563 (S.C.);* and *Life Insurance Corporation of India* v. *Escorts Ltd. & Others (1986) 59 Com Cases 548 (S.C.)].* These rights are derived by virtue of the membership contract between the company and the member and the general law. Some of these rights can be exercised by him individually and others along with other members unless member himself holds shares equivalent to the minimum holding prescribed under the various provisions of the Companies Act, 2013.

Individual Rights

Members of a company enjoy certain rights in their individual capacity, which they can enforce individually. These rights are contractual rights and cannot be taken away except with the written consent of the member concerned. These rights can be categorized as under:



(1) Right to receive copies of the following documents from the company:

(i) A copy of the financial statements, including consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements (Section 136);

(ii) Abridged financial statement and auditor's report in the case of a listed company (Section 136);

(iii) Report of the Cost Auditor, if so directed by the Government;

(iv) Notices of the general meetings of the company (Sections 101-102).

(2) Right to inspect statutory registers/returns and get copies thereof without payment on any fee or on payment of prescribed fee. The members have been given right to inspect the following registers etc.:

(i) Debenture trust deed (Section 71);

(ii) Register of Charges and instrument of charges (Section 85 & 87);

(iii) Copies of contract of employment with Managing or Whole-time Directors);

(iv) Shareholders' Minutes Book (Section 119);

(v) Register of Contracts, Companies and Firms in which Directors are interested (Section 189);

(vi) Register of directors and key managerial personnel and their shareholding (Section 170).

(3) Right to attend meetings of the shareholders and exercise voting rights at these meetings either personally or through proxy (Sections 96, 100, 105 and 107).

(4) Other rights: Over and above the rights enumerated at Item Nos. 1 to 3 above, the members have the following rights:

(i) To transfer shares (Sections 44 and 56 and Articles of Association of the company);

(ii) To resist and safeguard against increase in his liability without his written consent;

(iii) To receive dividend when declared (Section 123);

(iv) To have rights shares (Section 62);

(v) To appoint directors (Section 152);

(vi) To share the surplus assets on winding up (Section 320);

(vii) Right of dissentient shareholders to apply to Tribunal (Section 48);

(viii) Right to be exercised collectively by passing a special resolution and intimating the same to the Central Government for investigation of the affairs of the company (Section 210);

(ix) Right to make application collectively to the Tribunal for relief in cases of oppression and mismanagement (Sections 241);

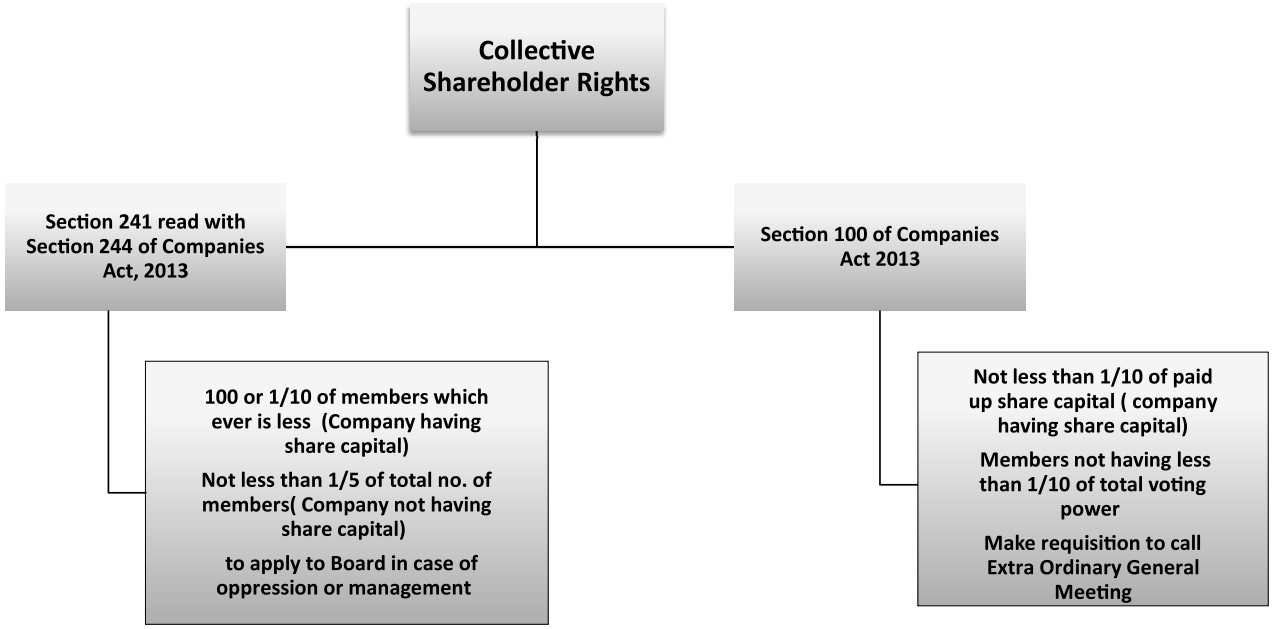
(x) Right to file class action suits before the Tribunal (Section 245);

(xi) Right of Nomination. (Section 72);

(xii) Right to file a suit or take any other action in case of any misleading statement or the inclusion or omission of any matter in the prospectus. (Section 37).

Collective Shareholder Rights

Members of a company have certain rights which can be exercised by members collectively by means of democratic process, i.e. by majority of members usually unless otherwise prescribed. This involves the principle of submission by all members to the will of the majority, provided that the will is exercised in accordance with the law and the Memorandum and Articles of Association of the company. Thus, the shareholders in majority determine the policy of the company and exercise control over the management of the company.



- **Application to Board in case of Oppression and Management:** However, if and when the majority becomes oppressive or is accused of mismanagement of the affairs of the company, Section 241 read with section 244 of the Act, confers right, to not less than one hundred members of a company or not less than one-tenth of the total number of its members whichever is less or any member or members holding not less than one-tenth of the issued share capital of the company (but they must have paid all

calls and others sums due on their shares) and in the case of a company not having a share capital, not less than one-fifth of the total number of its members, to apply to Board under Section 241 for relief in cases of oppression or for relief in cases of mismanagement respectively.

- **Making a requisition for calling Extra Ordinary General Meeting:** Section 100 of the Companies Act, 2013 confers on members, holding not less than one-tenth of the paid-up share capital of a company, right to make a requisition to the Board of Directors to call an extraordinary general meeting of the company. The section also confers on members having not less than one-tenth of the total voting power in a company not having a share capital, to make a requisition to the Board to call an extraordinary general meeting of the company. If the Board of Directors of the company does not, within twenty-one days from the date of the deposit of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of those matters on a day not later than forty-five days from the date of deposit of the requisition, the meeting may be called and held by the requisitionists themselves within a period of 3 months from the date of the requisition.

Voting Rights of Members

The right of attending shareholders' meetings and voting thereat is the most important right of a member of a company, as shareholders' meetings play a very important role in the company's life. Directors are appointed by the shareholders, who direct the affairs of the company, formulate short-term plans and long-term policies of the company, appoint management personnel to constitute organisation to implement their plans and policies in order to achieve the objects of the company.

- **Voting Rights on Poll:** Section 47 of the Act, provides that every member of a company limited by shares and holding equity share capital therein, shall have right to vote on every resolution placed before the company and his voting right on a poll shall be in proportion to his share in the paid up equity share capital of the company.

  Section 43 of the Companies Act, 2013 provides that a company limited by shares shall be entitled to issue (i) equity share capital with voting rights or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules as may be prescribed by the Central Government.

- **Preference Shareholder Rights:** Preference shareholders ordinarily vote only on matters directly affecting the rights attached to preference share capital and on any resolution for winding up of the company or for the repayment or reduction of the equity or preference share capital. The voting right of a preference shareholder on poll shall be in proportion to his share in the paid-up preference share capital of the company. In respect of a resolution on a matter affecting both equity shareholders and preference shareholders, the proportion of the voting rights of equity shareholders to the voting rights of the preference shareholders shall be in the same proportion as the paid-up capital in respect of the equity shares bears to the paid-up capital in respect of the preference shares. However, where the dividend in respect of a class of preference shares has not been paid for a period of two years or more, such class of preference shareholders shall have a right to vote on all the resolutions placed before the company (Section 47).

  Section 50 of the Act lays down that a company may, if authorised by its articles, accept from any member the whole or a part of the amount remaining unpaid on any shares held by him although no part of that amount has been called up. Such advance payment, however, shall not confer on the member concerned any voting rights.

- **Shareholders' Pre-emptive Rights with regard to further issue of share capital (Right Shares):** To preserve the shareholders' proportionate dividend, liquidation and voting rights, pre-emptive rights are

often recognised, but their existence and scope can be effected by provisions in the articles. However, Section 62 of the Companies Act, 2013 secures shareholders' pre-emptive rights with regard to the further issue of share capital by the company. The Section lays down:

"(1) Where at any time, a company having a share capital proposes to increase its subscribed capital by the issue of further shares, such shares shall be offered to persons who, at the date of the offer, are holders of equity shares of the company in proportion, as nearly as circumstances admit, to the paid-up share capital" on those shares by sending a letter of offer subject to the condition that unless the articles of the company otherwise provide, the offer aforesaid shall be deemed to include a right exercisable by the person concerned to renounce the shares offered to him or any of them in favour of any other person and the notice of offer shall contain a statement of this right [Sub- clause (a)].

Rights of Dissenting Shareholders

Section 48(2) of the Companies Act, 2013 confers certain rights upon the dissenting shareholders. According to section 48(2), where the rights of any class of shares are varied, the holders of not less than ten per cent of the issued shares of that class, being persons who did not consent to such variation or vote in favour of the special resolution for the variation, can apply to the Tribunal to have the variation cancelled. Where any such application is made to the Tribunal, the variation will not be effective unless and until it is confirmed by the Tribunal.

The above application shall be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

Nomination by Security holders (including members) (Section 72)

Section 72(1) of the Act, states that every holder of securities of a company may, at any time, nominate, in the prescribed manner, any person to whom his securities shall vest in the event of his death.

Section 72(2) of the Act, states that when the securities of a company are held by more than one person jointly, the joint holders may together nominate, in the prescribed manner, any person to whom all the rights in the securities shall vest in the event of death of all the joint holders.

Section 72(3) of the Act, states that notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of the securities of a company, where a nomination made in the prescribed manner purports to confer on any person the right to vest the securities of the company, the nominee shall, on the death of the holder of securities or, as the case may be, on the death of the joint holders, become entitled to all the rights in the securities, of the holder or, as the case may be, of all the joint holders, in relation to such securities, to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner.

Section 72(4) of the Act, states that when the nominee is a minor, it shall be lawful for the holder of the securities, making the nomination to appoint, in the prescribed manner, any person to become entitled to the securities of the company, in the event of the death of the nominee during his minority.

Rule 19 of the Companies (Share Capital and debentures) Rules, 2014 deals with Nomination by Securities Holders. It provides that:-

(1) Any holder of securities of a company may, at any time, nominate, in **Form No. SH.13,** any person as his nominee in whom the securities shall vest in the event of his death.

(2) On the receipt of the nomination form, a corresponding entry shall forthwith be made in the relevant register of securities holders, maintained under section 88 of the Act.

(3) Where the nomination is made in respect of the securities held by more than one person jointly, all joint holders shall together nominate in **Form No.SH.13** any person as nominee.

(4) The request for nomination should be recorded by the Company within a period of two months from the date of receipt of the duly filled and signed nomination form.

(5) In the event of death of the holder of securities or where the securities are held by more than one person jointly, in the event of death of all the joint holders, the person nominated as the nominee may upon the production of such evidence as may be required by the Board, elect, either-

(a) to register himself as holder of the securities; or

(b) to transfer the securities, as the deceased holder could have done.

(6) If the person being a nominee, so becoming entitled, elects to be registered as holder of the securities himself, he shall deliver or send to the company a notice in writing signed by him stating that he so elects and such notice shall be accompanied with the death certificate of the deceased share or debenture holder(s).

(7) All the limitations, restrictions and provisions of the Act relating to the right to transfer and the registration of transfers of securities shall be applicable to any such notice or transfer as aforesaid as if the death of the share or debenture holder had not occurred and the notice or transfer were a transfer signed by that shareholder or debenture holder, as the case may be.

(8) A person, being a nominee, becoming entitled to any securities by reason of the death of the holder shall be entitled to the same dividends or interests and other advantages to which he would have been entitled to if he were the registered holder of the securities except that he shall not, before being registered as a holder in respect of such securities, be entitled in respect of these securities to exercise any right conferred by the membership in relation to meetings of the company.

The Board may, at any time, give notice requiring any such person to elect either to be registered himself or to transfer the securities, and if the notice is not complied with within ninety days, the Board may thereafter withhold payment of all dividends or interests, bonuses or other moneys payable in respect of the securities, as the case may be, until the requirements of the notice have been complied with.

(9) A nomination may be cancelled, or varied by nominating any other person in place of the present nominee, by the holder of securities who has made the nomination, by giving a notice of such cancellation or variation, to the company in **Form No. SH.14**.

(10) The cancellation or variation shall take effect from the date on which the notice of such variation or cancellation is received by the company.

(11) When the nominee is a minor, the holder of the securities, making the nomination, may appoint a person in **Form No. SH.13** specified under sub-rule (1), who shall become entitled to the securities of the company, in the event of death of the nominee during his minority.

SHAREHOLDERS' DEMOCRACY

The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.

Democracy means the rule of people, by the people and for the people. In that context the shareholders democracy means the rule of shareholders, by the shareholders, and for the shareholders in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregate, communicate with co-shareholders and to learn about what is going on in the company.

Under the Companies Act the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of Board of directors and shareholders exercise their powers through General Meetings. Although constitutionally all the acts relating to the company can be performed in General Meetings but most of the powers in regard thereto are delegated to the Board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

Under Section 179 of the Companies Act 2013 a general power has been conferred on the Board of directors. The section provides that "Subject to the provisions of this Act, the Board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do."

Proviso to this section restricts the power of the Board of Directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act or Memorandum of Association or the Articles of Association.

Thus the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution or by postal ballot.

Few businesses which are required to be transacted by shareholders

1. Alteration of Memorandum of Association and Articles of Association.
2. Further issue of share capital.
3. To transfer some portions of uncalled capital to reserve capital to be called up only in the event of winding up of the company.
4. To reduce the share capital of the company.
5. To shift the registered office of the company outside the local limits of any city, town or village where the registered office is situated.
6. To decide a place other than the registered office of the company where the statutory books, required to be maintained.
7. Payment of interest on paid-up amount of share capital for defraying the expenses on construction when plant cannot be commissioned for a longer period of time.
8. To approach Central Government for investigation into the affairs of the company.
9. Any contract or arrangement with related party, above the threshold limits.
10. Payment of commission of more than statutory requirement to a managing or a whole-time director or a manager.
11. To make loans, to extend guarantee or provide security to other companies or make investment beyond the limit specified.

12. To borrow money and to charge out the assets of the company to secure the borrowed money where the sums to be borrowed along with money already borrowed exceeds the paid-up capital of the company and its free reserves i.e. reserves not set apart for any specific purpose.
13. To appoint directors.
14. To increase or reduce the number of directors within the limits laid down in Articles of Association.
15. To cancel, redeem debentures etc.
16. To make contribution to funds not related to the business of the company.

In view of the rights conferred on shareholders to be exercised at General Meetings, the Act casts an obligation on the directors to send notices for convening general meetings or else the meetings shall be declared to be void as also all proceedings transacted thereat.

Apart from the rights which are vested in the shareholders to be exercised in relation to the conduct of the business of the company, the directors of the company have certain obligations towards the shareholders.

The courts have determined two broad duties to be performed by a director:

1. Duty of utmost care and skill in managing the affairs of the company or else be liable for damages.
2. Fiduciary duty to act bona fide in the interest of the company, not to exercise powers for collateral benefit and not to earn profit from the position as a director.

VARIATION OF SHAREHOLDER'S RIGHTS

Shareholder's rights are determined by the Companies Act, Memorandum of association, and Articles of association of the company and the terms of issue of shares. Rights attached to a class of shares are known as "class rights".

Shareholder's rights relate to dividend, voting at members' meetings and return of capital. Preference shareholders may have rights to a fixed amount or a fixed rate of dividend or to cumulative dividend. Where the ordinary shareholders are conferred the right to participate in the surplus assets on winding up of a company, it is not deemed to be a class right as it is implied even in the absence of any express provision in the articles.

Section 48 (1) of the Companies Act, 2013 lays down that where a share capital of the company is divided into different classes of shares, the rights attached to the shares of any class can be varied with the consent in writing of the holders of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class. Further, the variation of rights of shareholders can be effected only:

(i) if provision with respect to such variation is contained in the Memorandum or Articles of association of the company; or

(ii) in the absence of any such provision in a Memorandum or Articles of association of the company, if such a variation is not prohibited by the terms of issue of the shares of that class.

However, if variation by one class of shareholders affects the rights of any other class of shareholders, the consent of three-fourths of such other class of shareholders shall also be obtained and the provisions of this section shall apply to such variation.

LIABILITY OF MEMBERS

The liability of a member depends on the nature of the company. If the company is registered with unlimited liability, every member is liable in full for all the debts of the company contracted during the period of his

membership. Where the company is limited by guarantee, each member will be bound to contribute in the event of winding up a sum specified in the liability clause of the memorandum of association. In case of company limited by shares, each member is bound to contribute the full nominal value of shares and his liability ends there. If before the full nominal value of the shares is paid, the company goes into liquidation, the member becomes liable as contributory to pay the balance when called upon to pay, by the liquidator of the company.

Where a company has been incorporated by furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company or by any fraudulent action, the Tribunal may, on an application made to it, on being satisfied that the situation so warrants, direct that liability of the members shall be unlimited [Section 7(7) of the Act].

If a member ceased to be member of a company within one year prior to the commencement of the winding up of the company he is liable to pay on the shares which he held to the extent of the amount unpaid thereon, if:

(i) on the winding up, debts exist which were incurred while he was a member, and

(ii) it appears to the Tribunal that the present members are not able to satisfy the contribution required from them in respect of their shares.

A person is liable as member inspite of a valid transfer of shares by him, if the name of the transferee is not placed on the register of members, in place of the transferors' name. If a person applies for shares in the name of a fictitious person or a person not in existence or uses another person's name for himself, or uses an alias, and shares are allotted in that name or alias, he will be liable as a member.

SHAREHOLDERS' AGREEMENT

Shareholders' agreements (SHA) are quite common in business. In India shareholder's agreement have gained popularity and currency only lately with bloom in newer forms of businesses. There are numerous situations where such agreements are entered into – family companies, JV companies, venture capital investments, private equity investments, strategic alliances, and so on. Shareholders' agreement is a contractual arrangement between the shareholders of a company describing how the company should be operated and the defining inter-se shareholders' rights and obligations. SHAs are the result of mutual understanding among the shareholders of a company to which, the company generally becomes a consenting party. Such agreements are specifically drafted to provide specific rights, impose definite restrictions over and above those provided by the Companies Act. SHA creates personal obligation between the members signing such agreement however, such agreements do not become a regulation of the company in the way the provisions of Articles are.

Enforceability of the Shareholder's Agreement

Though the international view is split but to a large extent courts are inclined towards favouring SHA as long as they are not found to be detrimental to the minority stakeholder's rights. In the leading case of *Russell v. Northern Bank Development Corporation Ltd [1992] BCC 578; [1992] 1 WLR 588,* the House of Lords found that though a company cannot deprive itself of its power to alter its constitution, the members of the company could agree in a shareholders' agreement as to how they will exercise their voting rights on a resolution to alter the articles/constitution. The US Courts have largely accepted shareholder agreements. *[Blount v. Taft [246 S.E.2d 763 at 769 (1978)]*

While shareholders' agreements are enforceable in England regardless of whether they have been incorporated in the articles of association of the company, in India courts have either refused to recognize clauses in shareholders agreements or, even when consistent with company legislation, enforced such clauses only if

they have been incorporated in the articles of association of the company. There is a series of rulings where the courts have upheld that in case of any conflict between the Articles and the SHA, the former will always prevail. Some of these are:

- *V.B. Rangaraj v. V.B. Gopalakrishnan (AIR 1992 SC 453)*
- *Shanti Prasad Jain v. Kalinga Tubes Ltd., (35 Com. Cas. 351 SC)*
- *Mafatlal Industries Ltd., v. Gujarat Gas Co. Ltd (97 Comp Cas 301 Guj),*
- *Pushpa Katoch v. Manu Maharani Hotels Limited* [*(2006) 131 Comp Cas 42 (Delhi)*]

The Supreme Court in *V.B. Rangaraj v. V.B. Gopalakrishnan, AIR 1992 SC 453* held that a restriction which is not specified in the articles of association is not binding either on the company or on the shareholders. This decision was reiterated by the Bombay High Court in *IL & FS Trust Co. Ltd. v. Birla Perucchini Ltd.* [2004] 121 Comp Cas 335 (Bom).

However, the Supreme Court in 2003 in its decision in *M.S. Madhusoodhanan v. Kerala Kaumudi Pvt. Ltd.* (2003 117 Comp Cas 19 (SC) not disagreeing with the decision in V.B Rangaraj case mentioned above, but distinguishing itself from the facts in that judgment, held that a restriction in relation to identified members on identified shares of a private company did not amount to restriction of transferability of shares *per se*.

In *Western Maharashtra Development Corporation Ltd. v. Bajaj Auto Ltd.* [(2010) 154 Company Cases 593 (Bom)], it was held that such clauses are to hamper the free transferability of shares and in violation of the Companies Act, and hence, are not enforceable. Subsequently in the case of *Messer Holdings Limited v. Shyam Madanmohan Ruia and Ors [(2010) 98 CLA 325]* the Division Bench of Bombay High Court overruled its judgement in Western Maharashtra Development Corporation Ltd and provided a more liberal interpretation and recognised the rights inter se among shareholders in case of restrictions on transfer of shares.

In Indian context, while the landmark decision of the Supreme Court in V.B. Rangaraj case mentioned above is often cited in the context of shareholders' agreements, most other decisions have been rendered by the High Courts in various states especially the Bombay High Court. The decisions on shareholders' agreements are not uniformly inclined in a direction. The High Court decisions are limited in their applicability as they are susceptible to disagreements by other High Courts, thereby conferring limited precedential value. It is difficult to come to clear and crisp answers as to enforceability of Shareholder's agreement.

VETO POWER

Meaning of the term – "veto"

A veto – Latin for "*I forbid*" – is the power to unilaterally stop an official action, especially the enactment of legislation.

A veto may give power only to stop changes, thus allowing its holder to protect the *status quo*.

The Companies Act, 2013 introduced various provisions to essentially bridge the gap towards protection and welfare of the minority shareholders under the Companies Act, 1956. As per the Companies Act, 1956, shareholders who hold the majority of shares, rule the company. This majority principle is recognised in a land mark case *Foss* vs. *Harbottle* (1843). The decision taken by the majority shareholders was binding on the minority. Now this principal has been replaced and minority shareholders have been given greater power under the Companies Act, 2013.

Veto Power or Rights

A right is inherent. Shareholders rights refer to rights enshrined in the constitutional document of the company or as provided by the law. A power has its genesis under the provisions of law.

As per the provisions of the Companies Act, 2013 there are some resemblance where the management can take decisions on their own, by virtue of law. However, there are some instances where the consent of the shareholders is mandatory to approve any decision or transaction which is said to be as the veto power or veto right of shareholders of the company.

For instance in case of related-party transactions, promoters, who are majority shareholders, cannot vote in resolutions in cases of related-party transactions (however a company in which ninety percent or more members in number are relatives of promoters or are related parties can vote in resolutions in cases of related-party transactions). As stated under the provisions of Section 188 any related-party transaction that is not done in the ordinary course of business and is not at an arm's length will need approval of minority shareholders by way of a resolution.

Difference between Veto Power and Casting Vote

Veto power is different than casting vote of Chairman. Casting vote is applicable in case of equality of votes in favour and against. In case of equality the Chairman may give vote either in favour or against the resolution and it can be carried accordingly. Veto power has not been defined in the Companies Act. However, dictionary meaning of veto power is: "to refuse to admit or approve; specifically: to refuse assent to (a legislative bill) so as to prevent enactment or cause reconsideration."

Shareholders Agreement and Articles of Association of a company may provide for certain rights to the minority shareholder who has invested funds in the company. Such powers may include power to refuse capital expenditure over certain specified limit. In case the representative of the minority group is not in favour of the capital expenditure proposed by the company, he can exercise his right under the Articles which in common terminology is referred to as "veto powers".

Veto Rights and 'Control'

The introduction of the concept of 'control' in the 2013 Act has implications for investors in Indian companies. Under the 2013 Act, 'control' is understood to include the right to:

(i) appoint a majority of directors; or

(ii) control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholding agreements or voting agreements, or in any other manner.

The definition is similar to the definition of 'control' under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations").

The definition of 'control' and the jurisprudence surrounding the same under the Takeover Regulations has been developed with the objective of protecting minority shareholders and providing an exit to them in the event of change in its control.

The definition of 'control' is linked closely with the definition of 'promoter'. The 2013 Act provides that a person having control over the affairs of the company would be regarded as its 'promoter'.

Given the similarity in the definition of 'control' under the Takeover Regulations and the 2013 Act and its linkage to the definition of 'promoter' it is likely that the jurisprudence of control under the Takeover Regulations would be applied under the 2013 Act, as well.

But, the scope of the term 'control' under the Takeover Regulations itself is not clear. The uncertainty around the interpretation of control would impact negotiation of shareholder agreements. Affirmative voting rights in favour of investors under a shareholders agreement are meant to be an effective tool for safeguarding investment or

the interest of the investors. These rights are negotiated and decided in the shareholders' agreement, which are subsequently incorporated into the articles of association of a target company.

Accordingly, an investor or shareholder who has secured for itself certain rights which enable a degree of control over 'management or policy decisions', whether by way of board representation or veto rights, may be regarded as having 'control' of the company and therefore be classified as a 'promoter'. Investors would need to carefully consider the obligations and liabilities associated with the position of a promoter under the 2013 Act when negotiating rights and powers in a company under the shareholders agreement.

ASSIGNMENT OF SHARES IN A COMPANY

Section 44 of the Companies Act, 2013 defines the nature of property in the shares of a company. It lays down: "The shares or debentures or other interest of any member in a company shall be movable property, transferable in the manner provided by the articles of the company."

The definition of "goods" in the Sale of Goods Act, 1930, specifically includes stocks and shares. Hence, it is necessary to provide by the articles the manner in which transfer of shares are to be affected. A "share" in a company is a right to a specified amount of the share capital of the company, carrying with it certain rights and liabilities, while the company is a going concern and in the winding up. It represents the interest of the holder measured for purposes of liability and dividend by a sum of a money.

A company cannot refuse to transfer shares except as provided by its articles. It is well settled that unless the articles otherwise provide, a shareholder has a free right to transfer his shares to whom he chooses. It is not necessary to look to the articles for a power to transfer, since that power is given by the Act. It is only necessary to look to the articles of association to ascertain the mode of transfer and the restrictions upon it.

As between buyer (transferee) and seller (transferor) of shares, the buyer is entitled to all dividends declared after the contract of sale, unless otherwise agreed. Whatever may be the agreement, a transfer of shares after declaration of dividend, does not, as against the company, carry the dividend, even though the transfer may be cum-dividend.

SPECIMEN RESOLUTION / FORMATS

Sample Resolution of Board Meeting for Transfer of Shares

CERTIFIED TRUE COPY OF THE RESOLUTION PASSED AT THE MEETING OF THE BOARD OF DIRECTORS OF **[Name of Company]**, HELD ON **[Date]**, AT **[Address]**.

The Director Mr./Mrs. **[Name of Director]**, informs to the board that they are in receipt of some share transfer application along with share certificates, share transfer deed, and other relevant documents duly signed, stamped and authenticated, for the approval of the company and to record the details of share transfer in the registers of members maintained by the company.

"RESOLVED THAT pursuant to the provision of section 56 of the Companies Act 2013 and other relevant provisions as amended from time to time, the consent of the board of directors is hereby accorded to record the transfer of share in the register of members maintained by the company as per details given below:-

Date	***Name of Transferor and Folio No.***	***Name of Transferee and Folio No.***	***Number of Shares***	***Share Certificate Number***	***Distinctive Number***

FURTHER RESOLVED THAT Mr./Mrs. **[Name of Director]** director of the company is hereby authorised to endorse the relevant share certificate and to enter the name of the transferee as a member in the register of members and make entries in the register of share transfer and to do all other necessary acts, deeds and things as may be required to give effect to the above resolution."

A Specimen of Deed of Assignment of Shares in a Company

THIS ASSIGNMENT is made this ..... day of ..... between AB, son of , resident of..... (hereinafter called "the Assignor") of the one part, and CD, son of....., resident of ..... (hereinafter called "the Assignee") of the other part.

THE DEED WITNESSES:

That in consideration of the sum of Rs..... (Rupees.....) paid by the assignee to the. assignor, the receipt whereof the assignor hereby acknowledges, the said AB hereby assigns, sells and transfers to the said CD..... Equity Shares of Rs.....each, fully paid up, bearing consecutive Nos..... to..... (inclusive), which stand in the name of the assignor in the Register of Members of... Co. Ltd. TO HOLD the same to the assignee absolutely, subject nevertheless to the conditions on which the assignor held the same up to date.

AND the assignee hereby agrees to take the said Equity Shares subject to such conditions.

IN WITNESS WHEREOF the assignor and the assignee do hereto affix their respective signatures on the day, month and the year stated above.

Assignor: Assignee:

Signed in the presence of :

Witness 1:

Witness 2:

LESSON ROUND-UP

- A Company is composed of members, though it has its own entity distinct from members.
- Every shareholder is a member and every member is a shareholder, however, there may be exceptions to this statement.
- Section 2(55) of the Companies Act, 2013 provides the modes by which a person may acquire membership of a Company:
  - by subscribing to the Memorandum,
  - by agreeing in writing to become a member,
  - by holding equity share capital of a Company as beneficial owner in the records of a depository.
- A non-profit making Company licensed under Section 8 of the Companies Act can become member of another company if it is authorized by its Memorandum of Association to invest into shares of the other company.
- Foreigners, trade unions can hold shares in a company, and consequently become its members.
- Person ceases to be a member when his name is removed from register of members of a company.
- In accordance with Section 88, every Company shall keep register of its members. This register shall be kept at the registered office of the Company subject to the provisions of Section 94 of the Companies Act, 2013.

- Every member of a public company limited by shares, holding equity shares, shall have votes in proportion to his share of the paid-up equity share capital of the company. On the other hand, preference shareholders ordinarily vote only on matters directly relating to rights attached to preference share capital and on any resolution for winding up of the company or for the repayment or reduction of the equity or preference share capital.
- On becoming member, a person is entitled to exercise all the rights of a member until he ceases to be a member in accordance with the provisions of the Companies Act, 2013.
- Under the Companies Act the powers have been divided between Board of Directors and the shareholders, the directors exercises their powers through meetings of Board of Directors and Shareholders exercise their powers through general meetings.
- Shareholders can exercise Veto Power through various provisions under the Companies Act, 2013. For instance, the shareholders can institute class action against the company as well as the auditors of the company.
- Particulars of register or index or return in respect of the members of the company related to address or registered address (in case of a body corporate), e-mail ID, Unique Identification Number, PAN, shall not be made available for any inspection or for taking extracts or copies.

GLOSSARY

Ipso facto: By that very fact or act.

***Sui juris*:** A person competent to contract

Minor: Person below the age of majority.

Estoppel: The principle that precludes a person from asserting something contrary to what is implied by a previous action or statement of that.

Global Depository Receipt (GDR): A GDR is an instrument in which a company located in domestic country issues one or more of its shares or convertible bonds outside the domestic country

Section 8 Companies: The company which is non-profit making and registered under section 8 of the Companies Act.

Cessation of membership: A person ceases to be a member of a company when his name is removed from its register of members.

Joint Members: If more than one person apply for shares in a company and shares are allotted to them, each one of such applicant becomes a member.

Class Rights: Rights attached to a class of shares are known as “Class Rights”

Veto: A Veto (latin for “I forbid”),is the power to unilaterally stop an official action, especially the enactment of legislation. Under the Act, there are some instances where the consent of the shareholders is mandatory to approve any decisions or transaction which is said to be as the veto power or veto right of shareholders of the company.

Insolvent: Insolvency is the inability of a debtor to pay their debt. If a person is unable to pay his debt, he is said to be insolvent.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Every shareholder of a company is known as a member while every member may not be known as a shareholder. Comment.
2. Who can become a member of the company? Can the following persons or institutions become member of a company:
   (a) Minor; (b) Company; (c) Partnership firm; (d) Foreigner; (e) Insolvent.
   (b) Is the subscriber to the memorandum of the company would be termed as member of the company?
3. Describe the circumstances under which a register of members may be rectified? Illustrate your answer in the light of the relevant provisions of the Companies Act, 2013.
4. What are the particulars to be recorded in a register of members of a company? Where is the register to be maintained and who has to maintain it? Can a member have access to the register?
5. The name of X is found entered in the register of a company. But X contends that he is not a member of the company. The company maintains that X had orally agreed to become a member and hence his name was entered in the register and so he is a member. Is the contention of the company valid?
6. What are the obligations of a person whose name is entered in the register of members of a company as holder of shares but does not hold beneficial interest in those shares?
7. What is the meaning and procedure for declaration of significant beneficial ownership? What are the obligations of Company upon receipt of declaration of significant beneficial ownership?
8. What are the individual and group rights of a member?
9. The Statement "Liability of the Members of the Company is always Limited" is False? Explain with reasoning.
10. Write short notes on:
    (a) Cessation of membership of a company;
    (b) Foreign Register;
    (c) Index of members;
    (d) Variation of members' rights;
    (e) Registration of shares in the name of public office;
    (f) Veto Power and Casting Vote.
11. Which all companies are required to comply with the provisions of Section 90?
12. What is the meaning of beneficial interest?
13. In case of non-convertible preference shares, where dividends distribution have consecutively failed for 2 years, will preference shares also be counted along with equity shares?

14. M/s Planet Stars Media Limited is planning to issue its equity shares to some of the persons residing outside India. In this context, Chairman of the company asks the Company Secretary of the Company provisions relating to maintenance of Foreign Register. As a Company Secretary suggest the management of the following:
    - What are the provisions relating to maintaining the foreign register of members?
    - Can company discontinue maintaining foreign register of members? If so, when?
15. Decide on the validity of following entries made by the Company Secretary Mr. A in the register of member, debenture holders and other security holders in light of the provisions of the Companies Act, 2013:
    (a) Allotment of debentures made on 11th November, 2021 and entry was made on 20th November, 2021.
    (b) Forfeiture of shares was made on 15th November, 2021 and entry made by Mr. A on 20th November, 2021.
    (c) Issue of duplicate Share Certificates on 10th November, 2021 and entry was made on 24th of November, 2021.
16. Examine the following statements with respect to Beneficial Ownership:
    (a) Capital Structure of Company ABC limited is as following: Equity Share Capital of Rs. 2,000 CCD's of Rs. 3000 CCPS' of Rs. 1000 TOTAL Rs. 6,000 Mr. A beneficially holds Rs. 520 equity shares in the Company. Whether Mr. A beneficially required to give disclosure under SBO?
    (b) If an Individual ('A') holding shares in any Company (Exp. Mr. A Holding 60% shareholding of ABC Pvt. Ltd. and his name entered into register of member) Whether provisions of SBO shall be applicable on Mr. A or Not?
    (c) If an Individual ('A'') holding shares in any Company, (Exp. Mr. A Holding 7% shareholding of ABC Pvt. Ltd. and his name not entered into register of member). On behalf of Mr. a name of Mr. B entered into register of Members. Whether provisions of SBO shall be applicable on Mr. A or Not?
    (d) If in the question B; Mr. A Holding 18% shareholding of ABC Pvt. Ltd. and his name not entered into register of member). On behalf of Mr. A name of Mr. B entered into register of Members. Whether provisions of SBO shall be applicable on Mr. A or Not?

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premiere on Company Law
- Bare Act- The Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

Debt Instruments – Concepts

Lesson 6

KEY CONCEPTS

■ Borrowings ■ Loans & Debts ■ Funding ■ Debentures ■ Bonds ■ Debenture Redemption Reserve ■ Debenture Trust Deed ■ Company Deposits

Learning Objectives

To understand:

- The borrowing powers of the Board
- Powers & Restrictions of Board to borrow money
- Unauthorised / *Ultra-Vires* Borrowings
- Types of Borrowings
- Creation of Security
- Conversion of Debentures into Shares
- Overview of Acceptance of Deposits

Lesson Outline

- Meaning and provisions related to Borrowing Powers of company
- Instruments for Corporate Funding-Debt Capital
- Kinds of Debentures
- Debenture Redemption Reserve Account
- Debenture Redemption Fund
- Debenture Trustee
- Overview of Acceptance of Deposit by Company
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 [Section 71 to 71A]
- The Companies (Share Capital & Debentures) Rules, 2014
- The Companies (Acceptance and Deposit) Rules, 2014
- The SEBI (LODR) Regulations, 2015
- The SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021
- The SEBI (Issue of Capital and Disclosure Requirements) Regulations 2018
- Reserve Bank of India Guidelines

PART A

BORROWING POWERS OF COMPANY AND DEBT CAPITAL

Borrowings - "the act of one who borrows".

In simple language borrowing can be defined as to obtain or receive money on loan with the promise or understanding that it will be repaid.

The one may not always have the money required to do certain things or to buy certain things. In such situations, individuals and businesses/firms/ Companies/institutions go for the option of borrowing money from lenders.

In order to run a business effectively and successfully, adequate amount of capital is necessary. In some cases capital which is arranged through internal resources i.e. by way of issuing equity share capital or using accumulated profit is not adequate and the organisation is resorted to external resources of arranging capital i.e. Bank Loan, Term Loan, Working Capital Loan, Overdraft facility from Bank, Debentures, Public Fixed Deposits, External Commercial borrowing (ECB) etc. Thus, borrowing is a mechanism used whereby the money is arranged through external resources with an implied or expressed intention of returning money.

What is Loan ?

A loan is a sum of money that one or more individuals or companies borrow from banks or other financial institutions so as to financially manage planned or unplanned events. In doing so, the borrower incurs a debt, which he has to pay back with interest and within a given period of time.

When a lender gives money to an individual or entity with a certain guarantee or based on trust that the recipient will repay the borrowed money with certain added benefits, such as an interest rate, the process is called lending or taking a loan.

Debts vs. Loans

Loan and debt are terms often used interchangeably due to the reason that they both primarily mean borrowing money. However, there is a small difference between the two. A loan is money borrowed from a lender. The lender can be a bank or a financial institution. Moreover, a loan is more structured in terms of payment, and the principal amount is paid back to the borrower in instalments over a period of time.

The term debt connotes that debt is the money that the company raises through the issuance of bonds and debentures. Governments, companies, trusts, or corporations can issue bonds and debentures to fund their business, and the lender, in this case, will be the investor. The investor will receive interest payment regularly until the bond or debenture matures. Also, upon maturity, the investor gets back the entire principal amount in lump sum.

Every company needs additional capital for its business from time to time. The company can meet such requirement of capital, to an extent, by the issue of share, and at times has to raise loans. Borrowing can be defined as a means through which companies arrange financial funds through external sources like bank loans, shareholders, public investment, etc. The manner to borrow money, from whom it can borrow, to the extent it can borrow and compliances to be done by a company is regulated by various provisions of Companies Act, 2013 ("Act").

Powers & Restrictions of Board u/s 179 and 180 of the Companies Act, 2013

Borrowings being an external source of raising money, a company cannot borrow money until it is so authorised by its memorandum.

Under Section 179 of the Companies Act, 2013, the Board of Directors of a company are entitled to exercise its power to borrow monies subject to the provisions contained in the Act and as contained in the memorandum or articles of association of the Company or in any regulations not inconsistent therewith, by passing a resolution at duly convened meeting of Board of Directors of the Company.

In terms of First proviso to section 179(3) of the Companies Act, 2013 the Board may, by a resolution passed at a meeting may delegate the power to borrow monies to any committee of Director the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office.

While section 179 of the Companies Act deals with Powers of Board and section 180 of the Companies Act, 2013 deals with restrictions on powers of Board.

Section 180(1) of the Companies Act, 2013 states that the Board of Directors of a company shall exercise the powers conferred under this section only with the consent of the company by a special resolution.

The power conferred under section 180(1)(c) talks about "to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves and securities premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business unless they have received the prior sanction of the company by a special resolution in general meeting.

Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable 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.

It is explained that, the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature;".

Exemption:

As per the exemption notification no 464(E) dated 5th June, 2015 issued by Ministry of Corporate Affairs, private companies have been exempted to comply the entire provisions of Section 180 of the Companies Act 2013, as a result special resolution is not required for private companies to borrow monies.

Unauthorised / *Ultra Vires* Borrowings

Ultra-vires

It is a Latin term made up of two words "*ultra"* which means *beyond* and *"vires"* meaning *power or authority*. So we can say that anything which is beyond the authority or power is called *ultra-vires*. In the context of the

company, we can say that anything which is done by the company or its directors which is beyond their legal authority or which was outside the scope of the object of the company is *ultra-vires*.

Doctrine of Ultra-Vires

Memorandum of association is considered to be the constitution of the company. It sets out the internal and external scope and area of company's operation along with its objectives, powers, scope. A company is authorized to do only that much which is within the scope of the powers provided to it by the memorandum. A company can also do anything which is incidental to the main objects provided by the memorandum. Anything which is beyond the objects authorized by the memorandum is an *ultra-vires* act.

Consequences of Ultra-Vires Borrowings

- *Void ab initio*: The *ultra-vires* acts are null and void ab initio. These acts are not binding on the company. Neither the company can sue, nor it can be sued for such acts. *[Ashbury Railway Carriage and Iron Company v. Riche].*
- *Estoppel:* Estoppel or ratification cannot convert an *ultra-vires* act into an *intra-vires* act.
- *Injunction*: the lender has been given authority under law to restrain the company for using the money lent. 'The members can restrain it from doing so by getting an injunction from the court". [*Attorney General v. Gr. Eastern Rly. Co., (1880) 5 A.C. 473*]
- *Subrogation:* Where the money of an *ultra-vires* borrowing has been used to pay off lawful debts of the company, he would be subrogated to the position of the creditor paid off and to that extent would have the right to recover his loan from the company. Subrogation is allowed for the simple reason that when a lawful debt has been paid off with an *ultra-vires* loan, the total indebtedness of the company remains the same. By subrogating the *ultra-vires* lender, the Court is able to protect him from loss, while debt burden of the company is in no way increased.
- *Liability of directors:* In case of *ultra-vires* borrowing, the lender may be able to sue the directors for breach of warranty of authority, especially if the directors deliberately misrepresented their authority.

***Intra vires* Borrowing but outside the Scope of Agents' Authority**

A distinction should always be made between a company's borrowing powers and the authority of the directors to borrow. Where the directors borrowed money beyond their authority but the borrowing is not *ultra-vires* of the company, such borrowing is called *Intra-vires* borrowing but outside the Scope of Agents' Authority. The company will be liable to such borrowing if the borrowing is within the directors' ostensible authority and the lender acted in good faith or if the transaction was ratified by the company.

Where the borrowing is *intra-vires* of the company but outside the authority of the directors e.g. where the articles provide that the directors shall have the power only up to Rs. 100 lakhs and prior approval of the shareholders would be required to borrow beyond Rs. 100 lakhs; any borrowing beyond Rs.100 lakhs without shareholders approval i.e. *intra-vires* borrowing by the company but outside the authority of directors and can be ratified by the company, then it becomes binding on the company. Here the legal position is quite clear. The company has power or capacity to borrow, but the authority of the directors is restricted either by the articles of the company or by the statute, and they have exceeded it. The company may, if it wishes, ratify the agent's act in which case the loan binds the company and the lender as if it had been made with company's authority in the first place.

On the other hand, the company may refuse to ratify the agent's act. Here the normal principles of agency apply. The doctrine of Indoor Management (also known as rule in *Royal British Bank v. Turquand* (1856) Cl & B 327) shall protect the lender, provided he can establish that he advanced the money in good faith. A third-party who deals with an agent knowing that the agent is exceeding his authority has no right of action against the

principal. Bearing in mind that the memorandum and articles are public documents, the contents of which the third-party is deemed to know, he will obviously have no right of action against the company if the agent's lack of authority is obvious from reading them. But a third-party is not effected by secret restrictions on the agent's authority, as the lack of authority is not clear from the public documents and the lender can not be aware of it from some other source. Therefore, the company will be liable.

CASE LAWS

Related to borrowing power of a company

(a) The behaviour of the directors, as the company's agents, can have no effect whatsoever on the validity of the loan for no agent can have more capacity than his principal. No agent can have a power which is not with the principal. If, therefore, the borrowing is *ultra-vires* the company, so that the company has no capacity to undertake it, the lender can have no rights at common law. No debt is created and any security which may have been created in respect of the borrowing is also void. The lender cannot sue the company for the repayment of the loan. *[Sinclain v. Brouguham (1914) 88 LJ Ch 465].*

(b) If the borrowing by the directors is *ultra-vires* their powers, the directors may, in certain circumstances, be personally liable for damages to the lender, on the ground of the implied warranty given by them, that they had power to borrow *[Firbank's Executors vs. Humphreys, (1886) 18 QBD 54; Garrard v. James, 1925 Ch. 616].*

(c) Sometimes it happens that a power to borrow exists but is restricted to a stated amount, in such a case if by a single transaction an amount in excess is borrowed, only the excess would be *ultra-vires* and not the whole transaction *[Deonarayan Prasad Bhadani v. Bank of Baroda, (1957) 27 Com Cases 223 (Bom)].*

(d) The acquiescence of all shareholders in excess loans contracted by directors beyond their powers but not *ultra-vires* the powers of the company would be sufficient to validate such excess debts. *[Sri Balasar aswathi Ltd. v. Parameswara Aiyar, (1956) 26 Com Cases 298, 308: AIR 1957 Mad 122].*

(e) If the borrowing is unauthorized, the company will be liable to repay, if it is shown that the money had gone into the company's coffers *[Lakshmi Ratan Cotton Mills Co. Ltd. v. J.K. Jute Mills Co. Ltd., (1957) 27 Com Cases 660: AIR 1957 All 311].*

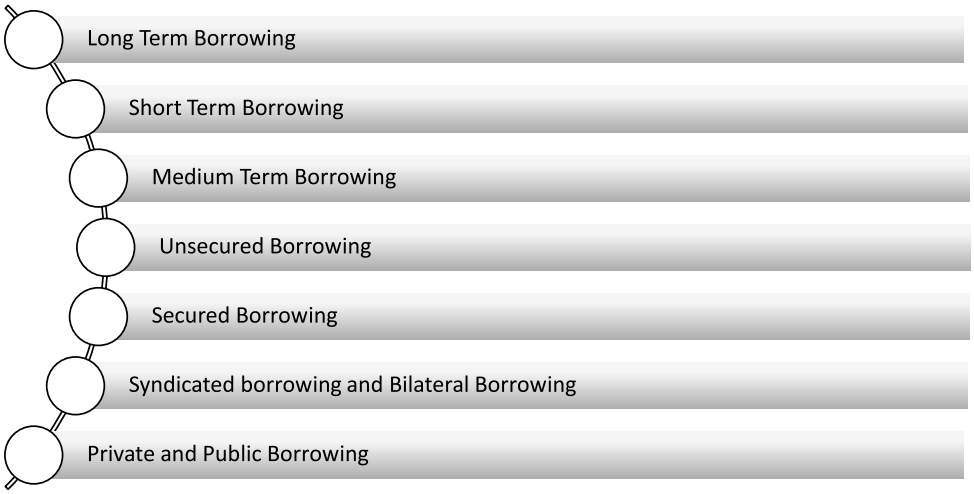
(f) In *V.K.R.S.T Firm v. Oriental Investment Trust Ltd., AIR 1944 Mad 532* under the authority of the company, its managing director borrowed large sums of money and misappropriated it. The company was held liable stating that where the borrowing is within the powers of the company, the lender will not be prejudiced simply because its officer have applied the loan to unauthorised activities provided the lender had no knowledge of the intended misuse.

(g) In *Equity Insurance Co. Ltd. v. Dinshaw& Co., AIR 1940 Oudh 202*, it was held that "where the managing agent of a company who is not authorised to borrow, has borrowed money which is not necessary, neither bona fide, nor for the benefit of the company, the company is not liable for the amount borrowed".

(h) In *SurajBabu v. Jaitly & Co. AIR 1946 All 372, P & Co.*, were the managing agents of L & Co., which was in liquidation. P the manager borrowed a sum of money from J in his own name. In one letter to J he indicated that the loan was for a requirement of L & Co. and that company had actually benefited. It was held that there was no intention to bind the company. "The mere fact that the company had benefited was not in itself sufficient to bind the company".

Types of Borrowings

A company uses various kinds of borrowing to finance its operations. The various types of borrowings can generally be categorized into:



1. *Long term Borrowing:* means liabilities that represent money borrowed from banks or other lenders to fund the on-going operations of a business and that will not come due within one year.

   Funds borrowed for a period ranging for five years or more are termed as long-term borrowings. A long term borrowing is made for getting a new project financed or for making big capital investment like purchase of property, plant, equipment and other fixed assets etc. Generally Long term borrowing is made against charge on fixed assets of the company.

2. *Short term Borrowing:* The funds are borrowed for a short period of up to one year. It is a temporary support for business and meeting the working capital needs is the main purpose. These are borrowings that have to be paid off within a year.

3. *Medium Term Borrowing*: Where the funds to be borrowed are for a period ranging from one to five years, such borrowings are termed as medium term borrowings. The commercial banks normally finance purchase of land, machinery, vehicles etc.

4. *Secured Borrowing:* A debt obligation is considered secured, if creditors have recourse to the assets of the company on a proprietary basis or otherwise ahead of general claims against the company.

5. *Unsecured Borrowing:* Under this, the debt consists of financial obligation. There is no collateral issued against the unsecured borrowings.

6. *Syndicated borrowing:* If a borrower requires a large or sophisticated borrowing facility this is commonly provided by a group of lenders known as a syndicate under a syndicated loan agreement. The borrower uses one agreement covering the whole group of banks and different types of facility rather than entering into a series of separate loans, each with different terms and conditions.

7. *Bilateral borrowing:* Refers to a borrowing made by a company from a particular bank/financial institution. In this type of borrowing, there is a single contract between the company and the lender.

8. *Private borrowing:* Under this, the company takes a loan from the bank of a financial institution. It consists of bank loan obligations.

9. *Public Borrowing:* Is a general definition covering all financial instruments that are freely tradable on a public exchange or over the counter, with few, if any, restrictions i.e. Debentures, Bonds etc.

Funding

How Companies execute funding?

Companies can fulfil their financial requirements by issuing equity or debt, borrowing funds through financial institutions. Unlike equity, debt has a specified interest rate and a schedule of dates when interest is to be paid and all the principal fully repaid. Equity is money the company already has in its coffers or can raise from investors.

Many companies would prefer to use debt to support their growth, rather than equity, as it is less expensive form of financing but there must still be sufficient operating cash flow generated by the Company to meet the debt's interest and principal payment obligations.

In every corporate organization engaged in doing business or involved in manufacturing activity or industry providing services etc., there is always requirement of finances and funds. In order to run a business effectively and successfully, adequate amount of capital is necessary. In some cases it is capital is arranged by way of issuing equity share capital or using accumulated profit. But, Equity funds most of the times when not adequate to meet the financial demand of the company for long run, the organization is resorted to external resources for arranging capital i.e. External Commercial Borrowing (ECB), Debentures, Bank Loan, Public Fixed Deposits etc.

The finances raised through debentures are generally long-term debt. Since debentures have no collateral backing, they must rely on the creditworthiness and reputation of the issuer for support. Both corporations and governments frequently issue debentures to raise capital or funds.

Debentures & Bonds

Meaning of Debentures

The word 'debenture' has been derived from a Latin word '*debere' which means to borrow*. Debenture is a written instrument acknowledging a debt. It contains a contract for repayment of principal after a specified period or at intervals or at the option of the company and for payment of interest at a fixed rate payable usually either half-yearly or yearly on fixed dates. For better understanding of the concept of Debentures, one must need to understand the few terms like, debt instruments, securities (convertible / Non-convertible) etc. as Debentures are one of the form of Debt securities.

Definitions

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 defines the following terms:

Regulation 2(1)(j)

"Convertible debt instrument" *means an instrument which creates or acknowledges indebtedness and is convertible into equity shares of the issuer at a later date at or without the option of the holder of the instrument, whether constituting a charge on the assets of the issuer or not.*

Regulation 2(1)(k)

"Convertible security" *means a security which is convertible into or exchangeable with equity shares of the issuer at a later date, with or without the option of the holder of such security and includes convertible debt instrument and convertible preference shares.*

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 defines the following terms:

Regulation 2(1)(zl)

"Specified securities" *means 'equity shares' and 'convertible securities' as defined under clause (eee) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.*

Regulation 2(1)(t)

*"**Non-convertible debt securities**" means 'debt securities' as defined under the Securities and Exchange Board of India (Issue and Listing of Non-Convertible Securities) Regulations, 2021.*

SEBI (Issue And Listing Of Non-Convertible Securities) Regulations, 2021 defines debenture under the definition of "Debt securities" and related terms:

Regulation 2(1)(k)

"***Debt securities**" means non-convertible debt securities with a fixed maturity period which create or acknowledge indebtedness and includes debentures, bonds or any other security whether constituting a charge on the assets/ properties or not, but excludes security receipts, securitized debt instruments, money market instruments regulated by the Reserve Bank of India, and bonds issued by the Government or such other bodies as may be specified by the Board.*

Regulation 2(1)(x)

*"**Non-convertible securities**" means debt securities, non-convertible redeemable preference shares, perpetual non-cumulative preference shares, perpetual debt instruments and any other securities as specified by the Board.*

Regulation 2(1)(hh)(ii)

"***Secured debt securities***" *shall mean such debt securities which are secured by creation of a charge on the properties or assets of the issuer or its subsidiaries or its holding companies or its associate companies having a value which is sufficient for the due repayment of principal and payment of interest thereon.*

Under the Companies Act, 2013

Section 2(30)

*"**Debenture**" includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.*

Provided that–

(a) the instruments referred to in Chapter III-D of the Reserve Bank of India Act, 1934; and

(b) such other instrument, as may be prescribed by the Central Government in consultation with the Reserve Bank of India, issued by a company,

shall not be treated as debenture;

From the above discussion, it can be said that debentures / debt securities are defined under various statues.

Concepts – Bonds & Debentures

Bonds and Debentures both are debt instrument issued by the government or companies. Both of these are fund raising tools for the issuer / forms of borrowed capital for companies.

Debentures, in comparison to other forms of bonds, serve a more specific purpose. While both are used to raise funds, debentures are frequently used to fund the costs of an upcoming project or to pay for a planned corporate expansion. These debt securities are a common form of long-term funding for companies.

A debenture is a marketable security that businesses can issue to obtain long-term financing without needing to dilute their equity. In corporate finance, a debenture is a medium- to long-term debt instrument used by large companies to borrow money, at a fixed rate of interest. The legal term "debenture" originally referred to a document that either creates a debt or acknowledges it, but in some countries the term is now used interchangeably with bond, loan stock or note. A debenture is thus like a certificate of loan or a loan bond evidencing the company's liability to pay a specified amount with interest. Although the money raised by the debentures becomes a part of the company's

capital structure, it does not become share capital. Senior debentures get paid before subordinate debentures, and there are varying rates of risk and payoff for these categories.

Debentures are freely transferable by the debenture holder. Debenture holders have no rights to vote in the company's general meetings of shareholders, but they may have separate meetings or votes e.g. on changes to the rights attached to the debentures. The interest paid to them is a charge against profit in the company's financial statements.

Another term used in companies in the same perspective is 'Bond'. Bond is also an instrument of acknowledgement of debt. Traditionally, the Government issued bonds, but these days, bonds are also being issued by semi-government and non-governmental organisations. In simple words it can be illustrated as, Bonds are debt financial instruments issued by large corporations, financial institutions and government agencies that are backed up by collaterals or physical assets.

The terms 'debentures' and 'Bonds' are many times used inter-changeably. The holder of bonds is called as lender, while the issuer of bonds is called as the borrower. There are various types of bonds and debentures, and an investor can invest their money depending on the preferences and risk-taking ability. Below are the points distinguishing between the two:

Difference between Bonds and Debentures

Basis of Difference	*Debentures*	*Bonds*
Nature	Debentures are debt financial instruments issued by private / public companies, for raising capital from the investors.	Bonds are debt financial instruments issued by large corporations, financial institutions and government agencies for raising additional fund from the public.
Security	Debentures can be secured as well as unsecured.	Bonds are secured in nature.
Owner	The owner of a debenture is called a debenture holder.	The owner of a bond is called a bondholder.
Collateral	Debentures do not get secured by the collateral or physical assets of the issuing company. Lenders purchase these instruments solely based on the reputation of the issuing company.	Bonds get secured by the collateral or physical assets of the issuing company.
Tenure	Debentures are generally short to medium term investments and their tenure is usually lower than bonds.	Bonds are long term investments and their tenure is generally higher than debentures.
Convertibility	Issuing company can convert only convertible and also partially convertible debentures into shares on the expiry as specified in the clause.	Bonds cannot be converted into equity shares of the company.
Rate of Interest	The debentures carry a fixed or floating interest rate that is generally higher than bonds because they are less stable in terms of repayment, and they are also not backed by collateral.	The bonds carry a fixed or floating interest rate that is generally lower than debentures because they are more stable in terms of repayment, and they get backed by collateral of the issuing company.
Liquidation	During liquidation, the debenture holders are paid after the bondholders.	During company liquidation, Bondholders are given priority over the debenture holders.

Payment Structure	The payment of interest for debentures is done on a periodical basis and depends on the company's performance.	The payment of interest for bonds is on an accrual basis. The issuing company pays this amount on a monthly, half-yearly or yearly basis and this payment is not dependent on the performance of a company.

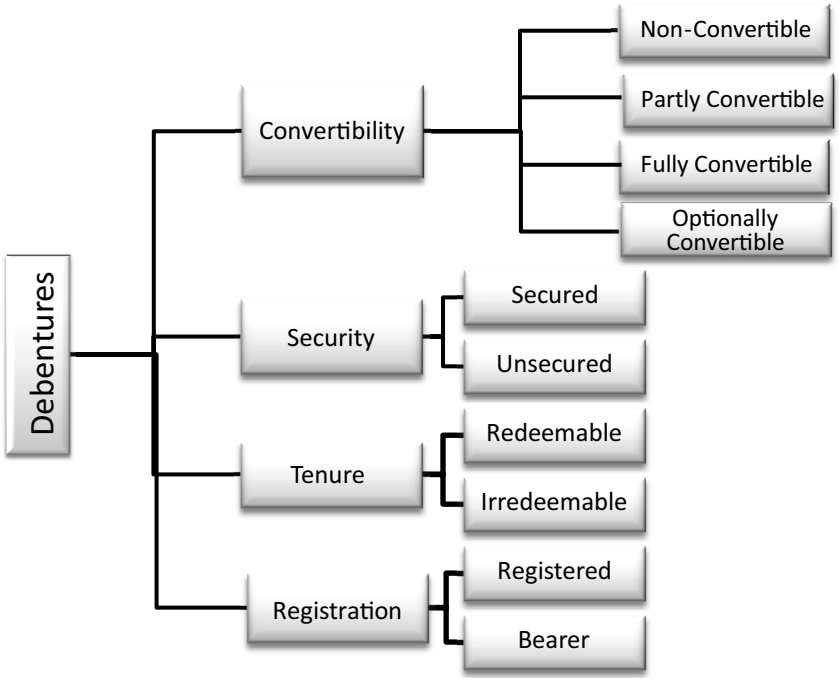
Nature of Debentures

As per Section 44 of the Companies Act, 2013, the debentures or other interest of any member in a company shall be movable property transferable in the manner provided by the Articles of Association of the company.

As per the provisions of Section 56, securities will be transferable vide Form SH-4. Transferability is governed by the provisions of the Articles of Associations.

Kinds of Debentures

Debentures are generally classified into different categories:



On the basis of Convertibility

(a) *Non-Convertible Debentures (NCD):* These instruments retain the debt character for the whole of the tenure and cannot be converted into equity shares or any other form of security.

(b) *Partly Convertible Debentures (PCD):* Partly convertible debentures, as the name suggests, a certain portion of these debentures are partially converted into equity shares upon exhaustion of the specified duration. These instruments allow holders to convert only a portion of their investment into equity shares at the end of the pre-determined period. The holders has the option to redeem the remaining amount of the debenture on maturity. Additionally, at the time of issuance, the Company chooses the conversion ratio for these debentures. Moreover, the holders of these debentures become shareholders in the Company to the extent of their holdings after being partially converted into equity.

(c) *Fully convertible Debentures (FCD):* These are fully convertible into Equity shares or any other form of security at the issuer's notice. The ratio of conversion is decided by the issuer. Upon conversion the investors enjoy the same status as shareholders of the company.

(d) *Optionally Convertible Debentures (OCD):* The investor has the option to either convert these debentures into shares at price decided by the issuer/agreed upon at the time of issue.

On the basis of Security

(a) *Secured Debentures*: Debentures that are issued against a security are called secured debentures. In other words, a charge is made against the assets of the issuing company. So, if the issuer fails on payment of the principal or interest amount, his assets can be sold to repay the liability to the investors. Section 71(3) of the Companies Act, 2013 provides that secured debentures may be issued by a company subject to such terms and conditions as may be prescribed by the Central Government through rules.

(b) *Unsecured Debentures*: Debentures which are issued without any charge against the issuing company's assets are called unsecured debentures. These instruments are unsecured in the sense that if the issuer defaults on payment of the interest or principal amount, the investor has to be along with other unsecured creditors of the company, are also said to be naked debentures. Unlike secured debentures, unsecured debentures are issued by the Company without creation of charge over the assets of the Company. In case a Company is unable to pay the principal or interest on due date, these debentures do not offer any protection to the debenture holders.

On the basis of Tenure

(a) *Redeemable Debentures*: Redeemable debentures clearly spell out the exact terms and date by which the issuer of the bond must repay their debt in full. It refers to the debentures which are issued with a condition that the debentures will be redeemed at a fixed date or upon demand, or after notice etc.

(b) *Irredeemable Debentures*: An irredeemable debenture is a type of debenture in which there is not fixed time for the issuer to repay the amount. The debenture holder cannot demand payment as long as the company is a going concern and does not make default in making payment of the interest. But all debentures, whether redeemable or irredeemable become payable on the company going into liquidation. Irredeemable (non-redeemable) debentures, on the other hand, do not hold the issuer liable to repay in full by a certain date. Because of this, irredeemable debentures are also known as perpetual debentures. However, after the commencement of the Companies Act, 2013, now a company cannot issue perpetual or irredeemable debentures.

On the basis of Registration

(a) *Registered Debentures*: Registered debentures are made out in the name of a particular person, whose name appears on the debenture certificate and who is registered by the company as holder on the Register of debenture holders. Such debentures are transferable in the same manner as shares by means of a proper instrument of transfer duly stamped and executed and satisfying the other requirements specified in Section 56 of the Companies Act, 2013.

(b) *Bearer debentures*: Bearer debentures on the other hand, are made out to bearer, and are negotiable instruments, and so transferable by mere delivery like share warrants. The person to whom a bearer debenture is transferred become a "holder in due course" and unless contrary is shown, is entitled to receive and recover the principal and the interest accrued thereon. [*Calcutta Safe Deposit Co. Ltd. v. Ranjit Mathuradas Sampat (1971) 41 Com Cases 1063]*

Pari Passu Clause in case of Debentures

Debentures are usually issued in a series with a *pari passu* clause and it follows that they would be on an equal footing as to security and should the security be enforced, the amount realised shall be divided pro-rata, i.e., they are to be discharged rateably. In the event of deficiency of assets, they will abate proportionately. The expression *'pari passu'* implies with equal step, equally treated, at the same rate, or at par with. When it is said that existing debentures shall be issued at *pari passu* clause, it implies that no difference will be made between the old and new debentures.

If the words *pari passu* are not used, the debentures will be payable according to the date of issue, and if they are all issued on the same day, they will be payable accordingly to their numerical order. However, a company cannot issue a new series of debentures so as to rank *pari passu* with prior series, unless the power to do so is expressly reserved and contained in the debentures of the previous series.

Debenture Stock

A company, instead of issuing debentures, each in respect of separate and distinct debt, may raise one aggregate loan fund or composite stock known as 'debenture stock'. Accordingly, a debenture stock is a borrowed capital consolidated into one mass for the sake of convenience. Instead of each lender having a separate bond or mortgage, he has a certificate entitling him to a certain sum being a portion of one large loan. It is generally secured by a trust deed. As in the case of shares, a person may subscribe for, or transfer any amount even a fraction amount. Debenture stock is the indebtedness itself, and the debenture stock certificate furnishes evidence of the title or interest of the holder in the indebtedness. Debenture is the document which furnishes evidence of the debt. Debenture stock must be fully paid, while debenture may or may not be fully paid.

ISSUE AND REDEMPTION OF DEBT SECURITIES

- Section 71(1) of the Act states that a company may issue debentures with an option to convert such debentures into shares, either wholly or partly at the time of redemption. Further, the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.
- No company shall issue any debentures carrying any voting rights [Section 71(2)].
- Section 71(3) read with Rule 18(1) of Companies (Share Capital and Debentures) Rules, 2014 provides that the secured debentures may be issued only when the following conditions are compiled with: -
  - *Redemption Clause* - The date of redemption of Secured Debentures shall not exceed ten years from the date of issue.

    The following classes of Companies may issue secured debentures for a period exceeding 10 years but not exceeding 30 years,

    (i) Companies engaged in setting up of infrastructure projects;

    (ii) Infrastructure Finance Companies as defined in clause (viia) of sub direction (1) of direction 2 of Non-Banking Financial (Non-deposit accepting or holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

    (iii) Infrastructure Debt Fund Non-Banking Financial Companies' as defined in clause (b) of direction 3 of Infrastructure Debt Fund Non-Banking Financial Companies (Reserve Bank) Directions, 2011;

    (iv) Companies permitted by a Ministry or Department of the Central Government or by Reserve Bank of India or by the National Housing Bank or by any other statutory authority to issue debentures for a period exceeding ten years.

  - *Appointment of Debenture Trustee & execution of Debenture Trust deed* - The company shall appoint the debenture trustee before the issue of prospectus or letter of offer for subscription of its

debentures and not later than 60 days after the allotment of the debentures, execute a debenture trust deed to protect the interest thereon.

- *Creation of security* - In terms of Rule 18(1)(b) of Companies (Share Capital and Debentures) Rules, 2014, an issue of secured debentures shall be secured by the creation of a charge on the properties or assets of the company or its subsidiaries or its holding company or its associates companies, having a value which is sufficient for the due repayment of the amount of debentures and interest thereon.

In terms of Rule 18(1)(d) of Companies (Share Capital and Debentures) Rules, 2014, the security for the debentures by way of charge or mortgage shall be created in favour of the debenture trustee on:

i. any specific movable property of the company or its holding company or subsidiaries or associate companies or otherwise;

ii. any specific immovable property wherever situated, or any interest therein.

In case of a non-banking financial company, the charge or mortgage as aforesaid may be created on any movable property.

In case of any issue of debentures by a Government company which is fully secured by the guarantee given by the Central Government or one or more State Government or by both, the requirement for creation of charge under this sub-rule shall not apply.

In case of any loan taken by a subsidiary company from any bank or financial institution, the charge or mortgage may also be created on the properties or assets of the holding company.

The term "Creation of Security" means mortgaging the property in favour of Debenture Trustee for the benefit of debenture holders. This is an incidence of ownership of property and creation of security has to be done by the owner of the property. However, the debenture holders are beneficiaries and they have no access to mortgaged property. The debenture trustee holds the secured property on behalf of issuer of security and for benefit of debenture holders. In the event of default by the issuer of security, the Debenture Trustee will have the power and authority to bring the secured property to sale following the procedure in the Transfer of Property Act and the proceeds of sale will have to be applied to redeem the debentures.

To sum-up: Issue of Debentures

Sl. No.	*Particulars*	*Time Frame*
1.	Obtain a valuation report from the registered valuer with respect to the Convertible Debentures to be issued. In case of Non-Convertible Debenture, there is no dilution of share-holding in the share capital of the company, valuation of securities and justification of price are not applicable.	-
2.	Hold a meeting of Board: (i) To consider and approve issue of Debentures including the terms and conditions of issue (ii) To identify the group of persons to whom debentures are proposed to be offered (iii) To approve the offer letter (iv) To fix day, date and time and agenda for General Meeting for passing Special Resolution (v) To approve draft notice of General Meeting.	-

Sl. No.	*Particulars*	*Time Frame*
3.	In case of a Public Company, a copy of Board Resolution for issue of debentures with ROC is required to be filed by the company.	File E-Form MGT-14 within 30 days of passing of Board Resolution
4.	Convene and hold Extra-Ordinary General Meeting to consider and approve the following items: – (i) Increase in the Borrowing power of the Board of Directors by passing Special Resolution, in case it exceeds the limit, in terms of Section 180(1)(c) (ii) Issue of Debentures	File E-Form MGT-14 along with explanatory statement within 30 days of passing of Special Resolution.
5.	Open a separate Bank Account in a scheduled bank for keeping monies received on the application.	-
6.	Prepare the list of such persons to whom offer to subscribe debenture will be given in draft offer letter under Form PAS-4.	-
7	Offer letter shall be accompanied by an application form serially numbered and addressed specifically to the person to whom the offer is made.	-
8.	Dispatch of Letter of Offer to identified persons.	-
9.	Maintain a complete record of persons to whom offer letter is sent in Form PAS-5.	-
10.	Receiving of Application Money through cheque or demand draft or other banking channel and not by cash. Keep the record of the bank account from where such payments for subscriptions have been received.	-
11.	Convene Board meeting within a period of 60 days from the date of receipt of subscription money: a. to consider the allotment of Debentures . b. Approval of draft agreement for Charge creation & authorizing the director for signing the same, if applicable. c. Approval of the draft of Debenture Trust Deed [SH–12], if applicable. d. Issue of Debentures Certificate and authorize two directors and a person to sign the same.	Filing of Form CHG-9 within 30 days from the date of creation of charge in case of Secured Debenture. Filing Return of Allotment in Form PAS-3 within 15 days of allotment.
12.	Make necessary entries in the Register of Debenture holders in Form MGT-2. Make necessary entries in the Register of Charges in Form CHG-7; if applicable.	within 7 days of the Board Meeting in which allotment of debentures was approved forthwith after the registration of creation of charge.
13.	Issue of Debenture Certificate.	Within 6 months from date of allotment of debentures.
14.	Stamp Duty settlement as per provisions & rates of Stamp Act.	-

To sum-up: Redemption of Debenture

- Conduct Board Meeting for the redemption of debentures
- Intimate the debenture holders about the redemption
- Coordinate with banks for refund
- Changes in debenture register
- Changes in charge register, if any charge created on debentures
- Further in case of Compulsory/Optionally Convertible Debentures, if at the time of issue the shareholders approval was not taking for the conversion part, then the approval of shareholders is necessary while such conversion. Also if the debentures are redeemed out of the profits of the company, the shareholders approval is required to be taken
- The redemption of secured debentures not to exceed 10 years from issue date.

Note : Board resolution under clause (c) of subsection (3) of section 179 would be adequate, in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation does not exceed the limit as specified in clause (c) of Section 180(1).

Further, in case of offer or invitation for non-convertible debentures, where the proposed amount to be raised through such offer or invitation exceeds the limit as specified in clause (c) of sub-section (1) of section 180, it shall be sufficient if the company passes a previous special resolution only once in a year for all the offers or invitations for such debentures during the year.

CONVERSION OF DEBENTURES INTO SHARES

Section 71(1) of the Act states that the issue of debentures with an option to convert such debentures into shares, wholly or partly, shall be approved by a special resolution passed at a general meeting.

As per section 71 (1) of the Companies Act 2013, a company has the power to issue debentures with an option of Conversion of Debentures into Shares wholly or partly. However, the same shall be approved by a special resolution passed at a general meeting. There being no prescribed rule under the Companies Act 2013 governing the procedure for the same, hence the provisions of section 42 and 62 of the Companies Act 2013 read with applicable rules governing the provisions for issue of shares / security must be taken into consideration.

DEBENTURE REDEMPTION RESERVE (DRR)

Meaning of DRR:

Debenture Redemption Reserve (DRR) is a fund maintained by companies who have issued debentures. Its purpose is to minimize the risk of default on repayment of debentures. The DRR ensures availability of funds for meeting obligations towards debenture holders on maturity. The DRR involves two components. The first component is setting aside a portion of the profit. The allocation of profit is done in a process known as 'earmarking of funds'. It ensures that adequate profits are available for repaying the debentures. The second component involves an investment of funds. It ensures that the company has enough liquidity to make the repayment.

Purpose and Uniqueness:

Companies which have borrowed money through debentures may at the time of maturity not have the funds to make a repayment. To minimize the chances of default, the Government introduced the concept of a Debenture

Redemption Reserve. The primary reasons for default on maturity are a lack of profitability and a lack of liquidity. To address both these concerns, the concept of a DRR provides for two requirements:

- Annually, a portion of the profit is 'earmarked' for transfer to the DRR. Such earmarked amount cannot be used until repayment of the debentures is made. The effect of this strategy is that the dividend available to shareholders is reduced. When dividends are lowered, enough funds are retained in the company to enable a future settlement to debenture-holders. Thus, the chance that the company may make a default due to profitability related issues is minimized.
- Every year, investments are purchased for an amount equal to the transfer made to the DRR. Only securities approved by the government can be purchased for investments. The investments cannot be sold for any purpose other than meeting the liability toward the debenture holders. The effect of this strategy is that a part of the company's assets is reserved for repaying the debenture liability. Thus, the chance that the company may make a default due to profitability related issues is minimized.

Creation of Debenture Redemption Reserve under Companies Act, 2013 and its Adequacy

Section 71(4) of the Companies Act 2013 states that where debentures are issued by a company, the company shall create a debenture redemption reserve account out of the profits of the company available for payment of dividend and the amount credited to such account shall not be utilized by the company except for the redemption of debentures.

Rule 18(7) of the Companies (Share Capital and Debenture) Rules, 2014 states that the company shall comply with the requirements with regard to Debenture Redemption Reserve (DRR) and investment or deposit of sum in respect of debentures maturing during the year ending on the 31st day of March of next year, in accordance with the conditions given under said Rule.

Rule 18(7)(a) of the Companies (Share Capital and Debenture) Rules, 2014 states that Debenture Redemption Reserve shall be created out of profits of the company available for payment of dividend.

Rule 18(7)(b) of the Companies (Share Capital and Debenture) Rules, 2014 states that the limits with respect to adequacy of Debenture Redemption Reserve and investment or deposits, as the case may be, shall be as under:

S. No.	***Classes of Company***	***Condition***
1	All India Financial Institutions (AIFIs) regulated by Reserve Bank of India and Banking Companies	No DRR for debentures issued by for both public as well as privately placed debentures
2	Financial Institutions (FIs) within the meaning of clause (72) of section 2 of the Companies Act, 2013	DRR shall be as applicable to NBFCs registered with RBI
3	For NBFCs registered with the RBI under Section 45-IA of the RBI Act, 1934 and Housing finance companies registered with the National Housing Bank:	
3A	Listed NBFCs and Housing Finance Companies	No DRR required for debentures issued for both public as well as privately placed debentures
3B	Unlisted NBFCs and Housing Finance Companies	No DRR is required in case of privately placed Debentures

4A	Listed Companies	No DRR required for debentures issued for both public as well as privately placed debentures
4B	Unlisted companies	Adequacy of DRR shall be 10% of the value of outstanding debentures.

Investments / Deposits from DRR

In case of public issue of debentures by Listed Companies including NBFCs registered with Reserve Bank of India under section 45- IA of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank and / or issue of debentures by unlisted companies, (other than All India Financial Institutions and Banking Companies and NBFCs registered with Reserve Bank of India under section 45- IA of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank), such Companies shall on or before the 30th day of April in each year, in respect of debentures issued by such a company, invest or deposit, as the case may be, a sum which shall not be less than fifteen percent., of the amount of its debentures maturing during the year, ending on the 31st day of March of the next year.

It may be noted that the amount remaining invested or deposited, as the case may be, shall not any time fall below fifteen percent of the amount of the debentures maturing during the year ending on 31st day of March of that year. The company may choose any of the below given methods:-

Methods of investments/ Deposits:

(A) in deposits with any scheduled bank, free;

(B) in unencumbered securities of the Central methods of deposits or from any charge or lien; Government or any State Government;

(C) in unencumbered securities mentioned in sub-clause (a) to (d)and (ee) of section 20 of the Indian Trusts Act, 1882;

(D) in unencumbered bonds issued by any other company which is notified under sub-clause (f) of section 20 of the Indian Trusts Act, 1882.

Creation of Debenture Redemption Reserve in case of partly convertible debentures:

Debenture Redemption Reserve shall be created in respect of non-convertible portion of debenture issue in accordance with said rule.

Utilization :

The amount invested or deposited as above shall not be used for any purpose other than for redemption of debentures maturing during the year referred above.

The amount credited to Debenture Redemption Reserve shall not be utilized by the company except for the purpose of redemption of debentures.

Disclosure in Directors Report:

The amount which is transferred as Debenture Redemption Reserve is to be disclosed in Directors' Report.

CASE LAWS

(1) The Regional Director has filed an affidavit on behalf of the central government in which two observations have been made. The first observation of the Regional Director is that at the meeting of the shareholders of the petitioner company, nine shareholders together holding 527 equity shares voted against the scheme. The second observation of the Regional Director is that in terms of section 117C(1) of the Companies Act, 1956 where a company issues debentures, it has to create a debenture redemption reserve for redemption of such debentures to which adequate amount has to be credited from out of its profits every year until such debentures are redeemed. *[Britannia Industries ltd vs. Unknown(2010)]*

(2) The apex court has considered as to whether the debenture redemption reserve is a reserve within the meaning of the Companies Act. The Supreme Court has held in the said case that any amount set apart in the accounts of the company to redeem the debentures must be treated as monies set apart to meet a known liability. The debentures will have to be shown in the company's balance sheet of the year as liability.

Merely because the debentures are not redeemable during the accounting period, the liability of redeemed debenture does not cease to exist. The Supreme Court further held that the debenture redemption Reserve must be regarded as a provision made by the assessee-company to enable it to redeem the said debentures when they become due for redemption. The Supreme Court further stated that the amounts set apart for redemption of debentures are not in the nature of charge against profit but are merely appropriation of profits. The said debenture redemption reserve account cannot be held to be a reserve on that ground itself. [*Rayon Corpn. Ltd. (supra)]*

(3) The mere fact that a Debenture Redemption Reserve is labeled as a reserve will not render it as a reserve in the true sense or meaning of that concept. An amount which is retained by way of providing for a known liability is not a reserve. Consequently, the Tribunal was correct in holding that the amount which was set apart as a Debenture Redemption Reserve is not a reserve within the meaning of Explanation (b) to Section 115JA of the Income Tax Act, 1961. *[Alembic Limited, Baroda vs. Dy.Cit.,Circle-1(1)(2016)]*

DEBENTURE TRUSTEES & DEBENTURE TRUST DEED

No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding five hundred for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees. The names of the debenture trustees shall be stated in letter of offer inviting subscription for debentures and also in all the subsequent notices or other communications sent to the debenture holders;

Appointment of Debenture Trustee:

The Company shall before the appointment of debenture trustee or trustees obtain a written consent from such debenture trustee or trustees proposed to be appointed and a statement to that effect shall appear in the letter of offer issued for inviting the subscription of the debentures;

The conditions governing the appointment of debenture trustee or trustees is prescribed under Rule 18(2)(c) the Companies (Share Capital and Debenture) Rules, 2014.

A person shall not be appointed as a debenture trustee, if he-

(i) beneficially holds shares in the company;

(ii) is a promoter, director or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;

(iii) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;

(iv) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(v) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;

(vi) has any pecuniary relationship with the company amounting to two per cent. or more of its gross turnover or total income or fifty lakh rupees or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;

(vii) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel.

Casual Vacancy and Removal:

In terms of Rule 18(2)(d) of the Companies (Share Capital and Debenture) Rules, 2014, the Board may fill any casual vacancy in the office of the trustee but while any such vacancy continues, the remaining trustee or trustees, if any, may act: Provided that where such vacancy is caused by the resignation of the debenture trustee, the vacancy shall only be filled with the written consent of the majority of the debenture holders.

In terms of Rules 18(2)(e) of the Companies (Share Capital and Debentures) Rules, 2014, any debenture trustee may be removed from office before the expiry of his term only if it is approved by the holders of not less than three fourth in value of the debentures outstanding, at their meeting.

Duties of Debenture Trustee

The duties of debenture trustee or trustees prescribed under Rule 18(3) of the Companies (Share Capital and Debenture) Rules, 2014 is as follows:

(a) To satisfy himself that the letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed;

(b) To satisfy himself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;

(c) To call for periodical status or performance reports from the company;

(d) To communicate promptly to the debenture holders defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee therefor;

(e) To appoint a nominee director on the Board of the company in the event of-

  (i) two consecutive defaults in payment of interest to the debenture holders; or

  (ii) default in creation of security for debentures; or

  (iii) default in redemption of debentures.

(f) To ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed and take such reasonable steps as may be necessary to remedy any such breach;

(g) To inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;

(h) To ensure the implementation of the conditions regarding creation of security for the debentures, if any, and debenture redemption reserve;

(i) To ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;

(j) To do such acts as are necessary in the event the security becomes enforceable;

(k) To call for reports on the utilization of funds raised by the issue of debentures;

(l) To take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;

(m) To ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;

(n) To perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders.

Meetings of Debenture holders

In terms of Rule 18(4) of the Companies (Share Capital and Debenture) Rules, 2014, the meeting of all the debenture holders shall be convened by the debenture trustee on-

(a) requisition in writing signed by debenture holders holding at least one-tenth in value of the debentures for the time being outstanding;

(b) the happening of any event, which constitutes a breach, default or which in the opinion of the debenture trustees affects the interest of the debenture holders.

DEBENTURE TRUSTEE DEED

A debenture trust deed is an instrument that a company executes in favour of a debenture trustee, thereby appointing them and defining their role and duties to protect the interest of debenture holders before debentures are offered for public subscription.

No company shall issue a prospectus or make an offer or invitation to the public or to its members exceeding 500 for the subscription of its debentures, unless the company has, before such issue or offer, appointed one or more debenture trustees and the conditions governing the appointment of such trustees shall be such as may be prescribed under the rule.

The company shall not later than sixty days after the allotment of the debentures, execute a debenture trust deed to protect the interest thereon.

A debenture trust deed shall be in ***Form No. SH.12*** or as near thereto as possible and shall be executed by the company issuing debentures in favour of the debenture trustees within three months of closure of the issue or offer.

Section 71 (8) of the Companies Act 2013 puts an obligation on the company to pay interest and redeem the debentures in accordance with the terms and conditions of their issue.

Trust Deed in Form SH-12 contains the following:

- Description of Debenture issue
- Details of charge created
- Particulars of the appointment of Debenture Trustee
- Events of defaults
- Obligations of the company
- Miscellaneous

Conflicting Provisions in the Trust Deed:

Section 71(7) of the Companies Act, 2013 states that any provision contained in a trust deed for securing the issue of debentures, or in any contract with the debenture-holders secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from, or indemnifying him against, any liability for breach of trust, where he fails to show the degree of care and due diligence required of him as a trustee, having regard to the provisions of the trust deed conferring on him any power, authority or discretion.

Liability of the debenture trustee:

The liability of the debenture trustee shall be subject to such exemptions as may be agreed upon by a majority of debenture-holders holding not less than three-fourths in value of the total debentures at a meeting held for the purpose.

Rights to inspect Trust Deed:

In terms of Rule 18(8) of the Companies (Share Capital and Debenture) Rules, 2014, a trust deed for securing any issue of debentures shall be open for inspection to any member or debenture holder of the company, in the same manner, to the same extent and on the payment of the same fees, as if it were the register of members of the company. A copy of the trust deed shall be forwarded to any member or debenture holder of the company, at his request, within 7 days of the making thereof, on payment of fee.

Power of debenture trustee to file petition before the Tribunal in event of insufficient assets:

In terms of Section 71(9) of the Companies Act 2013, where at any time the debenture trustee comes to a conclusion that the assets of the company are insufficient or are likely to become insufficient to discharge the principal amount as and when it becomes due, the debenture trustee may file a petition before the Tribunal and the Tribunal may, after hearing the company and any other person interested in the matter, by order, impose such restrictions on the incurring of any further liabilities by the company as the Tribunal may consider necessary in the interests of the debenture-holders.

Power of debenture holders to file petition before the Tribunal:

In terms of Section 71(10) of the Companies Act 2013, where a company fails to redeem the debentures on the date of their maturity or fails to pay interest on the debentures when it is due, the Tribunal may, on the application of any or all of the debenture-holders, or debenture trustee and, after hearing the parties concerned, direct, by order, the company to redeem the debentures forthwith on payment of principal and interest due thereon.

A contract with the company to take up and pay for any debentures of the company may be enforced by a decree for specific performance.

Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 not to apply under certain circumstances:

In terms of Rule 18(9),18(10) and 18(11) of the Companies (Share Capital and Debentures) Rules, 2014, nothing contained above shall apply ;

- To any amount received by a company against issue of commercial paper or any other similar instrument issued in accordance with the guidelines or regulations or notification issued by the Reserve Bank of India.
- In case of any offer of foreign currency convertible bonds or foreign curency bonds issued in accordance with the Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 or regulations or directions issued by the Reserve Bank of India, the provisions of this rule shall not apply unless otherwise provided in such Scheme or regulations or directions.
- To rupee denominated bonds issued exclusively to overseas investors in terms of A.P. (DIR Series) Circular No. 17 dated September 29, 2015 of the Reserve Bank of India."

CASE LAWS

The following kinds of documents have been held to be treated as debentures:

a) A series of income-bonds by which a loan to the company was repayable only out of its profits [*Lemon vs. Austin Friars Investment Trust Ltd. 1926 Ch 1 (CA)].*

b) A receipt or a certificate for a deposit made with a company (other than a bank) when the deposit was repayable after affixed period after it was made, [*United Dominions Trust Ltd. vs .Kirkwood,(1966)2QB43].*

c) The definition of debenture is so wide as to include any security of a company whether constituting a charge on the company's assets or not *[Cf. Pearl Assurance Co. Ltd. v. West Midlands Gas Board, (1950) 2 All ER 844 (ChD)].*

PART B

OVERVIEW OF COMPANY DEPOSITS

Funds can be raised by the Company by issuing shares, debentures, or by taking loan or by inviting deposits from public. Companies have always been attracted towards financing through deposits and, at times, problems have arisen in the context of such deposits. In order to control the malpractices, the Companies Act, 2013 has introduced strict provisions under the deposit regime. Sections 73 to 76 of the Companies Act 2013 read with the Companies (Acceptance of Deposits) Rules, 2014 made under Chapter V of Companies Act, 2013 regulate the receipt of money not to be considered as deposit, invitation, acceptance and repayment of deposits by Companies. The Deposits Rules provide an exhaustive definition of deposits which is exclusionary in nature and exclude certain amounts received by a company, from the ambit of deposits.

Meaning of Deposits:-

Section 2(31) of the Companies Act, 2013 read with Rule 2(1)(c) of Companies (Acceptance of Deposits) Rules, 2014, 'deposit' includes any receipt of money by way of deposit or loan or in any other form by a company, but does not include the followings –

(i)	**any amount received from the Central Government or a State Government**, or any amount received from any other source whose repayment is guaranteed by the Central Government or a State Government or any amount received from a local authority, or any amount received from a statutory authority constituted under an Act of Parliament or a State Legislature;
(ii)	**any amount received from foreign Governments**, foreign or international banks, multilateral financial institutions (including, but not limited to, international Finance Corporation, Asian Development Bank, Commonwealth Development Corporation and International Bank for Industrial and Financial Reconstruction), foreign Governments owned development financial institutions, foreign export credit agencies, foreign collaborators, foreign bodies corporate and foreign citizens, foreign authorities or persons resident outside India subject to the provisions of Foreign Exchange Management Act, 1999 and rules and regulations made there under;
(iii)	**any amount received as a loan or facility from any banking company or from the State Bank of India or any of its subsidiary banks or from a banking institution** notified by the Central Government under section 51 of the Banking Regulation Act, 1949, or a corresponding new bank as defined in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or in clause (b) of section (2) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, or from a co-operative bank as defined in clause (b-ii) of section 2 of the Reserve Bank of India Act, 1934;

(iv)	**any amount received as a loan or financial assistance from Public Financial Institutions** notified by the Central Government in this behalf in consultation with the Reserve Bank of India or any regional financial institutions or Insurance Companies or Scheduled Banks as defined in the Reserve Bank of India Act, 1934;
(v)	**any amount received against issue of commercial paper** or any other instruments issued in accordance with the guidelines or notification issued by the Reserve Bank of India;
(vi)	**any amount received by a company from any other company**;
(vii)	**any amount received and held pursuant to an offer** made in accordance with the provisions of the Act towards subscription to any securities, including **share application money or advance towards allotment of securities pending allotment**, so long as such amount is appropriated only against the amount due on allotment of the securities applied for; (a) if the securities for which application money or advance for such securities was received cannot be allotted within 60 days from the date of receipt of the application money or advance for such securities and such application money or advance is not refunded to the subscribers within 15 days from the date of completion of 60 days, such amount shall be treated as a deposit under these rules. (b) any adjustment of the amount for any other purpose shall not be treated as refund.
(viii)	**any amount received** from a person who, at the time of the receipt of the amount, was a **director of the company or a relative of the director of the Private company**: Provided that the director of the company or relative of the director of the private company, as the case may be, from whom money is received, furnishes to the company at the time of giving the money, a declaration in writing to the effect that the amount is not being given out of funds acquired by him by borrowing or accepting loans or deposits from others and the company shall disclose the details of money so accepted in the Board's report;
(ix)	**any amount raised by the issue of bonds or debentures secured by a first charge or a charge ranking *pari passu*** with the first charge on any assets referred to in Schedule III of the Act excluding intangible assets of the company or bonds or debentures compulsorily convertible into shares of the company within Ten years. Provided that if such bonds or debentures are secured by the charge of any assets referred to in Schedule III of the Act, excluding intangible assets, the amount of such bonds or debentures shall not exceed the market value of such assets as assessed by a registered valuer;
(ixa)	**any amount raised by issue of non-convertible debenture** not constituting a charge on the assets of the company and listed on a recognised stock exchange as per applicable regulations made by Securities and Exchange Board of India;
(x)	**any amount received from an employee of the company** not exceeding his annual salary under a contract of employment with the company in the nature of non-interest bearing security deposit; **Test Yourself:** The salary of Mr. Rahul is Rs. 20 lacs per annum of the ABC Ltd.. The company has the requirement of fund of Rs. 50 lacs. However, Rs. 30 lacs is shortfalling for the working capital requirement. The remaining amount is agreed to be funded by Mr. Rahul. Please comment whether the fund will be treated as deposit or not.

(xi)	any **non-interest bearing amount received and held in trust**;
(xii)	**any amount received** in the course of, or **for the purposes of, the business** of the company,- (a) as an **advance for the supply of goods or provision of services** accounted for in any manner whatsoever provided that such advance is appropriated against supply of goods or provision of services within a period of three hundred and sixty five days from the date of acceptance of such advance, Provided that in case of any advance which is subject matter of any legal proceedings before any court of law, the said time limit of three hundred and sixty five days shall not apply; (b) as **advance**, accounted for in any manner whatsoever, received in connection with [**consideration for an immovable property**] under an agreement or arrangement, provided that such advance is adjusted [against such property] in accordance with the terms of agreement or arrangement; (c) as **security deposit** for the performance of the contract for supply of goods or provision of services; (d) as advance received under **long term projects** for supply of capital goods except those covered under item (b) above; (e) as an **advance towards consideration for providing future services** in the form of a warranty or maintenance contract as per written agreement or arrangement, if the period for providing such services does not exceed the period prevalent as per common business practice or five years, from the date of acceptance of such service whichever is less; (f) as an **advance received and as allowed by any sectoral regulator** or in accordance with directions of Central or State Government; (g) as an **advance for subscription towards publication**, whether in print or in electronic to be adjusted against receipt of such publications. If the amount received under (a) (b) and (d) above becomes refundable (with or without interest) because the company accepting the money does not have necessary permission or approval, wherever required, to deal in the goods or properties or services for which the money is taken, then the amount received shall be deemed to be a Deposit under these rules. *Explanation*: For the purpose of sub-clause the amount shall be deemed to be deposits on the expiry of 15 days from the date they become due for refund.
(xiii)	**any amount brought in by the promoters of the company by way of unsecured loan** in pursuance of the stipulation of any lending financial institution or a bank subject to fulfillment of the following conditions, namely:- (a) the loan is brought in pursuance of the stipulation imposed by the lending institutions on the promoters to contribute such finance; (b) the loan is provided by the promoters themselves or by their relatives or by both; and (c) the exemption under this sub-clause shall be available only till the loans of financial institution or bank are repaid and not thereafter.

(xiv)	**any amount accepted by a Nidhi company** in accordance with the rules made under section 406 of the Act. *Explanation.*- For the purposes of this clause, any amount.- (a) received by the company, whether in the form of instalments or otherwise, from a person with promise or offer to give returns, in cash or in kind, on completion of the period specified in the promise or offer, or earlier, accounted for in any manner whatsoever, or (b) any additional contributions, over and above the amount under item (a) above, made by the company as part of such promise or offer, shall be considered as deposits unless specifically excluded under this clause.
(xv)	**any amount received by way of subscription in respect of a chit** under the Chit Fund Act, 1982.
(xvi)	**any amount received by the company under any collective investment scheme** in compliance with regulations framed by the Securities and Exchange Board of India.
(xvii)	**an amount of twenty five lakh rupees or more received by a start-up company, by way of a convertible note** (convertible into equity shares or repayable within a period not exceeding ten years from the date of issue) in a single tranche, from a person.
(xviii)	**any amount received by a company from Alternate Investment Funds**, Domestic Venture Capital Funds, "Infrastructure Investment Trusts", "Real Estate Investment Trusts" and Mutual Funds registered with the Securities and Exchange Board of India in accordance with regulations made by it.

Meaning of depositor:-

In terms of Rule 2(1)(d) of the Companies (Acceptance of Deposits) Rules 2014 'Depositor' means –

(i) any member of the company who has made a deposit with the company in accordance with section 73(2) of the Act; or

(ii) any person who has made a deposit with a public company in accordance with section 76 of the Act.

Meaning of Eligible Company

'Eligible Company' means a public company as referred to in sub-section (1) of Section 76, having:

- a net worth of not less than one hundred crore rupees; or
- a turnover of not less than five hundred crore rupees; and
- which has obtained the prior consent of the company in general meeting by means of a special resolution and also filed the said resolution with the Registrar of Companies before making any invitation to the public for acceptance of deposits. However, an eligible company, which is accepting deposits within the limits specified under clause (c) of sub-section (1) of section 180, may accept deposits by means of an ordinary resolution.

Prohibition on Acceptance of Deposits from public

In terms of Section 73(1) of the Companies Act, 2013, on and after the commencement of this Act, no company shall invite, accept or renew deposits under the Companies Act, 2013 from the public except in a manner provided under Chapter V of the Act.

CASE LAW:

In Re Ind-Swift Ltd. Vs. Registrar of Companies (Punjab & Haryana), New Delhi NCLAT Company Appeal (AT) No.52 - 53 of 2018, it was held that, once in view of weak financial condition of the company, the CLB has given relief of huge extension of time as well as reduced interest rate while sanctioning scheme of repayment of deposit, no further extension of time could be allowed to company.

In Re Bimla Kothari Vs. Unitech Ltd. (2017) 136 CLA 74 (NCLT-New Delhi), it was held that there is no categorisation or difference between deposits accepted prior to or after the Companies Act, 2013

Companies exempted from Sec. 73 of the Companies Act 2013

The provisions under Sections 73 to 76 of the Companies Act 2013 and Rule 1 of the Companies (Acceptance of Deposits) Rules, 2014 shall apply to all companies except –

- A banking company;
- A non-banking financial company as defined in the Reserve Bank of India Act, 1934;
- A housing finance company registered with the National Housing Bank established under the National Housing Bank Act, 1987; and
- Such other company as the Central Government may, after consultation with the Reserve Bank of India, specify in this behalf. [Section 73(1) read with Rule 1(3)].

Terms and Conditions for Acceptance of Deposits from its Members - Section 73(2)

A company may, subject to the passing of a resolution in general meeting and subject to such rules as may be prescribed in consultation with the Reserve Bank of India, accept deposits from its members on such terms and conditions, including the provision of security, if any, or for the repayment of such deposits with interest, as may be agreed upon between the company and its members, subject to the fulfilment of the following conditions, namely:

a) Issuance of a circular to its members including therein a statement showing the financial position of the Company ,the credit rating obtained, the total number of depositors and the amount due towards deposits in respect of any previous deposits accepted by the Company and such other particulars in Form DPT 1 and in such manner prescribed under Rule 4 of the Companies (Acceptance of Deposits) Rules 2014;

b) Filing a copy of the circular along with such statement with the Registrar within 30 days before the date of issue of the circular;

c) Depositing on or before the 30th day of April each year, such sum which shall not be less than 20% of the amount of deposits maturing during the following financial year and kept in a scheduled bank in a separate bank account to be called deposit repayment reserve account;

d) Certifying that the company has not committed any default in the repayment of deposits accepted either before or after the commencement of this Act or payment of interest on such deposits and where

a default has occurred, the company made good the default and a period of five years had elapsed since the date of making good the default; and

e) Providing security, if any for the due repayment of the amount of deposit or the interest thereon including the creation of such charge on the property or assets of the company.

It is to be noted that where a company does not secure the deposits or secures such deposits partially, then, the deposits shall be termed as "unsecured deposits" and shall be quoted in every circular, form, advertisement or in any document related to invitation or acceptance of deposits.

In case of Specified IFSC Public Company - Clauses (a) to (e) of subsection (2) of section 73 Shall not apply to a Specified IFSC public company which accepts from its members, monies not exceeding one hundred per cent. of aggregate of the paid up share capital and free reserves, and such company shall file the details of monies so accepted to the Registrar in such manner as may be specified. - Notification Date 4th January, 2017.

As per Notification dated 13th June, 2017

Clause (a) to (e) of Sub-section 2 of Section 73 shall not apply to private Companies :

(A) which accepts from its members monies not exceeding one hundred per cent. of aggregate of the paid up share capital, free reserves and securities premium account; or

(B) which is a start-up, for five years from the date of its incorporation; or

(C) which fulfils all of the following conditions, namely:-

(a) which is not an associate or a subsidiary company of any other company;

(b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and

(c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section:

Provided that the company referred to in clauses (A), (B) or (C) shall file the details of monies accepted to the Registrar in such manner as may be specified."

Acceptance of deposits based on time period - Rule 3 of the Companies (Acceptance of Deposits) Rules 2014

No company referred to in section 73 (2) and no eligible company shall accept or renew any deposit, whether secured or unsecured, which is repayable on demand or upon receiving a notice within a period of less than six months or more than thirty-six months from the date of acceptance or renewal of such deposit.

However, a company may, for the purpose of meeting any of its short-term requirements of funds, accept or renew such deposits for repayment earlier than six months from the date of deposit or renewal, as the case may be, subject to the condition that-

(a) such deposits shall not exceed ten per cent. of the aggregate of the Paid-up share capital, free Reserves and securities premium account of the company, and

(b) such deposits are repayable not earlier than three months from the date of such deposits or renewal thereof.

Can deposits be accepted in joint names?

Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any of the clauses, namely, "Jointly", "Either or Survivor", "First named or Survivor", "Anyone or Survivor".

Acceptance Limits for Deposits

- No company u/s section 73(2) shall accept or renew any deposit from its members, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal of such deposits exceeds thirty five per cent of the aggregate of the Paid-up share capital, free Reserves and securities premium account of the company.
- No eligible company shall accept or renew any deposit from its members, if the amount of such deposit together with the amount of deposits outstanding as on the date of acceptance or renewal of such deposits from members exceeds ten per cent. of the aggregate of the Paid-up share capital, free Reserves and securities premium account of the company.
- No eligible company shall accept or renew any other deposit, if the amount of such deposit together with the amount of such other deposits, other than the deposit referred above, outstanding on the date of acceptance or renewal exceeds twenty-five per cent. of aggregate of the Paid-up share capital, free Reserves and securities premium account of the company.
- No Government company eligible to accept deposits under section 76 shall accept or renew any deposit, if the amount of such deposits together with the amount of other deposits outstanding as on the date of acceptance or renewal exceeds thirty five per cent. of the aggregate of its Paid-up share capital, free Reserves and securities premium account of the company.

The Quantum of deposits in nutshell:

Type of company	*Members*	*Public*
Eligible Company	Upto 10% of aggregate of the paid up share capital, free reserves and securities premium account	Upto 25% of aggregate of the paid up share capital, free reserves and securities premium account
Company referred in section 73(2) i.e. Non-eligible Companies	Upto 35% of aggregate of the paid up share capital, free reserves and securities premium account	Prohibited
Government Company (eligible under section 76)	–	Upto 35% of aggregate of the paid up share capital, free reserves and securities premium account

Exemptions to Specified IFSC Public company and Private Company

A Specified IFSC Public company and a private company may accept from its members monies not exceeding one hundred per cent. of aggregate of the paid up share capital, free reserves and securities premium account and such company shall file the details of monies so accepted to the Registrar in Form DPT-3.

Explanation.- A Specified IFSC Public company means an unlisted public company which is licensed to operate by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act 2005 (28 of 2005) read with the Special Economic Zones Rules, 2006:

The maximum limit in respect of deposits to be accepted from members shall not apply to following classes of private companies, namely:-

(i) a private company which is a start-up, for ten years from the date of its incorporation;

(ii) a private company which fulfils all of the following conditions, namely:-

(a) which is not an associate or a subsidiary company of any other company;

(b) the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is less ; and

(c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under section 73:

Provided also that all the companies accepting deposits shall file the details of monies so accepted to the Registrar in Form DPT-3.

Rate of interest of deposits/payment of brokerage –Rule 3(6)

No company referred to in sub-section (2) of section 73 or any eligible company shall invite or accept or renew any deposit in any form, carrying a rate of interest or pay brokerage thereon at a rate exceeding the maximum rate of interest or brokerage prescribed by the Reserve Bank of India for acceptance of deposits by non-banking financial companies.

It is explained that the person who is authorised, in writing, by a company to solicit deposits on its behalf and through whom deposits are actually procured shall only be entitled to the brokerage and payment of brokerage to any other person for procuring deposits shall be deemed to be in violation of these Rules.

Rights to alter terms & conditions-Rule 3(7)

The company shall not reserve to itself either directly or indirectly a right to alter, to the prejudice or disadvantage of the depositor, any of the terms and conditions of the deposit, deposit trust deed and deposit insurance contract after circular or circular in the form of advertisement is issued and deposits are accepted.

Credit Rating-Rule 3(8)

(a) Every eligible company shall obtain, at least once in a year, credit rating for deposits accepted by it and a copy of the rating shall be sent to the Registrar of Companies alongwith the return of deposits in Form DPT-3.

(b) The credit rating referred to in clause (a) shall not be below the minimum investment grade rating or other specified credit rating for fixed deposits, from any one of the approved credit rating agencies as specified for Non-Banking Financial Companies in the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998, issued by the Reserve Bank of India, as amended from time to time.

Form and Particulars of Advertisements or Circulars – Rule 4

(1) Every company referred to in section 73(2) intending to invite deposit from its members shall issue a circular to all its members by registered post with acknowledgement due or speed post or by electronic mode in Form DPT-1.

Provided that in addition to issue of such circular to all members in the manner specified above, the circular may be published in English language in an English newspaper and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated.

Further a certificate of the statutory auditor of the company shall be attached in Form DPT-1, stating that the company has not committed default in the repayment of deposits or in the payment of interest on such deposits accepted either before or after the commencement of the Act and in case a company had committed a default in the repayment of deposits accepted either before or after the commencement of the Act or in the payment of interest on such deposits, a certificate of the statutory auditor of the company shall be attached in Form DPT-1, stating that the company had made good the default and a period of five years has lapsed since the date of making good the default as the case may be.

(2) Every eligible company intending to invite deposits shall issue a circular in the form of an advertisement in Form DPT-1 for the purpose in English language in an English newspaper having country wide circulation and in vernacular language in a vernacular newspaper having wide circulation in the State in which the registered office of the company is situated, and shall also place such circular on the website of the company, if any."

(3) Every company inviting deposits from the public shall upload a copy of the circular on its website, if any.

(4) No company shall issue or allow any other person to issue or cause to be issued on its behalf, any circular or a circular in the form of advertisement inviting deposits, unless such circular or circular in the form of advertisement is issued on the authority and in the name of the Board of directors of the company.

(5) No circular or a circular in the form of advertisement shall be issued by or on behalf of a company unless, not less than thirty days before the date of such issue, there has been delivered to the Registrar for registration a copy thereof signed by a majority of the directors of the company as constituted at the time the Board approved the circular or circular in the form of advertisement, or their agents, duly authorised by them in writing.

(6) A circular or circular in the form of advertisement issued shall be valid until the expiry of six months from the date of closure of the financial year in which it is issued or until the date on which the financial statement is laid before the company in annual general meeting or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier, and a fresh circular or circular in the form of advertisement shall be issued, in each succeeding financial year, for inviting deposits during that financial year.

Explanation: For the purpose of this rule, the date of the issue of the newspaper in which the advertisement appears shall be taken as the date of issue of the advertisement and the effective date of issue of circular shall be the date of dispatch of the circular.

Repayment of Deposits

How to repay deposits?	**Sec. 73(3)**	Every deposit accepted by a company under section 73(2) shall be repaid with interest in accordance with the terms and conditions of the agreement.
If Company fails to repay deposits?	**Sec. 73(4)**	where a company fails to repay the deposit or part thereof or any interest thereon under section 73(3), the depositor concerned may apply to the Tribunal for an order directing the company to pay the sum due or for any loss or damage incurred by him as a result of such non-payment and for such other orders as the Tribunal may deem fit.
Utilization of Deposit Repayment Reserve	**Sec. 73(5)**	The deposit repayment reserve account referred to section 73(2)(c) shall not be used by the company for any purpose other than repayment of deposits.
Repayment of Deposits accepted before commencement of the Act	**Sec. 74(1)**	(1) Where in respect of any deposit accepted by a company before the commencement of this Act, the amount of such deposit or part thereof or any interest due thereon remains unpaid on such commencement or becomes due at any time thereafter, the company shall— (a) file, within a period of three months from such commencement or from the date on which such payments, are due, with the Registrar a statement of all the deposits accepted by the company and sums remaining unpaid on such amount with the interest payable thereon along with the arrangements made for such repayment, notwithstanding anything contained in any other law for the time being in force or under the terms and conditions subject to which the deposit was accepted or any scheme framed under any law; and [(b) repay within three years from such commencement or on or before expiry of the period for which the deposits were accepted, whichever is earlier: Provided that renewal of any such deposits shall be done in accordance with the provisions of Chapter V and the rules made thereunder.
Power of Tribunal to allow further time to repay deposits	**Sec. 74(2)**	The Tribunal may on an application made by the company, after considering the financial condition of the company, the amount of deposit or part thereof and the interest payable thereon and such other matters, allow further time as considered reasonable to the company to repay the deposit.
Liability of Company & officers in case of failure to comply with Sec. 74(1) and 74(2)	**Sec. 74(3)**	If a company fails to repay the deposit or part thereof or any interest thereon within the time specified in section 74(1) or such further time as may be allowed by the Tribunal under section 74(2), the company shall, in addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than one crore rupees but which may extend to ten crore rupees and every officer of the company who is in default shall be punishable with imprisonment which may extend to seven years or with fine which shall not be less than twenty-five lakh rupees but which may extend to two crore rupees, or with both.

		Illustration: ABC Ltd, accepted Rs. 2 cr deposit in 2012. It failed to repay the deposit in time mentioned under section 74 and no request is made to the NCLT to allow some reasonable time for repayment of deposit. It is liable for fine not less than Rs. 1 Crore but which may extend to Rs. 10 Crores.
Liability of officers in case of failure to repay deposits with intent of fraud	**Sec. 75(1) & 75(2)**	(1) Where a company fails to repay the deposit or part thereof or any interest thereon referred to in section 74 within the time specified in sub-section (1) of that section or such further time as may be allowed by the Tribunal under sub-section (2) of that section, and it is proved that the deposits had been accepted with intent to defraud the depositors or for any fraudulent purpose, every officer of the company who was responsible for the acceptance of such deposit shall, without prejudice to the provisions contained in sub-section (3) of that section and liability under section 447, be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by the depositors. (2) Any suit, proceedings or other action may be taken by any person, group of persons or any association of persons who had incurred any loss as a result of the failure of the company to repay the deposits or part thereof or any interest thereon.

CASE LAW

19/09/2018	***M/s Ind-Swift Limited (Appellant) v. Registrar of Companies (Respondent)***	***NCLAT***

Repayment of Deposits accepted before Commencement of the Companies Act, 2013

The Company filed application before CLB and obtained relief under Section 58AA read with Section 58A(9) of the Companies Act, 1956 and got instalments fixed to repay deposits, Appellant sought re-fixing of periods, instalments and rate of interest from NCLT, New Delhi under Section 74 of the Companies Act, 2013 which was rejected by NCLT, New Delhi bench. This Appeal is against rejection of the application/s.

The NCLAT observed that the NCLT considered that the Appellant had at the time of first grant of time got relief of huge extension and that there was no reason to accept the plea for further extension. The NCLT appears to have found that when big relief had already been granted to the Company, further extension was not justified.

Section 76 makes it clear that legislature has put in many safeguards when deposits are to be taken from public. One of the important provisions is to ensure that the Company creates a charge of its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders.

Section 76(2) read with Sections 73 and 74 would apply to acceptance of deposits from public by eligible Companies but it saves the Company which had accepted or invited public deposits under the relevant provisions of the old Act and Rules thereunder and has been repaying such deposits and interests thereon in accordance with such provisions, then the provisions of Clause (b) of Sub-Section (1) of Section 74 of the

new Companies Act, 2013 shall be deemed to have been complied with. This is, however, subject to the fact that the Company complies with the requirements under the Act and the Rules and "continues to repay such deposits and interest due thereon on due dates for the remaining period" as per the terms and conditions.

Considering these provisions, it appears to us that Section 74(1)(b) was attracted and when it appears from record that the Appellant defaulted, the penal provisions would get attracted.

Thus, when once a scheme had been got settled, from CLB, default on the part of the Appellant would attract penal provisions as the earlier scheme itself laid down. Hence, present appeal for further extension is dismissed.

Creation of Security - Rule 6 of the Companies (Acceptance of Deposits) Rules, 2014

(1) For the purposes of providing security, every company referred to in sub-section (2) of section 73 and every eligible company inviting secured deposits shall provide for security by way of a charge on its assets as referred to in Schedule III of the Act excluding intangible assets of the company for the due repayment of the amount of deposit and interest thereon for an amount which shall not be less than the amount remaining unsecured by the deposit insurance:

Provided that in the case of deposits which are secured by the charge on the assets referred to in Schedule III of the Act excluding intangible assets, the amount of such deposits and the interest payable thereon shall not exceed the market value of such assets as assessed by a registered valuer.

Explanation. I - For the purposes of this sub-rule it is clarified that the company shall ensure that the total value of the security either by way of deposit insurance or by way of charge or by both on company's assets shall not be less than the amount of deposits accepted and the interest payable thereon.

(2) The security (not being in the nature of a pledge) for deposits as specified in sub-rule (1) shall be created in favour of a trustee for the depositors on:

(a) specific movable property of the company, or

(b) specific immovable property of the company wherever situated, or any interest therein.

Acceptance of Deposits from Public by certain Companies - Section 76

Section 76(1) states that notwithstanding anything contained in section 73, a public company, (Eligible Company) having:

- a net worth of not less than one hundred crore rupees, or
- turnover not less than five hundred crore rupees,

may accept deposits from persons other than its members subject to compliance with the requirements provided in sub-section (2) of section 73 and subject to such rules as the Central Government may, in consultation with the Reserve Bank of India, prescribe.

Provided that such a company shall be required to obtain the rating (including its net worth, liquidity and ability to pay its deposits on due date) from a recognised credit rating agency for informing the public the rating given to the company at the time of invitation of deposits from the public which ensures adequate safety and the rating shall be obtained for every year during the tenure of deposits.

Provided further that every company accepting secured deposits from the public shall within thirty days of such acceptance, create a charge on its assets of an amount not less than the amount of deposits accepted in favour of the deposit holders in accordance with such rules as may be prescribed.

The provisions of this Chapter shall, *mutatis mutandis*, apply to the acceptance of deposits from public under this section.

Punishment u/s 76A for contravention of section 73 or section 76

Where a company accepts or invites or allows or causes any other person to accept or invite on its behalf any deposit in contravention of the manner or the conditions prescribed under section 73 or section 76 or rules made thereunder or if a company fails to repay the deposit or part thereof or any interest due thereon within the time specified under section 73 or section 76 or rules made thereunder or such further time as may be allowed by the Tribunal under section 73:-

Company	In addition to the payment of the amount of deposit or part thereof and the interest due, be punishable with fine which shall not be less than Rs. 1 Crore or twice the amount of deposit accepted by the company, whichever is lower rupees but which may extend to Rs. 10 Crores; and
Officer of the company who is in default	Imprisonment which may extend to 7 years and with fine which shall not be less than Rs. 25 Lakhs but which may extend to Rs. 2 Crores.
Provided that if it is proved that the officer of the company who is in default, has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or depositors or creditors or tax authorities, he shall be liable for action under section 447.	

Trustee for Depositors

Rule 7 of the Companies (Acceptance of Deposits) Rules, 2014

Appointment of Trustee for Depositors :

No company referred to in sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more trustees for depositors for creating security for the deposits:

A written consent shall be obtained from the trustee for depositors before their appointment and a statement shall appear in the circular or circular in the form of advertisement with reasonable prominence to the effect that the trustees for depositors have given their consent to the company to be so appointed.

The company shall execute a deposit trust deed in Form DPT-2 at least seven days before issuing the circular or circular in the form of advertisement.

Persons who cannot be appointed as Deposit trustees :

No person including a company that is in the business of providing trusteeship services shall be appointed as a trustee for the depositors, if the proposed trustee -

(a) is a director, key managerial personnel or any other officer or an employee of the company or of its holding, subsidiary or associate company or a depositor in the company;

(b) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;

(c) has any material pecuniary relationship with the company;

(d) has entered into any guarantee arrangement in respect of principal debts secured by the deposits or interest thereon;

(e) is related to any person specified in clause (a) above.

Removal of deposit trustees:

No trustee for depositors shall be removed from office after the issue of circular or advertisement and before the expiry of his term except with the consent of all the directors present at a meeting of the Board. Provided that in case the company is required to have independent directors, at least one independent director shall be present in such meeting of the Board.

Duties of Trustees for Depositors –

Rule 8 of the Companies (Acceptance of Deposits) Rules, 2014

- To ensure that the assets of the company on which charge is created together with the amount of deposit insurance are sufficient to cover the repayment of the principal amount of secured deposits outstanding and interest accrued thereon
- To satisfy himself that the circular or advertisement inviting deposits does not contain any information which is inconsistent with the terms of the deposit scheme or with the trust deed and is in compliance with the rules and provisions of the Act
- To ensure that the company does not commit any breach of covenants and provisions of the trust deed
- To take such reasonable steps as may be necessary to procure a remedy for any breach of covenants of the trust deed or the terms of invitation of deposits
- To take steps to call a meeting of the holders of depositors as and when such meeting is required to be held
- To supervise the implementation of the conditions regarding creation of security for deposits and the terms of deposit insurance
- To do such acts as are necessary in the event the security becomes enforceable and carry out such acts as are necessary for the protection of the interest of depositors and to resolve their grievances

Meeting of Depositors

Rule 9 of the Companies (Acceptance of Deposits) Rules, 2014

The trustee for depositors shall call a meeting of all the depositors on-

(a) requisition in writing signed by at least one-tenth of the depositors in value for the time being outstanding;

(b) the happening of any event, which constitutes a default or which, in the opinion of the trustee for depositors, affects the interest of the depositors.

Form of Application for Deposits

Rule 10 of the Companies (Acceptance of Deposits) Rules, 2014

(1) On and from the commencement of these rules, no company shall accept, or renew any deposit, whether secured or unsecured, unless an application, in such form as specified by the company, is submitted by the intending depositor for the acceptance of such deposit.

(2) The form of application, shall contain a declaration by the intending depositor to the effect that the deposit is not being made out of any money borrowed by him from any other person.

Power to Nominate

Rule 11 of the Companies (Acceptance of Deposits) Rules, 2014

Every depositor may, at any time, nominate any person to whom his deposits shall vest in the event of his death and the provisions of section 72 shall, as far as may be, apply to the nomination made under this rule.

Furnishing of Deposit Receipts to Depositors

Rule 12 of the Companies (Acceptance of Deposits) Rules, 2014

(1) Every company shall, on the acceptance or renewal of a deposit, furnish to the depositor or his agent a receipt for the amount received by the company, within a period of twenty one days from the date of receipt of money or realisation of cheque or date of renewal.

(2) The receipt referred to in sub-rule (1) shall be signed by an officer of the company duly authorised by the Board in this behalf and shall state the date of deposit, the name and address of the depositor, the amount received by the company as deposit, the rate of interest payable thereon and the date on which the deposit is repayable.

Maintenance of Liquid Assets and Creation of Deposit Repayment Reserve Account.

Rule 13 of the Companies (Acceptance of Deposits) Rules, 2014

Every company referred to in sub-section (2) of section 73 and every eligible company shall on or before the 30th day of April of each year deposit the sum as specified in clause (c) of the said sub-section with any scheduled bank and the amount so deposited shall not be utilised for any purpose other than for the repayment of deposits:

Provided that the amount remaining deposited shall not at any time fall below 20% of the amount of deposits maturing during the financial year.

Registers of Deposits

Rule 14 of the Companies (Acceptance of Deposits) Rules, 2014

(1) Every company accepting deposits shall maintain at its registered office one or more separate registers for deposits accepted or renewed, in which there shall be entered separately in the case of each depositor the following particulars, namely:

(1) name, address and PAN of the depositor/s;

(2) particulars of guardian, in case of a minor;

(3) particulars of the nominee;

(4) deposit receipt number;

(5) date and the amount of each deposit;

(6) duration of the deposit and the date on which each deposit is repayable;

(7) rate of interest or such deposits to be payable to the depositor;

(8) due date for payment of interest;

(9) mandate and instructions for payment of interest and for non-deduction of tax at source, if any;

(10) date or dates on which the payment of interest shall be made;

(11) particulars of security or charge created for repayment of deposits;

(12) any other relevant particulars.

(2) The entries specified, shall be made within seven days from the date of issuance of the receipt duly authenticated by a director or secretary of the company or by any other officer authorised by the Board for this purpose.

(3) **Preservation of Registers-** The register referred to in sub-rule (1) shall be preserved in good order for a period of not less than eight years from the financial year in which the latest entry is made in the register.

General Provisions Regarding Premature Repayment of Deposits

Rule 15 of the Companies (Acceptance of Deposits) Rules, 2014

Where a company makes a repayment of deposits, on the request of the depositor, after the expiry of a period of six months from the date of such deposit but before the expiry of the period for which such deposit was accepted, the rate of interest payable on such deposit shall be reduced by one per cent. from the rate which the company would have paid had the deposit been accepted for the period for which such deposit had actually run and the company shall not pay interest at any rate higher than the rate so reduced :

Provided that nothing contained in this rule shall apply to the repayment of any deposit before the expiry of the period for which such deposit was accepted by the company, if such repayment is made solely for the purpose of–

(a) complying with the provisions of rule 3; or

(b) providing war risk or other related benefits to the personnel of the naval, military or air forces or to their families, on an application made by the associations or societies formed by such personnel, during the period of emergency declared under Article 352 of the Constitution :

Provided further that where a company referred to in under sub-section (2) of section 73 or any eligible company permits a depositor to renew his deposit, before the expiry of the period for which such deposit was accepted by the company, for availing of a higher rate of interest, the company shall pay interest to such depositor at the higher rate if such deposit is renewed in accordance with the other provisions of these rules and for a period longer than the unexpired period of the deposit.

Explanation: For the purposes of this rule, where the period for which the deposit had run contains any part of a

year, then, if such part is less than six months, it shall be excluded and if such part is six months or more, it shall be reckoned as one year.

Return of Deposits to be Filed with the Registrar

Rule 16 of the Companies (Acceptance of Deposits) Rules, 2014

Every company to which these rules apply, shall on or before the 30th day of June, of every year, file with the Registrar, a return in Form DPT-3 along with the fee as provided in Companies (Registration Offices and Fees) Rules, 2014 and furnish the information contained therein as on the 31st day of March of that year duly audited by the auditor of the company and declaration to that effect shall be submitted by the auditor in Form DPT-3.

Explanation.- It is hereby clarified that Form DPT-3 shall be used for filing return of deposit or particulars of transaction not considered as deposit or both by every company other than Government company.

Disclosures in the financial statement –

Rule 16A of the Companies (Acceptance of Deposits) Rules, 2014

(1) Every company, other than a private company, shall disclose in its financial statement, by way of notes, about the money received from the director.

(2) Every private company shall disclose in its financial statement, by way of notes, about the money received from the directors, or relatives of directors."

(3) Every company other than Government company shall file a onetime return of outstanding receipt of money or loan by a company but not considered as deposits, in terms of clause (c) of sub-rule 1 of rule 2 from the 01st April, 2014 to 31st March 2019, as specified in Form DPT-3 within ninety days from 31st March, 2019 along with fee as provided in the Companies (Registration Offices and Fees) Rules, 2014.

Penal Rate of Interest

Rule 17 of the Companies (Acceptance of Deposits) Rules, 2014

Every company shall pay a penal rate of interest of 18% per annum for the overdue period in case of deposits, whether secured or unsecured, matured and claimed but remaining unpaid.

Power of Central Government to Decide Certain Questions

Rule 18 of the Companies (Acceptance of Deposits) Rules, 2014

If any question arises as to the applicability of these rules to a particular company, such question shall be decided by the Central Government in consultation with the Reserve Bank of India.

Applicability of Sections 73 and 74 to Eligible Companies

Rule 19 of the Companies (Acceptance of Deposits) Rules, 2014

Pursuant to provisions of sub-section (2) of section 76 of the Act, the provisions of sections 73 and 74 shall, *mutatis mutandis*, apply to acceptance of deposits from public by eligible companies.

Explanation.- For the purposes of this rule, it is hereby clarified that in case of a company which had accepted or invited public deposits under the relevant provisions of the Companies Act, 1956 and rules made under that Act (hereinafter known as "Earlier Deposits") and has been repaying such deposits and interest thereon in

accordance with such provisions, the provisions of clause (b) of sub-section (1) of section 74 of the Act shall be deemed to have been complied with if the company complies with requirements under the Act and these rules and continues to repay such deposits and interest due thereon on due dates for the remaining period of such deposit in accordance with the terms and conditions and period of such Earlier Deposits and in compliance with the requirements under the Act and these rules.

Provided further that the fresh deposits by every eligible company shall have to be in accordance with the provisions of Chapter V of the Act and these rules.

Statement Regarding Deposits Existing as on the Date of Commencement of the Act –

Rule 20 of the Companies (Acceptance of Deposits) Rules, 2014

The statement shall be in Form DPT-4.

Punishment for Contravention–

Rule 21 of the Companies (Acceptance of Deposits) Rules, 2014

Companies u/s 73(2) / Eligible Cos. inviting deposits or any other person contravenes any provision of these rules for **which no punishment is provided in the Act**	The company and every officer of the company who is in default - Punishable with fine which may extend to Rs. 5000/- and where the contravention is a continuing one, with a further fine which may extend to Rs. 500/- for every day after the first day during which the contravention continues.

Disclosure in Board Report

Sec. 134 of the Companies Act 2013 read with Rule 8 of the Companies (Accounts) Rules, 2014

Following shall be disclosed in the Board Report-

I. Details relating to deposits, covered under Chapter V of the Act

(a) accepted during the year;

(b) remained unpaid or unclaimed as at the end of the year;

(c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved-

(i) at the beginning of the year;

(ii) maximum during the year;

(iii) at the end of the year.

II. Details of deposits which are not in compliance with the requirements of Chapter V of the Act.

CASE LAW

In the case of ***Reflektion Media Software (India), Private limited, ROC Karnataka*** imposed a penalty on the Company and officers in default when the Board failed to provide the required information about the company's subsidiaries, internal complaint committee compliance, expense records, and business nature changes was not included in the board report in accordance with Section 134(3) of the Companies Act, 2013 read with Rule 8 of the Companies (Accounts) Rules, 2014.

SPECIMEN RESOLUTION

BOARD RESOLUTION FOR ISSUE AND ALLOTMENT OF UNSECURED-CONVERTIBLE DEBENTURES AND/ OR OTHER DEBT SECURITIES ON PRIVATE PLACEMENT BASIC

"RESOLVED THAT subject to the authorisation by the Company in the general meeting and pursuant to section 42, 71 of the Companies Act 2013 and all other applicable provisions, if any, of the Companies Act, 2013, (including any statutory modification(s) or re-enactment(s) thereof, for the time being in force) read with the Rules made thereunder along with Companies (Prospectus and Allotment of Securities) Rules, 2014, as may be amended from time to time _____ Unsecured-Convertible debenture of Rs. _____ each of the Company be and are hereby allotted to the persons mentioned in the allotment list placed before the meeting and initialled by the Chairman so that each allottee receives the number of debentures specified against his name in the list.

RESOLVED FURTHER THAT the draft letter of allotment placed before the meeting and initialled by the Chairman for the purpose of identification be and are hereby approved and the Company Secretary Mr. _____ of the Company be directed to issue the said letters of allotment or letter of regret with refund vouchers as the case may be.

RESOLVED FURTHER THAT the _____ (Bank Name), _____ Branch, _____ (City), in which the Company has opened an account "_____ Limited Debenture Account" be and is hereby authorized to receive debenture allotment monies and to credit the said account with such amount.

RESOLVED FURTHER THAT the said Bank be and is hereby authorized to honour debenture refund vouchers from and out of the credit balance in the said account."

RESOLVED FURTHER THAT Mr./Mrs. _____ (Designation) of the company, be and is hereby authorized to do all other acts, deeds and things necessary to give effect to the said resolution.

BOARD RESOLUTION FOR ACCEPTANCE OF DEPOSIT FROM THE MEMBERS OF THE COMPANY

"**RESOLVED THAT,** pursuant to the provisions of section 73 of the Companies Act, 2013 and the Companies (Acceptance of Deposits) Rules, 2014, including any statutory modification(s) and re-enactment (s) thereof for the time being in force, subject to article number _____ of Articles of Association of the company and subject to such approvals, consents, sanctions and permissions from any appropriate authority(ies) as may be necessary, and subject to the members approval by way of ordinary resolution, the consent of the board be and is hereby given to invite and accept unsecured deposits from members subject to the maximum aggregate of not more than Rs. _____/- outstanding at any point of time or an amount equal to 100% of aggregate of paid up share capital, free reserves and securities premium account (As per the latest audited balance sheet), whichever is less.

RESOLVED FURTHER THAT the forms of application and fixed deposit receipt a draft of which is placed before the meeting duly initiated by the Chairman for the purpose of identification, be and are hereby approved.

RESOLVED FURTHER THAT Mr./Mrs. _____ and Mr./Mrs. _____ (designation) of the company, be and are hereby authorized to sign the fixed deposit receipts and other documents on the behalf of company and to issue the same to the depositors of the company and Mr. _____ be and is hereby authorized to make necessary entries in the register maintained for this purpose.

RESOLVED FURTHER THAT for the purpose of giving effect to this Resolution, the Board of Directors be and is hereby authorized to do such acts, deeds, matters and things as Board of Directors may in its absolute discretion consider necessary, proper, expedient, desirable or appropriate for such invitation/acceptance/ renewal/receipts as aforesaid and matters incidental thereto."

LESSON ROUND-UP

- All companies are given power to borrow by their articles which fix the maximum limit of borrowings.
- The power to borrow monies and to issue debentures (whether in or outside India) can only be exercised by the Directors at a duly convened meeting.
- Where the company borrows without the authority conferred on it by the Articles or beyond the amount set out in the Articles, it is an *ultra-vires* borrowing and hence void. Ultra vires borrowings cannot even be ratified by a resolution passed by the company in general meeting. In case of *ultra-vires* borrowings the lender has the following remedies: (a) Injunction and Recovery, (b) Subrogation, (c) Suit against Directors.
- A debenture is a document given by a company under its seal as an evidence of a debt to the holder usually arising out of a loan and most commonly secured by a charge.
- Debentures may be of different kinds, viz. redeemable debentures, registered and bearer debentures, secured and unsecured or naked debentures, convertible debentures.
- A debenture stock is a borrowed capital consolidated into one mass for the sake of convenience.
- A loan creates a right in the creditor to demand repayment, and the substance of a debt is a liability upon the debtor to repay the money.
- A debenture trust deed is one of the several instruments required to be executed to secure redemption of debentures and payment of interest on due dates.
- Section 71(4) of the Act required every company to create a debenture redemption reserve account to which adequate amount shall be credited out of its profits available for payment of dividend until such debentures are redeemed and shall utilize the same exclusively for redemption of a particular set or series of debentures only.
- Certificate of deposit is a document of title to a time deposit.
- Commercial paper refers to unsecured promissory notes issued by credit worthy companies to borrow funds on a short term basis.
- Section 73 prohibits a company to invite, accept or renew deposits from public except in the manner provided under Chapter V. This prohibition however shall not apply in case of banking company and non- banking financial company and such other company as the Central Government may specify.
- A company can invite deposits from its members subject to the passing of a resolution in general meeting subject to some conditions.
- No company under sub-section (2) of section 73 or any eligible company shall issue a circular or advertisement inviting secured deposits unless the company has appointed one or more deposit trustees for creating security for the deposits.
- The Company accepting deposits shall, on or before 30th day of April each year, deposit a sum not less than twenty percent of the amount of deposits maturing during the following year in a scheduled bank in a separate bank account to be called deposit repayment reserve account. The said reserve shall not be used by the Company for any purpose other than repayment of deposits.
- The company accepting deposits shall maintain at its registered office one or more registers for deposits accepted or renewed.
- The Return of Deposits shall be filed in Form DPT-3 with the Registrar.
- There are stringent penal provisions (Section 75 and 76A) to safeguard the interest of depositors.

GLOSSARY

- **Injunction:** an official order from a court of law to do/not do something.
- **Subrogation:** the substitution of one person or group by another in respect of a debt or insurance claim, accompanied by the transfer of any associated rights and duties.
- **Redeemable securities:** Redeemable securities are those types of securities issued to lender/ shareholders with/without option implanted, meaning they are redeemed or repurchased later by the company.
- **Irredeemable securities:** The irredeemable securities are unlike redeemable securities. They cannot get money back invested in the company. Therefore the amount is generally redeemed only at the time of the company's liquidation.
- **Encumbered:** a mortgage or other claim on property or assets.
- **Casual vacancy:** Casual Vacancy is when a one's office is vacated before the expiry of his tenure.
- **Tribunal:** The National Company Law Tribunal.
- **Doctrine of estoppels:** It precludes a person from denying or to negate anything to the contrary of that which has been constituted as truth, either by his own actions, by his deeds or by his representations or by the acts of judicial or legislative officers.
- ***Void ab initio:*** A *void ab initio* is Latin for "void from the beginning i.e having no legal effect from inception.
- **Earmark:** Earmarking is the practice of setting particular money aside for a specific purpose.
- **Pari-passu:** Latin for "equal footing"—is a financing arrangement that gives multiple lenders equal claim to the assets used to secure a loan.
- **Charge:** An interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. What are the restrictions imposed on the borrowing powers of the Board of Directors? If a company borrows beyond its powers, examine the remedies open to such creditor:
   (i) When the money has not been spent;
   (iii) When the money has been spent to pay the debts of the company.
2. What is the difference between debenture and a loan? Is fixed deposit a Debenture or Loan?
3. What is debenture? What are the kinds of debentures?
4. What is a convertible debenture? What are the provisions of the Companies Act, 2013 regarding convertible debentures or loans?
5. Is it compulsory to maintain a Debenture Redemption Reserve Account? If yes, how?

6. Write short notes on the following:
    (i) Ultra vires borrowings
    (ii) Intra vires borrowings
    (iii) Security for borrowings
    (iv) Types of borrowings
    (v) Commercial Papers
7. Who is a debenture trustee? Why is it compulsory to appoint a trustee in connection with the issuance of debentures? What are the duties of a trustee?
8. Whether the following can be appointed as Debenture Trustee:
    (i) A shareholder who has no beneficial interest
    (ii) A creditor whom the Company owes Rs. 500 only
    (iii) Spouse of Mr. X, director of the Company
    (iv) A person who has given a guarantee for repayment of amount of debentures issued by the Company?
9. Which of the following Companies can accept deposits from Public:
    a. XYZ Private Limited having a net worth of 200 Crore
    b. A Limited having a turnover of 550 Crore
    c. B Limited having a net worth of 90 Crore and turnover of 440 Crore
10. Write short note on the following:
    (i) Depositor
    (ii) Eligible Company
    (iii) Secured and Unsecured Deposits
    (iv) Return of Deposits
    (v) Deposit Repayment Reserve Account
    (vi) Register of Deposits
11. What are the consequences of failure to invite or accept deposits or repay deposits by a Company in contravention of manner or conditions prescribed under the provisions under Chapter V.
12. Prepare a checklist of secretarial compliance to be made by a company secretary for acceptance of deposits.
13. What is the procedure for accepting deposits from members?
14. What are the exemptions available to companies for not complying with provisions under Chapter V. Name the class of companies exempted and which conditions are to be fulfilled for availing such exemptions?

15. Adaa Ltd. has accepted deposits from the public for three years with interest payable at 8% p.a annually or at the end of three years at 9% p.a. One depositor ''D'' has requested the company for repayment of deposit after one year. Is the depositor eligible to get repayment before maturity period? Choose the answer with legal provisions.

    (a) As per Rule 31 of the Companies (Acceptance of Deposits) Rules, 2014, D can get repayment of deposit after one year of deposit with reduction of 1% i.e., 7% per annum from Adaa Ltd.

    (b) As per Rule 15 of the Companies (Acceptance of Deposits) Rules, 2014, D can get repayment of deposit after one year of deposit with reduction of 2% i.e., 6% per annum from Adaa Ltd.

    (c) As per Rule 15 of the Companies (Acceptance of Deposits) Rules, 2014, D can get repayment of deposit after one year of deposit with reduction of 1% i.e., 7% per annum from Adaa Ltd.

    (d) As per Rule 15 of the Companies (Acceptance of Deposits) Rules, 2014, D can get repayment of deposit after one year of deposit with reduction of 0.5 % annum from Adaa Ltd.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- the Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

Charges

Lesson 7

KEY CONCEPTS

■ Charges ■ Exclusive Charge ■ Pari-passu Charge ■ Fixed Charge ■ Floating Charge ■ Creation ■ Modification ■ Satisfaction ■ Lien ■ Crystallization ■ Interest ■ Pledge ■ Mortgage

Learning Objectives

To understand:

- Definition and meaning of Charges
- Regulatory provisions under the Companies Act, 2013 and Rules made thereunder for registration, modification and satisfaction of charges
- Procedural aspects relating to registration modification and satisfaction of charges
- Forms prescribed by MCA
- Search and Status Report
- Judicial Pronouncements and its relevance to various regulatory provisions

Lesson Outline

- Introduction
- Definition of Charge
- Types of Charges
- Registration of Charges
- Consequences on non-registration of Charge
- Modification of Charges
- Procedural Aspects of Registration or modification of Charge
- Purchase or Acquisition of a property subject to Charge
- Satisfaction of charges and its procedural aspects
- Rectification by Central Government in Register of Charges
- Search and Status Report
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 77-87, 117, 180, 179)
- The Companies (Registration of Charges) Rules, 2014

INTRODUCTION

A charge is a form of security for a loan under which certain property is agreed to be "charged". It is a right created by a Company ("the borrower") on its assets or properties or any of its undertakings present and future, in favor of a financial institution or a bank or any other lender("the lenders"), which has agreed to extend financial assistance.

A charge may be created by executing loan agreements, hypothecation agreements, mortgage deeds and any other similar documents, which the borrowing company is required to execute in favour of the lending institutions and banks.

Definition & Meaning of "Charge"

Charge as defined under Transfer of Property Act, 1882- According to section 100 of the Transfer of Property Act, 1882, "where an immovable property of one person is by act of parties or operation of law made security for the payment of money to another and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property, and all the provisions which apply to a simple mortgage shall, so far as may be, apply to such charge."

In Kent and *Sussex Sawmills Ltd. [1947] 17 Comp Cas 169 (Ch D)*, it was held by the Court that 'Whether a particular transaction is a charge or not is determined not by the form in which it is couched but by looking at the substance of it. Though a document is given in the form of an assignment, if, in reality, it is an instrument creating a security, registration as a charge cannot be evaded.'

Charge as defined under the Companies Act, 2013- Clause 16 of Section 2 of the Companies Act, 2013 defines the term "charge" as an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.

Charge also includes a lien and an equitable charge whether created by an instrument in writing or by the deposit of title deed (In Dublin City Distillery Co. v. Deherty, 1914 AC 823)

Meaning of the key word "Interest" and "Lien" used in the definition of Charge:

Interest

- The meaning of "interest" as per Black's law dictionary *is 'legal share in something: all or part of a legal or equitable claim to or right in property, right, title, and interest. Collectively, the word includes any aggregation of rights, privileges, powers and immunities; distributively, it refers to anyone right, privilege, power, or immunity.'*
- Any and all, partial or total right to property or for the use of property, including an easement to pass over a neighboring parcel of land, the right to drill for oil, a possibility of acquiring title upon the happening of some event, or outright title.

Lien

- *Lien is a French word meaning 'knot or binding' that was brought to Britain with the French language during the Norman Conquest in 1066.*
- *As per Black's Law Dictionary-"It is a legal right or interest that a creditor has in another's property lasting usually until a debt or duty it secures is satisfied."*
- *It is defined by Story as 'Lien, strictly is neither a jus in rem nor a jus ad rem, but is simply a right to possess and retain property until some claim attaching to it is satisfied or discharged."*
- `Lien' in its primary sense is a right of a person to retain a property which is in his possession belonging to another until the present and accrued claims of the person in possession are satisfied. In this primary sense is given by law and not by contract.
- In view of this the term 'lien' as used in the definition of the 'Charge' in Section 2(16) of the Companies Act, 2013 would also include a 'negative lien' since a 'negative lien' is a subset of a 'lien'. Thus, in terms of Section 77 of the Companies Act, 2013 a 'Charge' created by a company in favour of a Corporate Lender over its assets, including shares which is form of a 'negative lien' will have to be registered with the Registrar of Companies.

- In the case of *K. Saradambal v Jaganathan & Bros. (1972) 42 Comp Cas 359 (Mad),* it was held that a holder of a lien is a secured creditor and if the lien is statutory, his claim need not be registered under erstwhile section 125 of the Companies Act, 1956.

  However, as per the provisions of clause (16) of section 2 read with section 77 of the Companies Act, 2013, it is required to be registered as a charge with the Registrar.
- In the case of *the Bank of India Ltd. vs. Rustom Fakirji Cowasjee (1955) 57 BOMLR 850*, it was held that negative lien, like any other type of lien, is merely an assurance to keep the property unencumbered and does not amount to right to sale. As per the inclusive definition of 'charge' such type of lien shall also be included.

As per U.K. Companies Act, 2006, "charge includes a mortgage, a standard security, assignation in security, and any other right in security constituted under the law of Scotland, including any heritable security, but not including a pledge.

Essential Features of Charge

In general, a charge has the following essential features:

Parties to the Charge

There are minimum **two parties** to the transaction, the creator of the charge (company on whose property the charge is created) and the charge holder (one who lends money).

Subject Matter

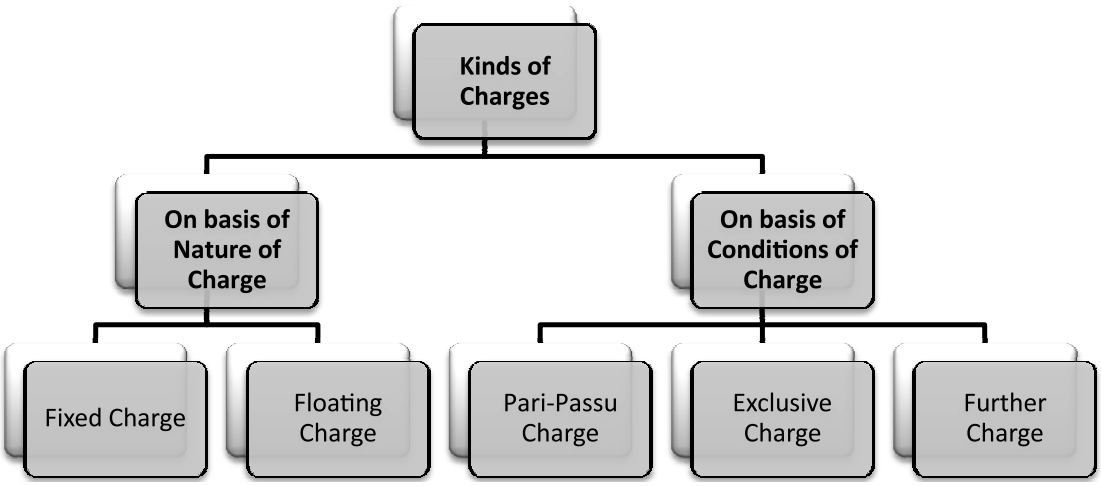
There must be a **subject matter** for which the charge is created.The subject matter of charge may be on current or future assets and properties of the borrower.

Agreement

There must be an **agreement** between the two parties specifying the security rendered for repayment of borrowed money, together with payment of interest at the agreed rate etc.

Therefore, one should be able to distinguish between the charge created by an act of parties or by operation of law. As the section uses the expression 'duty of every company creating a charge', it refers to only such charge which are created by act of parties i.e. between the company and the lender and not to charge created by way of operation of statute or a decree.

Types of Charges



Difference between Fixed or Specific Charge and Floating Charge

Basis	*Fixed Charge*	*Floating Charge*
Nature	It is a legal Charge	It is an equitable Charge
Meaning	Security in terms of certain specific property	Security remains dormant until it is fixed or crystallised
Scope	It is created to cover assets which are ascertained and definite or are capable of being ascertained and defined, at the time of creating the charge	It is created on variable property which keeps on changing or moving. The property or assets of the Company cannot be specifically ascertained
Created on	It is created on fixed assets like land, building, or plant and machinery	It is created on floating assets like stock-in-trade, debtors etc.
Priority	It has priority over floating Charge	No such priority
Disposing of assets	The Mortgagor i.e., Company cannot dispose off the property without the consent of the charge holder	The Mortgagor is free to deal with the property as it sees fit until the holders of charge take steps to enforce their security

On the basis on the conditions of the charge

The charge may be created in favour of the charge holders as per the terms and conditions agreed by the parties in the following manner:

- ***Pari-Passu* charge** - Under this, the charge is shared by more than one lender in the ratio of their outstanding amount. The prior consent of the existing charge holder is required by the company.

- **Exclusive charge** - The security under the exclusive charge is provided to a particular lender only.
- **Further charge** - With the consent on the first charge holder, the particular assets on which charge is already created may be provided to other lenders as second charge. In case of liquidation of assets, the first charge holder has the right to recover his dues and the balance is recovered by the second charge holder followed by others.

Crystallization of Floating Charge

A floating charge is a security (that is mortgage, lien etc) that has an underlying asset or group of assets which is subject to change in quantity and value. It is a security interest over a fund of changing assets of a company or other artificial person, which 'floats' until the point at which it is converted into a fixed charge; at which point the charge attaches to specific asset of the business.

A floating charge attaches to the company's property generally and remains dormant till it crystallizes or becomes fixed. The company has a right to carry on its business with the help of assets over which a floating charge has been created till the happening of some event which determines this right.

This conversion of the floating charge into a fixed charge known as crystallization can be triggered by following events:

(1) Cessation of business, including winding up and ceasing business operations as a going concern prior to winding up; and

(2) Debenture holder intervention, including appointment of a receiver or manager, taking possession as debenture holder and obtaining an injunction against company dealings with charged asset generally;

(3) On the happening of event specified in deed.

CASE LAWS

The Supreme Court has remarked in *Narendra Kumar Maheshwari vs Union of India & Ors (1989 SCR (3) 43*, as follows: *"The concept of floating charge was, invented by the Victorian Lawyers only because of its special advantages in as much as it leaves a company free to deal with its assets in the ordinary course of business and does not require the permission of debenture-holders or debenture trustees for dealing with them or creating further charges.*

It has been pointed out that the business of a corporation would be paralysed if it could not deal with its assets and create future charges, ranking superior in priority, and if it would have to obtain the permission of the debenture holders for doing so."

While elaborating another contour of floating charges it remarked further, "This however does not mean that the company can keep on creating future charges with superior ranking without any let or hindrance because the debenture holders/ trustees can any time move to crystallise the floating security if they feel that the security is in jeopardy."

In *Government Stock Investment Co. Ltd. v. Manila Railway Co. Ltd., (1897) A.C. 81*, the debentures were secured by a floating charge. Three months' interest became due but the debenture holders took no steps and so the charge did not crystallize but remained floating. The company then made a mortgage of a specific part of its property. Held, the mortgagee had priority. The security for the debentures remained merely a floating security as the debenture holders had taken no steps to enforce their security.

Maturi U. Rao v. Pendyala (A.I.R 1970 A.P 225)- In this case, it was held that when floating charge crystallizes it becomes fixed and the assets comprised are subject to the same restrictions as the fixed charge.

Suppose, Xenon Ltd. borrowed money from Bank till 2021, and the bank has created a floating charge on the company's stock. If the company does not pay the borrowed amount till 2021, then their stock will be crystallised, and they won't be able to sell their goods from 2021.

From the above example, it is clear that the company has the right to carry on its business with its stock having a floating charge till the time the charge comes into action or the charge holder determines its rights.

Effect of Crystallisation of a Floating Charge

On crystallization, the floating charge converts into a fixed charge on the property of the company. It has priority over any subsequent equitable charge and other unsecured creditors. But preferential creditors who have priority for payment over secured creditors in the winding-up, gets priority over the claims of the debenture holders having floating charge.

CASE LAWS

In *Permanent Houses (Holdings) Ltd. 1988 BCLC 563(CHD*), where a company issued debenture creating a charge in favor of a lending bank mentioning that the charge shall crystallize on happening of an event or default in payment. When the payment was not made on demand by bank, it was held that the charge was no longer a floating charge at the time when receiver was appointed.

The learned Judges from an English case reported in case of *Evans v. Rival Granite Quarries Ltd*. "A floating security is not a future security; it is a present security, which possibly affects all the assets of the company expressed to be included in it.

On the other hand, it is not a specific security; the holder cannot affirm that the assets are specifically mortgaged to him. The assets are mortgaged in such a way that the mortgagor can deal with them without the concurrence of the mortgagee. A floating security is not a specific mortgage of the assets, plus a license to the mortgagor to dispose of them in the course of the business, but is a floating mortgage applying to every item comprised in the security, but not specifically affecting any item until some event occurs or some act on the part of the mortgagee is done which causes it to crystallize into a fixed security."

In *Stein v Saywell (1968-1969)*``Its distinguishing feature is that, the class of present and future assets that are charged being such as in the ordinary course of the company's business would be changing from time to time, the company is left at liberty, until one of the `crystallizing' events happens, to dispose freely, in the ordinary course of its business, of any property to which it attaches."

*Official Liquidator vs. Sri Krishna Deo, (1959) 29 Com Cases 476: AIR 1959 All 247 and Roy& Bros. v. Ramnath Das, (1945) 15 Com Cases 69, 75 (Cal)]***.** The plant and machinery of a company embedded in the earth or permanently fastened to things attached to the earth became a part of the company's immovable property and therefore apart from the registration under the Companies Act, registration under the Indian Registration Act would also be necessary to make the charge valid and effective.

Cosslett (Contractors) Ltd., Re, (1996) 1 BCLC 407 (Ch D) A construction company's washing machine which was in use at the site was declared under the terms of the contract to be the employer's property during the period of construction. This was held to have created a fixed charge and not a floating charge on the machine because the machine was only one fixed item and was not likely to change.

In Lord Macnaghten in Government Stock Investment Company Ltd. vs. Manila Rly. Company Ltd., (1897) A.C. 81, observed "is an equitable charge on the assets for the time being of a going concern. It attaches to the subject charged in the varying condition in which it happens to be from time to time. It is the essence of such a charge that it remains dormant until the undertaking charged ceases to be a going concern, or until the person in whose favour the charge is created intervenes".

Illingworth & Another vs. Holdsworth & Another, [1904] AC 355 "A floating charge is ambulatory and shifting in its nature hovering over and so to speak floating with the property which it is intended to affect until some event occurs or act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp.

In *Smith vs. Bridgend County Borougn Council (2002) 1 BCLC 77 (HC)*, the agreement was held to constitute a floating charge, in so far as it allowed the employer, in various situations of default by the contractor,to sell the contractor's plant and equipment and apply the proceeds in discharge of its obligations. A right to sell an asset belonging to a debtor and appropriate the proceeds to payment of the debt could not be anything other than a charge. It was a floating charge because the property in question was a fluctuating body of assets which could be consumed or removed from the site in the ordinary course of the contractor's business.

Whether Preferential Creditors having priority over the floating charge-holder?

Yes, Preferential Creditors who have priority for payment over secured creditors in the winding up get priority over the claims of the Debenture holders having floating charge.

Difference between Mortgage and Charge

S. No.	*Mortgage*	*Charge*
1.	A mortgage is created by the act of the parties.	A charge may be created either through the act of parties or by operation of law.
2.	A mortgage requires registration under the Transfer of Property Act, 1882.	A charge created by operation of law does not require registration but a charge created by act of parties requires registration.
3.	A mortgage is a transfer of an interest in specific immovable property.	A charge only gives a right to receive payment out of a particular property. There is no such transfer of interest in the case of a charge. Charge does not operate as transfer of an interest in the property and a transferee of the property gets the property free from the charge provided, he purchases it for value without notice of the charge.
4.	A mortgage is for a fixed term.	The charge may be in perpetuity.
5.	A mortgage is good against subsequent transferees.	A charge is good against subsequent transferees with notice.
6.	A simple mortgage carries personal liability unless excluded by express contract.	In case of charge, no personal liability is created. But where a charge is the result of a contract, there may be a personal remedy.

In a charge, the right to sell the property is contractual and can be defeated by a bona fide purchaser for value without notice, whereas, in the case of a mortgage, the right to sell will consist of interest in the property being transferred to the mortgagee. In the case of a charge as well as in the case of a mortgage two elements are common. First, that there is a loan and secondly, that there is a security for the repayment of the loan. The only difference between a charge and a mortgage is that in the case of a mortgage there is transfer of interest but in the case of a charge there is no transfer of interest. The above dictum was propounded in In *Re. Calcutta National Bank Ltd. v. Rangaroon Tea Co. Ltd [(1970) 40 Comp. Cas. 565(Cal.)].* Clause 16 of section 2 of the Act states that "charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage. A charge includes a lien and also an equitable charge.

Difference between Charge and Pledge

S. No.	***Charge***	***Pledge***
1.	It is not a physical transfer of property of one to another.	It is a bailment of personal property as security for some debt or engagement, redeemable on certain terms, and with an implied power of sale on default.
2.	It is a right created in favour of one, referred to as "the lender" in the immovable property of another, referred to as "the borrower", as security for repayment of the loan and payment of interest on the terms and conditions contained in the loan documents evidencing charge.	It consists of a delivery of goods by a debtor to his creditor as security for a debt or other obligation, to be held until the debt is repaid along with interest or other obligation of the debtor is discharged, and then to be delivered back to the pledger, the title not being changed during the continuance of the pledge.
Both a pledge and a charge are the result of voluntary act of parties. Both create security but the nature of the security is different.		

Registrable Charges

Section 2(16) and section 77 of the Act require to register the charge created by way of every kind of interest or lien (including negative lien) on the property or assets, tangible or otherwise, of a company as security, including mortgage.

The following is an indicative list of charges to be registered with the Registrar:—

I. a charge created for the purpose of securing any issue of debentures or deposits;

II. a charge on uncalled share capital of the company;

III. a charge on any immovable property, wherever situate, or any interest therein. This includes mortgage by deposit of title deeds. *[Wallis v. Simmonds (Builders) Ltd. (1974) 1 All ER 561]*;

IV. a charge on any book debt of the company. Assignment of book-debts as security is covered. [*Paul and Frank Ltd v. Discount Bank Overseas Ltd. (1966) 2 All ER 9221 (Ch D)];*

V. a lien on sub freight is a charge on book-debt of the company. *{Welsh Irish Ferries Ltd. (1985) [ECLE 327 (Ch D)]}; Ladenberg & Co. v. Goodwin (1912) 3 KB 275;*

VI. a charge, on any movable property of the company;

VII. a floating charge on the undertaking or any property of the company including stock-in-trade;

VIII. a charge on calls made but not paid;

IX. a charge on a ship or any share in a ship;

X. a charge on intangible assets, including goodwill, patent, a license under a patent, trade mark, copy right or a license under a copyright;

XI. a charge or assignment on insurance policies obtained by the company;

XII. all and every kind of pledge margin money, including shares, is a pledge;

XIII. Lien on shares in the company (e.g. company A has invested in shares of company B. The latter, through its Articles has lien over shares including fully paid shares for any debts due from member including trade debts. Company B supplies goods to company A on credit. On such supply, lien is created and should be registered as charge).

Illustration:

There are two Companies ABC Ltd and XYZ td. ABC Ltd. took loan from the Bank and XYZ Ltd. gave guarantee on its property.

- Whether Charge will be created in ABC Ltd?
- Whether Charge will be created in XYZ Ltd?

In the above situation XYZ Ltd. is giving its assets as security to bank for loan to ABC Ltd., therefore assets of the XYZ Ltd. is involved. Charge will be created in the XYZ Ltd and not on the property of ABC Ltd.

REGISTRATION OF CHARGES (SECTION 77, 78 &79)

Primarily, under section 77(1) of the Act, every company creating a charge is required to register the particulars of charge signed by the company and its charge-holder together with the instruments creating the charge.

The legislative intent behind the section 77 of the Act, is to ensure that all encumbrances made by the company on its property or assets or any of its undertakings are made public. This is especially required to protect the interest of the lenders to ensure that the assets being offered as security for their proposed facilities are not already encumbered.

Once a charge is registered, it will be in the public domain and the lender can verify the details of financial facilities obtained and charge created on property or assets or any of its undertakings. This section serves two fold purpose: preventing the company from simultaneously borrowing on the same assets without notice to previous lender and providing clear information to the new lender about the status of the assets.

The provisions applicable to the registration of a charge under Section 77 shall *mutatis mutandis* apply to modification of the charge.

It is the duty of every company creating or modifying a charge to register the particulars of the charge together with the instruments, if any, creating such charge in such form, on payment of such fees and in such manner as may be prescribed, with the Registrar.

Registration of Charge - Rule 3(1) of the Companies (Registration of Charges) Rules, 2014 prescribes the rule for registration of creation or modification of charges.

Where the Charge is created	Within or outside India
Charge is created on	Charge is created on property, assets or any undertakings of the company whether tangible or intangible
Location of the assets	Property, assets or any undertakings may be located within or outside India
Time Limit for Registration	The particulars of the charge together with a copy of the instrument, if any, creating or modifying the charge shall be filed with the Registrar within a period of **30 days** of the date of creation or modification of charge
Forms for Registration of charge	• **Form No. CHG-1 (for other than debentures)** • **Form No. CHG-9 (for debentures),** as the case may be, With prescribed fees, Form duly signed by the Company and the charge holder.

If the particulars of a charge are not filed within the prescribed period of 30 days, then such creation or modification shall be filed in Form No. CHG-1 or Form No. CHG- 9 on payment of additional fee or *ad-valorem* fee in a manner as prescribed below:

(a) in case of charges created or modified before the 02.11.2018, within a period of 300 days of such creation; or 6 months from 02.11.2018 as the case may be, the following additional fees is payable:

S.No.	***Period of Delay***	***Additional Fees applicable***
1.	Up to 30 days	2 times of normal fees
2.	More than 30 days and up to 60 days	4 times of normal fees
3.	More than 60 days and up to 90 days	6 times of normal fees
4.	More than 90 days and up to 180 days	10 times of normal fees
5.	More than 180 days	12 times of normal fees

(b) in case of charges created or modified on or after the 02.11.2018, within a period of 60 days of such creation or modification, on payment of such additional fees as prescribed or Registrar may, on an application, allow such registration to be made within a further period of 60 days after payment of such *ad-valorem fees* as prescribed:

The MCA has prescribed the following additional fees or *ad valorem* fees as the case may be, payable with effect from 01.08.2019 on the charges created after 02.11.2018: -

Period of delay	*Small Companies and One Person Company*	*Other than Small Companies and One Person Company*
Up to 30 days of Delay (up to 60 Days from the date of Creation or Modification)	3 times normal fee	6 times normal fee
More than 30 days and up to 90 days delay (up to 120 days from the date of Creation or Modification)	3 times of normal fees plus an *ad valorem fee* of 0.025 per cent. of the amount secured by the charge, subject to the maximum of rupees one lakh.	6 times of normal fees, plus an *ad valorem* fee of 0.05 per cent. of the amount secured by the charge, subject to the maximum of rupees five lakhs.

After amendments in Section 77 of the Act, the provisions restricts the ability of the company to register charge after expiry of 120 days resulting beyond 120 days the charge cannot be registered. In such case the lending institution or the company should ensure registration before 120 days otherwise the entire purpose of registration of charge to have transparent information in public domain will be defeated. This situation also deprives genuine lenders to recover their dues. This also gives wrong picture of charges on the property of the company, when third party takes search of MCA for registration of charges.

Illustration :

Moniin Ltd. having authorized and paid up capital of Rs.10 Crore has created charge of Rs.500 Crore on its fixed assets on 01st June, 2022 in favor of Fincon Ltd., but failed to register it with the Registrar of Companies. The Company made an application to ROC on 15th September, 2022 for registration of charges. The fees leviable on the Company is as mentioned below:

Particulars	*Date*	*Remarks*
Date of creation	1st June, 2022	
Amount secured	Rs. 500 crores	
Upto 30 days	30th June, 2022	Normal fees=Rs. 600
More than 30 days and up to 60 days	30th June, 2022 to 29th July, 2022	Additional fees 6 times *Rs.600=Rs.3600
More than 60 days and up to 120 days	29th July, 2022 to 29th September, 2022	Additional fees + ad valorem fees *Ad-valorem* fees= 0.05% of Rs. 500 crores = Rs. 25 lakhs or Maximum *Ad-valorem* Fees=Rs.5 Lakhs
Total Fees		3600+5,00,000= Rs.5,03,600

Overseas Ltd. having authorized and paid-up capital of Rs. 10 Lakhs with its headquarter in Kolkata had created a floating charge on its assets of Rs.1 crore on 1st June, 2022 for raising a new loan and to continue its expansion of business smoothly. There was no filing of form CHG-1. The Company made an application to ROC on 15th September, 2022 for registration of charges. The fees leviable on the Company (small company) is as mentioned below:

Particulars	***Date***	***Remarks***
Date of creation	1st June, 2022	
Amount secured	Rs. 1 crore	
Upto 30 days	30th June, 2022	Normal fees=Rs. 400
More than 30 days and up to 60 days	30th June, 2022 to 29th July, 2022	Additional fees 3 times *Rs.400=Rs.1200
More than 60 days and up to 120 days	29th July, 2022 to 29th September, 2022	Additional fees + *ad valorem* fees Ad-valorem fees = 0.025% of Rs. 1 crore = Rs. 2500 or Maximum *Ad-valorem* Fees = Rs.1 Lakh
Total Fees		1200+2500= Rs.3700

Test Yourself

If a charge is created on 18-07-2022 but the registration is not made within the original period of 30 days and also not made within next 30 days after the expiry of original 30 days, then the Registrar is empowered to allow such registration to be made within a further period of _____ :

(a) 30 days

(b) 45 days

(c) 60 days

(d) 90 days

Answer: 60 Days

Verification of Instruments- Rule 3(4) of the Companies (Registration of Charges) Rules, 2014

A copy of every instrument evidencing any creation or modification of charge are required to be filed with the Registrar in pursuance of section 77, 78 or 79 shall be verified as follows:

- where the instrument or deed relates solely to the property situated outside India, the copy shall be verified by a certificate issued either under the seal, if any, of the company, or under the hand of any Director or Company Secretary of the company or an authorised officer of the charge holder or under the hand of some person other than the company who is interested in the mortgage or charge;

- where the instrument or deed relates, whether wholly or partly, to the property situated in India, the copy shall be verified by a certificate issued under the hand of any Director or Company Secretary of the company or an authorised officer of the charge holder.

Subsequent Registration shall not Prejudice any Right

Third Proviso to Section 77(1) states that any subsequent registration of a charge shall not prejudice any right acquired in respect of any property before the charge is actually registered which means that the rights of the former charge holder will not be affected in case of the creation of the subsequent charge.

Non-Applicability to certain charges as prescribed in consultation

Fourth Proviso to Section 77(1) states that the section w.r.t. registration of charges, shall not apply to such charges as may be prescribed in consultation with the Reserve Bank of India.

Central Government has been empowered that in consultation with RBI, they may specify certain charges, for which section 77 is not applicable. Therefore, registration of such charges is not required to be registered with the ROC.

Consequences of Non-Registration of Charges

According to Section 77 of the Companies Act, 2013, all types of charges created by a company are to be registered by the ROC, where they are non-compliant and are not filed with the Registrar of Companies for registration, it shall be void as against the liquidator and any other creditor of the company. This does not, however, mean that the charge is altogether void and the debt is not recoverable. So long as the company does not go into liquidation, the charge is good and may be enforced.

Void against the liquidator means that the liquidator on winding up of the company can ignore the charge and can treat the concerned creditor as unsecured creditor. The property will be treated as free of charge i.e. the creditor cannot sell the property to recover its dues.

Void against any creditor of the company means that if any subsequent charge is created on the same property and the earlier charge is not registered, the earlier charge would have no consequence and the latter charge if registered would enjoy priority. In other words, the latter charge holder can have the property sold in order to recover its money.

Thus, non-filing of particulars of a charge does not invalidate the charge against the company as a going concern. It is void only against the liquidator and the creditors at the time of liquidation. The company itself cannot have a cause of action arising out of non- registration *[Independent Automatic Sales Ltd. v. Knowles & Foster (1962) 32 Comp Cas].*

In light of the expression "Notwithstanding anything contained in any other law for the time being in force, no charge created by a company shall be taken into account by the liquidator appointed under this Act or the Insolvency and Bankruptcy Code, 2016, as the case may be, or any other creditor unless it is duly registered under sub-section (1) of Section 77 and a certificate of registration of such charge is given by the Registrar under sub-section(2).

In other words, unless the charge created is registered with the Registrar and a certificate of registration of such charge is given by the Registrar, no other law can force the liquidator or other creditor to take into account the said charge.

The liquidator or other creditor of the company need not consider the said unregistered charge against assets of the company.

CASE LAWS

In the case of *ONGC Ltd v. Official Liquidators of Ambica Mills Co. Ltd. (2006) 132 Comp Cas 606 (Guj)*. The ONGC had not been able to point out whether the so called charge, on the basis of which it was claiming preference as a secured creditor, was registered or not. It was held that in the light of this failure, ONCG could not be treated as a secured creditor in view of specific provisions of section 125 under the erstwhile Companies Act, 1956 and the statutory requirement under the said section. This does not, however, mean that the charge is altogether void and the debt is not recoverable. So long as the company does not go into liquidation, the charge is good and may be enforced.

In the case of *Antifriction Bearing Corporation Limited v. State of Maharashtra, [(1966) (1999) 20 SCL, 373 (Bom)]* it was held that charges were to be void against the liquidator or creditor unless registered. The Bombay High Court observed that filing of copy of document of charge with Registrar is not the formality but a definite legal requirement and that non-filing creates a certain legal impediment.

In the case of *Official Liquidator v. Suryakant Natvarlal Surati [(1986) 59 Comp Cas 147 (Bom)]* it was held that if a decree was passed on an unregistered charge, before company was ordered to be wound up, section 125 of the Companies Act, 1956 (Now section 77 of the Companies Act, 2013) would still apply in case the decree keeps the unregistered charge alive.

In the absence of registration of a charge, on date of winding up order, Official Liquidator would be justified in treating such charge holder as ordinary creditor. [*Rajasthan Financial Corporation v. Official Liquidator, Jaipur Spinning & Weaving Mills Ltd. (In liquidation)][(1997) 88 Comp Cas 192 (Raj)]*

Unless and until a charge is registered with the Registrar, it has no sanctity notwithstanding the fact that such charge was brought into vogue by reason of agreement inter-parties between the two creditors or by registration of guarantee bond. *[A.P. State Financial Corpn. v. Mopeds India Ltd. [(2005) 124 Comp Cas 833 (AP)].*

Case Study:

Volkswagen Finance Pvt. Ltd vs. Shree Bala Printopack Pvt Ltd & Ors, NCLAT, 19th October, 2020

Fact of the Case

The Company (under Liquidation) namely Shree Balaji Printopack Pvt. Ltd. executed a Loan and Hypothecation Agreement on 25.11.2013, for an amount of Rs. 36,00,000/- payable in 84 monthly instalments of Rs. 61,964/- each from 15.12.2013 to 15.11.2020, for the purchase of an AUDI Q3 TDI 2.0 vehicle. It was stated by the Appellant that they have security of the vehicle in terms of Sections 52 and 53 of the Insolvency and Bankruptcy Code, 2016. It was averred that a demand of Rs. 21,83,819.18/- was made which was not paid and hence there was a 'default' and the amount became 'due and payable'.

The Learned Adjudicating Authority had appointed a Liquidator vide Order dated 03.04.2019 and Claims were invited Company Appeal (AT) (Insolvency) No. 02 of 2020 from the Creditors as per the provisions of the Code. The Applicant namely, M/s. Volkswagen Finance Pvt. Ltd. filed its claim on 22.07.2019 with the copies of the Loan Agreement, the Hypothecation Deed, the Demand Letter and the Registration Certificate of the vehicle together with the invoices concerned for the consideration of the Liquidator. The Applicant had informed the Liquidator that the 'Charge' was duly registered by way of hypothecation registration with the Regional Transport Office (RTO) in terms of Section 51 of the Motor Vehicles Act, 1988 (M.V. Act). It is the Applicant's case that there was no requirement of registration of 'Charge' with the R.O.C and that the Liquidator, without examining the Certificate issued by the Registration Authority under the 'M.V. Act' dismissed the Claim made by the Applicant. Being aggrieved with the decision dated 26.07.2019 of the Liquidator, the Applicant approached the Adjudicating Authority seeking to set aside the Order of the Liquidator.

The Learned Adjudicating Authority while dismissing the Application observed as follows;

The Liquidator has referred to Regulation 21 of the IBBI (Liquidation Process) Regulation, 2016 and submitted that the claim of the Applicant is not supported by any documentary evidence as prescribed under the said Regulation and the Applicant cannot be treated as a secured creditor. Further, as per submission of the Liquidator, the Applicant is to be treated as Unsecured Financial Creditor.

Further, the claim of the Applicant is not fulfilling any of the requirements under Regulation 21 of the IBBI (Liquidation Process) Regulation, 2016. Further, the Liquidator has referred to the provisions of Section 77(3) of the CA, 2013 and submitted that no charge has been registered under Section 77(1) in relation to the Subject Property.

Arguments

Learned Counsel appearing for the Appellant contended that the Learned Adjudicating Authority failed to take into consideration that the 'Charge' of the Appellant was duly registered by way of hypothecation under Registration Certificate with the RTO in terms of Section 51 of the Motor Vehicles Act, 1988; that the Hypothecation Deed, Loan Agreement, CIBIL Record, Admission of the 'Debt and Default' was not considered; that Hypothecation is a method of creation of security of movable property and the goods so hypothecated continued to be in possession of the owner, i.e. the Borrower and hence it is a way of Company Appeal (AT) (Insolvency) No. 02 of 2020 creating security without delivery of possession and as in the literal sense of term, the lender is 'hypothetically' in control of the property; that the definition of 'Hypothecation', 'Charge', 'Secured Asset', 'Financial Asset', 'Financial Creditor', 'Secured Creditor', clearly explains the position of Law on the subject more particularly Sections 3 (4), 3 (31), 3 (37) of IBC and Sections 2(1)(b) and 2 (16) of the Companies Act 2013; that the hypothecated vehicle of the Applicant is the 'Security' as recognised under Law and, therefore, the Appellant has every right under Sections 52 and 53 read with Section 36(4)(b) of the IBC to proceed independently. The Learned Appellant Counsel strenuously contended that Hypothecation is merely an extended form of 'Pledge' which allows a lender to retain possession in trust for himself and, therefore, Hypothecation is a subset of 'Pledge'.

He further contended that Section 77 (1), 77 (2) require that 'Charge' is to be registered, but nowhere categorises on what items Company Appeal (AT) (Insolvency) No. 02 of 2020 the 'Charge' is to be registered by a Company or a Financial Institution. Section 77 (3) states that unless 'Charge' is registered, the claim would not be considered and read with Section 77 (4) and Section 79, it is made clear that non-Registration of 'Charge' does not impact the original contract and 'Security' so created.

He submitted that the Learned Adjudicating Authority failed to adopt a Harmonious Construction of the 'MV Act' and the IBC Code.

Learned Counsel for the Respondent relied on the Judgment of the Hon'ble Supreme Court in *Kerala State Financial Enterprises Ltd. vs. Official Liquidator, High Court of Kerala, (2006) 10 SCC 709*, in which the Hon'ble Apex Court, while confirming the Order of the Hon'ble High Court of Kerala observed that 'ordinarily a 'Charge' should be registered in terms of Section 125 of the Act and if the charges are not registered the same would be void against the Liquidator or Creditors'. He also drew our attention to the Judgement of the Hon'ble Supreme Court in *Oil and Natural Gas Corporation Ltd. vs. Official Liquidator of Ambica Mills Co. Ltd. and Ors., (2015) 5 SCC 300* in which the Hon'ble Apex Court while placing reliance on *Indian Bank vs. Official Liquidator, Chemmeens Exports (P.) Ltd. and Ors., (1998) 5 SCC 401* in which the Hon'ble Apex Court has observed that 'Section 125 applies to every 'Charge' created by the Company on or after 01.04.1914. But where the 'Charge is by Operation of Law or is created by order or decree of the Court, Section 125 has no Application'.

Point of Contention

The main issue which falls for consideration in this Appeal is whether the Liquidator was justified in rejecting the Application filed by the Applicant on the ground that the Applicant was not a 'Secured Financial Creditor' in the absence of the 'Charge' being registered with the Registrar of Companies (ROC) under Section 77 (1) of the Companies Act 2013 with respect to the Subject Property that the Appellant was not a Secured Creditor entitled to realise the security interest in accordance with Section 52(1)(b) of the Code.

Decision

In connection with the above, it is relevant to refer to the judgement passed by the Hon'ble High Court of Kerala in *Kerala State Financial Enterprises vs. Official Liquidator*, reported in (2006) 133 Company Case 912 (Kerala), wherein it has been held that if, *'the charge had not been registered under Section 125 of the Companies Act 1956, then, undisputedly the Appellant has to be considered as an Unsecured Creditor and has to be in que with other creditors to receive its dues as and when assets of the company are collected by the Official Liquidator for distribution in accordance with law'.*

The said judgement was upheld by the Hon'ble Apex Court on the Appeal filed as reported in (2006) Company Appeal (AT) (Insolvency) No. 02 of 2020 133 Company Case 915 (SC).

It is concluded that no charge has been registered under the provisions of Section 77(1) of the CA, 2013 in relation to the Subject Property. This is also confirmed from the format as provided under the Rule 3(1) of the Companies (Registration of charges) Rules, 2014 (Form No. CHG-1), which indicated various types of charge i.e. immovable Property, book debts, Motor Vehicle (hypothecation), goodwill etc. indicating that motor vehicle is one of the specific type of charge which is mandatory to be registered with ROC. Therefore, the Applicant cannot be treated as Secured Financial Creditor. Accordingly, the issue framed herein above is decided against the Applicant and in favour of the Liquidator.

Certificate of Registration of Charge & Certificate of Modification of Charge Section 77(2) read with Rule 6 of Companies (Registration of Charges) Rules, 2014

Registrar shall issue, to the company or to the person in whose favor the charge is created, in the below mentioned form:	
Certificate of registration of charge	Form CHG-2
Certificate of modification of charge	Form CHG-3

The certificate issued by the Registrar whether in case of registration of charge or registration of modification of charge, as the case may be shall be conclusive evidence that the requirements of Chapter VI of the Act (Registration of Charges) and the rules made thereunder as to registration of creation or modification of charge, as the case may be, have been complied with.

Importance of Registration of Charge and its Certificate

As per Section 77(3) of the Companies Act, 2013 , the registration under Section 77(1) and Certification under Section 77(2) plays very important role. This is because of the initial words under sub-section(3) "Notwithstanding anything contained in any other law for the time being in force". This has overriding effect to take cognizance of any charge either by the liquidator appointed under the Companies Act, 2013 or under the Insolvency and Bankruptcy Code, 2016, if and only if it is registered and certificate is issued as per this section.

However, Section 77(4) provides an exemption to this stringency. Under this sub-section, it will not prejudice any contract or obligation for the repayment of the money secured by a charge, even though it is not registered and a certificate is not issued by the Registrar as mentioned under this section.

CASE STUDY

Indiabulls Housing Finance Ltd vs. Samir Kumar Bhattacharya & Anr on 18 December, 2019, NCLAT

Fact of the case

It is the case of the Appellant that the Appellant was treated as Unsecured Financial Creditor in the Resolution Plan although according to the Appellant, the Appellant should have been treated as a Secured Financial Creditor.

Learned Counsel for the Appellant has argued that the Appellant had given loan to the Corporate Debtor sometime in 2012 and against the loan provided, Title Deed belonging to the Corporate Debtor were handed over to the Appellant and thus it is stated that the equitable mortgage had been created. Learned Counsel states that when CIRP started, the Appellant filed the claim before the Resolution Professional-Respondent No. 1 but the Resolution Professional treated the Appellant as Unsecured Claimant on the basis that the Charge was not created under Section 77 of the Companies Act, 2013.

Arguments

Learned Counsel for the Appellant submits that as per Section 77 of the Companies Act, 2013, it was the responsibility of the Corporate Debtor to get the Charge registered and thus the Appellant could not be made to suffer. It is argued that in spite of this, the Appellant applied to ROC on 05.12.2018 for registering its charge and when ROC pointed out that Delay Condonation Application was required, the same was filed on 19.07.2019 and the Charge has now been registered on 03.10.2019. Submission of the learned Counsel for the Appellant is that the Appellant should be treated as Secured Financial Creditor.

Learned Counsel for the Respondent No. 2 referred to Sections 77 and 78 of the Companies Act, 2013 to submit that when a Charge is created, the Company creating Charge and Charge holder both are required to get the Charge registered and if the concerned Company fails to register the Charge within given period of 30 days from the date of creation of Charge, (referring Section 78 of Companies Act, 2013) there is an option even for the Charge Holder to move ROC and get the Charge registered. It is the submission that no such steps had been taken till CIRP started. The benefit cannot be taken by such Creditor.

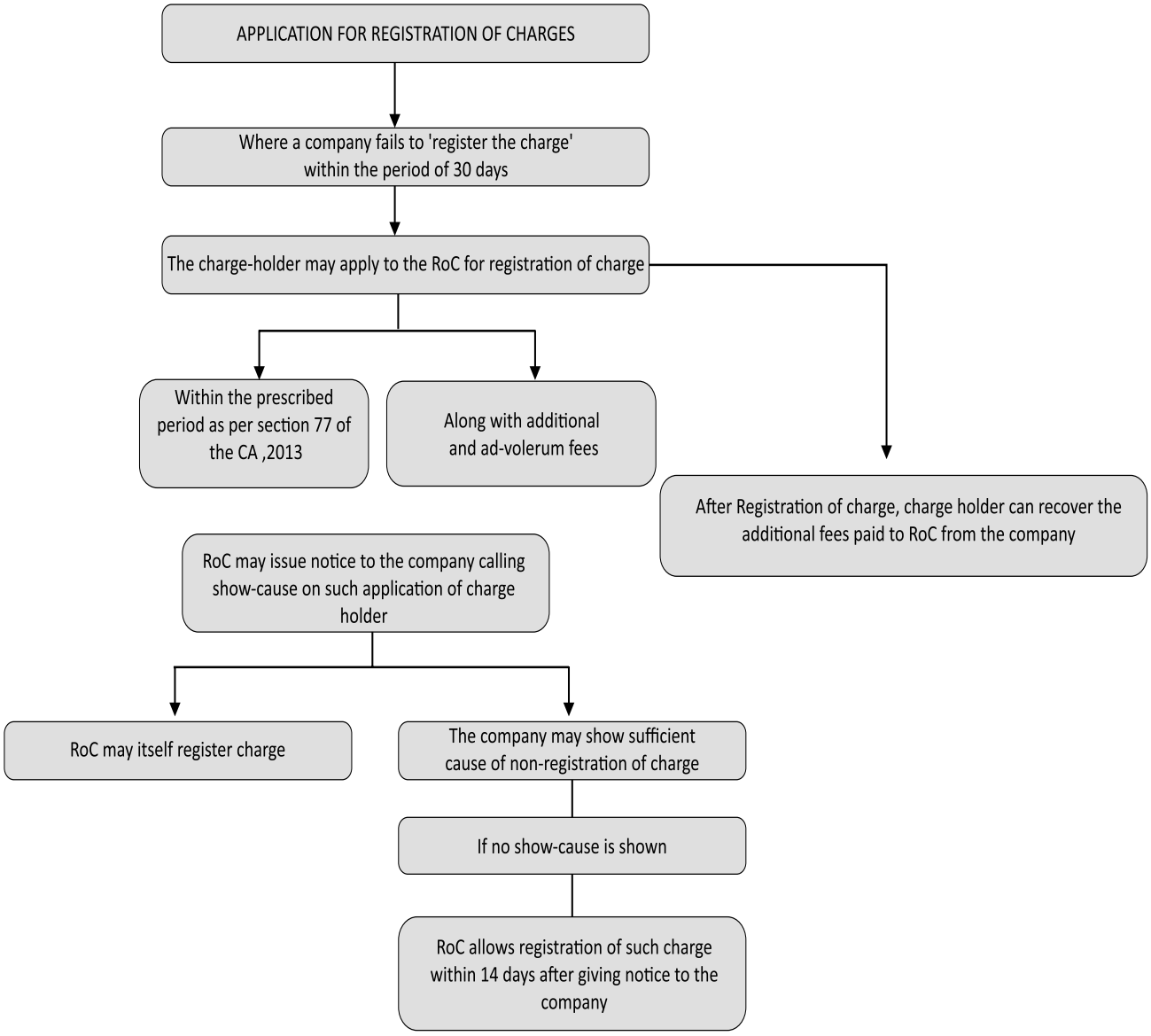
Decision

The NCLAT observed that, the CoC (Committee of Creditors) had made it clear that in absence of Charge being registered, the Appellant could not be treated as Secured Financial Creditor. Although the transaction is stated to be of 2012, it is clear that the Charge was not got registered either by the Corporate Debtor or the Appellant till now on 03.10.2019 which is after the Resolution Plan was approved on 04.07.2019.

Section 77 of the Companies Act, 2013 required the Charge to be registered and the Appellant had an option to resort to even Section 78 of Companies Act, 2013, if there were any grievances. Not having done so, when CIRP started trying to rely on the equitable mortgage without a charge created, we do not find there was any error in the CoC meetings which in its wisdom did not recognize creation of security. The transaction did not even reflect in the Books of Account of the Corporate Debtor. Appellant should be happy that it has been at least treated as Financial Creditor. Appellant took no actions since 2012 and till late stage of CIRP. Charge registered after Resolution Plan is approved cannot be considered.

It is held that, there is no reason to interfere now in the Appeal directly filed before us without subject having been taken up with the Adjudicating Authority at any earlier time nor when the Resolution Plan was being discussed. In the circumstances, there is no substance in the appeal. The appeal is dismissed.

APPLICATION FOR REGISTRATION OF CHARGE (SECTION 78)



- Where a company fails to *"register the charge within the period of thirty days referred to in sub-section (1) of section 77",* the person in whose favor the charge is created may apply to the Registrar for registration of the charge along with the instrument created for the charge in Form No.CHG-1 or Form No.CHG- 9, as the case may be, within the period as specified in Section 77 duly signed along with payment of additional fee or ad valorem fee.
- The registrar may, on such application, give notice to the company about such application. The company may either itself register the charge or shows sufficient cause why such charge should not be registered.
- On failure on part of the company, the Registrar may allow registration of such charge within 14 days after giving notice to the company. This does not extinguish the liability of the company in case any offence has been committed in registration like delay to register the charge.

- Where registration is affected on application of the person in whose favour the charge is created, that person shall be entitled to recover from the company, the amount of any fee or additional fees paid by him to the Registrar for the purpose of registration of charge.

Acquiring Property subject to a Charge (Section 79)

The provisions of section 77 relating to registration of charges shall, so far as may be, apply to -

- a company acquiring any property subject to a charge within the meaning of that section; or
- where there is modification in the terms or conditions or the extent or operation of any charge registered under that section.

(a) Company acquiring any property subject to a Charge

When the modification in the particulars of charge by Asset Reconstruction Company (ARC) in terms of Securitization and Reconstruction of Financial Assets and Enforcement of Interest Act, 2002 (SERFASAI). The Charge is required to be registered as required in case of the registration of Charge under section 77 of the Companies Act, 2013.

The time limit provided under the section 77 shall apply from the date of completion of acquisition as the assets become assets of the company form such date.

Test Yourself

Any person acquiring property (on which charge is registered under section 77) shall be deemed to have notice of the charge from:

(a) end of 30 days (b) date of application for charge (c) date acquiring the property (d) date of such registration

(b) Modification of Charge

The term 'modification' includes variation of any of the terms of the agreement including variation of rate of interest, increase / decrease in amount of borrowings, change / swap of security, extension of time for repayment, which may be by mutual agreement or by operation of law. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification.

Modification of charge is a stage subsequent to the creation of charge. It is quite likely that the terms and conditions or limits of charge already created/registered with the concerned Registrar are subsequently changed or modified due to further developments by creation of equitable mortgage on a subsequent date or enhancement or reduction of credit facilities, etc.

MCA has clarified that so long as the terms and conditions or the extent of operation of any charge is modified for whatever reason, the provision of section 79 would become applicable. Therefore, even in case of modification of charge without any mutual agreement between the parties thereto namely as a result of change in law, the provision of Section 79 of the Act are attracted.

The Department has also clarified that a transfer or an assignment of a charge by the charge holder is a case of modification of the conditions of the charge and it necessarily fall within the purview of Section 79 of the Companies Act, 2013. Consequently, requisite particulars will have to be filed in Form CHG-1 with the Registrar.

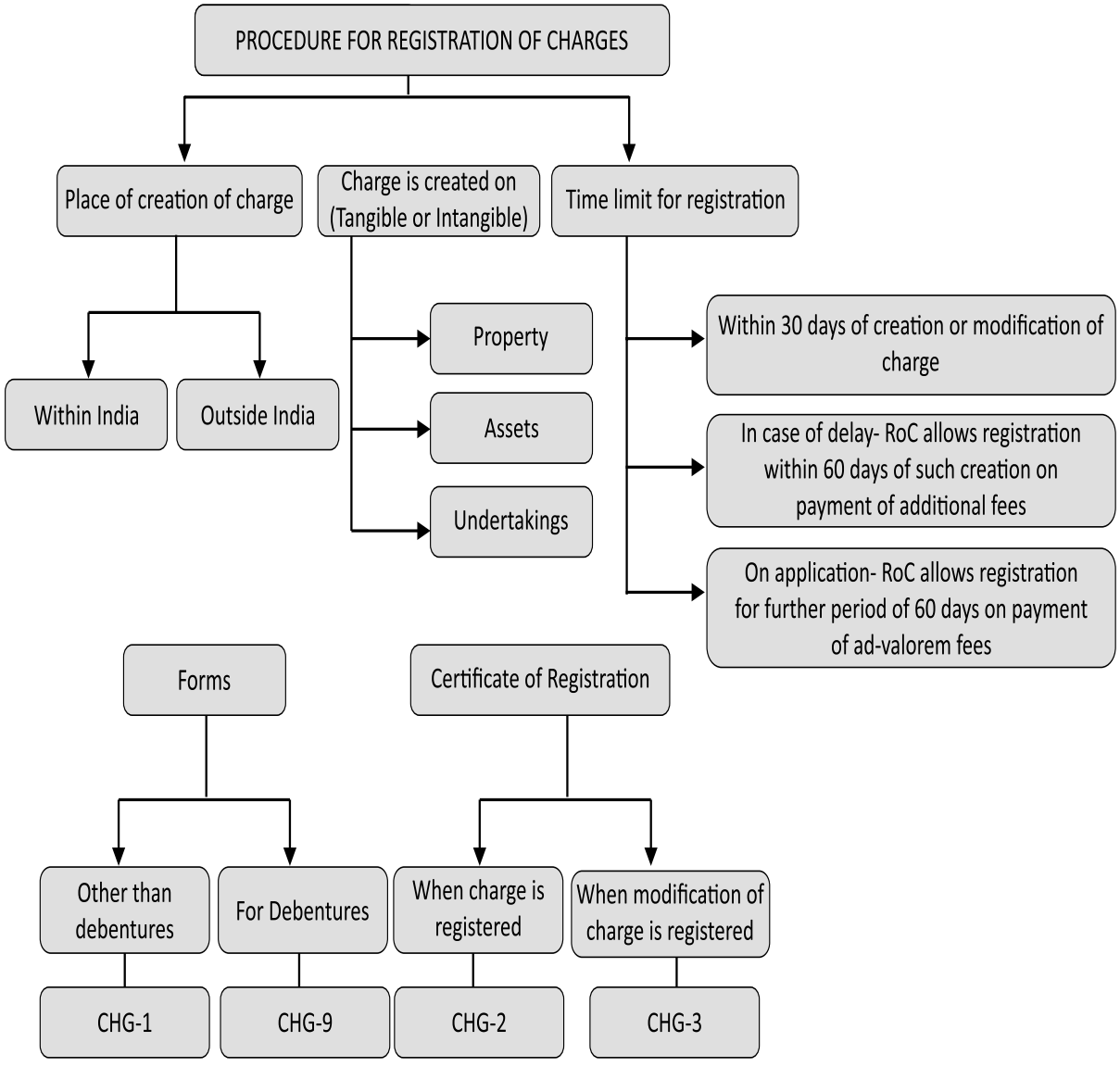
Useful modifications may include, *inter alia*, the following:

1) Increase/decrease in amount of borrowings
2) Change/swap of Security
3) Change/variation in rate of interest (other than change in relation to bank rate)
4) Extension of time for repayment
5) Assignment of charge in favour of another person

Section 79 of the Act makes it clear that the requirement of registering the charge shall also apply to a company acquiring any property subject to charge or any modification in terms and conditions of any charge already registered.

The provisions relating to application to Registrar under Rule 4 shall apply, *mutatis mutandis*, to the registration of charge on any property acquired subject to such charge and modification of charge under section 79 of the Act.

Summary of registration of creation or modification of charge



Procedure to be followed for creation or modification of charge

Notice of Board Meeting	▪ Issue not less than 07 (seven) days' notice and agenda of a Board Meeting to consider the borrowing of money and creation of charge on the assets or properties of the company.
Board Meeting	▪ Hold a meeting of Board of Directors to pass the necessary resolution for creating charge on assets of the company in favour of the charge-holder, subject to the approval of shareholders. ▪ Approve draft notice of general meeting of members with explanatory statement. ▪ Authorise the Directors/Managing Director of the Company to sign and execute the required documents and file necessary forms for creation or modification of charge on the properties/assets of the company in favour of the charge-holder after obtaining approval of shareholders through special resolution.
Authorisation to the Board	▪ Hold general meeting of members and pass Special Resolution under section 180(1)(a) & (c) to authorize the company to borrow money and create charge on any of its property or assets or any undertakings in favour of the charge-holders. ✓ *In case of Private Company the provisions of Section 180 is not applicable unless the Articles provide otherwise.* ▪ *Ensure that such borrowing is within the borrowing limits fixed by the company in compliance with the provision of Section 179(3)(d) and Section 180(1)(c).* *(Not Applicable in case of Private Company.*
Filing of Forms	e-form MGT-14 ▪ MGT-14 for Special Resolution under section 180(1)(a) and (1) (c) by all companies except the Private Company. However, if the Borrowing is within the limits prescribed or approved by the company the filing of form is not required. ▪ MGT-14 on the Board Resolution to power exercised under section 179(3) to Borrow money by all companies except the Private Company. ▪ **e-Form CHG-1 (other than Debentures)/CHG-9 (Debentures)** shall be filed with the concerned Registrar of Companies within 30 days of creation of charge/ modification of charge ▪ If the particulars of charge cannot be filed within 30 days due to unavoidable reasons, then it may be filed: ✓ within the period next 30 days after payment of such additional fee and supported by a declaration from the company signed by its secretary or director that such belated filing shall not adversely affect rights of any other intervening creditors of the company. ✓ If the particulars of charge cannot be filed within 60 days as above, then the Registrar may on an application, allow such registration to be made within the period next 60 days by paying additional fees and *ad valorem* fee.

	✓ The following particulars in respect of each charge are required to be filed with the Registrar: (a) date and description of instrument creating charge; (b) type of charge; (c) total amount secured by the charge; (d) date of the resolution authorising the creation of the charge (in case of issue of secured debentures only); (e) general description of the property charged; (f) in case of acquisition of property subject to charge, details relating to the existing charge on the property so acquired; (g) a copy of the deed/instrument containing the charge duly certified or if there is no such deed, any other document evidencing the creation of the charge to be enclosed; (h) principal terms and conditions and extent and operation of the charge and name and address of the charge holder particulars of all joint charge holders is mandatory if number of charge holder is more than one; (i) In case the e-Form is to be filed for modification of charge, enter the charge identification number allotted at the time of registration of the charge and such charge ID entered for modification should be open charge ID and not satisfied; (j) Details relating to involvement of consortium finance is involved, joint charge is involved pari passu ranking if applicable the charge holder(s); (k) In case the asset charged is an immoveable property, the details like a 'Plot Unit' or 'Dwelling Interest' and furnish the related details viz., ● Evaluated Price of Asset as on Security Interest Creation date ● Nature of Property ● Plot ID number ● All other location related field details ● The fields for latitude and longitude are mandatory in the Charge Forms. ✓ Attach the following documents with e-Form No. CHG-1/CHG-9: (a) A certified true copy of every instrument evidencing any creation or modification of charge; (b) Instrument(s) evidencing creation or modification of charge in case of acquisition of property which is already subject to charge together with the instrument evidencing such acquisitions.

Entries in the Register of charge	**e-Form-CHG-7** ▪ The register of charges maintained by the company in Form No. CHG.7 and enter therein particulars of creation/modification of charge registered with the Registrar on any of the property, assets or undertaking of the company. ▪ The register is to be kept at the registered office of the company.

CASE STUDY

***SICOM Limited vs. Mr. Sundaresh Bhat,* NCLAT dated 6th January, 2022**

The brief facts of the case and sequence of events necessary to be noted for deciding this Appeal are:

(i) The ABG Shipyard Limited – Corporate Debtor had obtained financial assistance from the Appellant vide sanction letter dated 28th March, 2013. A Medium Term Loan of Rs. 90,00,00,000 (Rupees Ninety Crores Only) was sanctioned by the Appellant to the Corporate Debtor.

The Loan Agreement was entered between the Corporate Debtor and the Appellant. Security was provided by the Corporate Debtor for the loan by mortgage and hypothecation. The Loan Agreement was executed on 30th March, 2013.

(ii) The Deed of Hypothecation was also executed on 11th April, 2013, creating first exclusive charge for the entire receivables under Shipbuilding Subsidy Scheme.

(iii) On 31st October, 2013, the account of Corporate Debtor was classified as Non-Performing Asset (NPA). The Appellant issued notices and reminders to pay outstanding money and ultimately filed an O.A. No.274 of 2016 before the Debt Recovery Tribunal, (DRT) Ahmedabad seeking recovery of Rs.144,46,95,879/- together with interest. The DRT Ahmedabad vide its judgment dated 26th April, 2017 allowed the O.A. and directed the defendants to jointly and severally deposit Rs.144,46,95,879/- within 30 days, failing which due was to recover from their mortgaged and hypothecated properties.

(iv) On 30th November, 2018, the Resolution Professional circulated the list of Financial Creditors wherein the claim of the Appellant was categorized as 'Secured Financial Creditor'. An order dated 25th April, 2019 was passed directing for liquidation by the Adjudicating Authority. Liquidator issued public announcement on 3rd May, 2019, in response to which, the Appellant filed its proof of claim of Rs.259,97,90,186/-

(v) The Liquidator on 24th May, 2019 wrote an email to the Appellant seeking relinquishment of security interest in the assets of Corporate Debtor. On 6th June, 2019, the Appellant gave its consent regarding relinquishment of security interest in accordance with Section 52(1)(a) of the IB code. List of stakeholders and Financial Creditors was prepared by the Liquidator, in which the claim of the Appellant was put under the head of "amount unsecured". The Appellant protested the categorization.

Arguments

Appellants submitted that Adjudicating Authority committed error in rejecting the Application of the Appellant filed under Section 60 sub-section (5) of the IB Code and not under Section 42, hence limitation provided for filing an Appeal was not applicable. The Appellant was aggrieved with regard to its categorization as 'unsecured creditor', which was fully covered by Section 60 sub-section (5), relating to question of priorities.

It is further submitted that Section 77 of the Companies Act, 2013 was not applicable in the present case in view of the fact that there was a Decree in favour of the Appellant by Debt Recovery Tribunal.

It is further argued that Section 77 sub-section (3) of the Companies Act, 2013 is applicable only to the charge created by a 'company' and not on the encumbrance created over an asset of a company pursuant to DRT judgment.

Respondents refuting the submissions of the Appellant contends that verification of security interest is mandatory during the liquidation process. In view of the fact that charge of the Appellant was not registered under Section 77 sub-section (3) of the Companies Act, 2013, the same was not binding on the Liquidator.

The recovery certificate issued by the Debt Recovery Tribunal is not a Decree. Section 77 sub-section (3) of the Companies Act was fully attracted in the present case and charge of Appellant having not been registered, no illegality has been committed by the Adjudicating Authority in rejecting the claim of the Appellant as 'secured creditor'

Observation

The judgment of the Hon'ble Supreme Court in *Indian Bank (supra*), thus, fully support the submissions of the learned Counsel for the Appellant. There being adjudicatory order of the Debt Recovery Tribunal in favour of the Appellant, the mortgage and hypothecation was created in favour of the Appellant by the Corporate Debtor, hence, non-registration of mortgage and hypothecation under Section 77 of the Companies Act cannot be a ground to held that Appellant was not a 'secured creditor'. Under the order of the Debt Recovery Tribunal, the Corporate Debtor having not deposited the amount within 30 days' time period, the Appellant was at liberty to realise the amount from mortagaged and hypothecated assets.

Judgment

It was held that the Adjudicating Authority committed error in rejecting the claim of the Appellant to be of 'secured creditor'. By virtue of judgment and order of the Debt Recovery Tribunal, the Appellants were entitled to recover their dues from the secured assets and they having relinquished the security interest according to Section 52 of the IB Code, as was requested by the Liquidator, in the liquidation proceedings, they have to be treated as 'secured creditor'. In result, we allow the appeal and set aside the order dated 28th April, 2021 of the Adjudicating Authority and allow the Application being I.A. No.33 of 2021 filed by the Appellant and direct the Respondent/ Liquidator to correct the classification of claim of the Appellant as 'secured'. No order as to costs.

Date of Notice of Charge (Section 80)

Where any charge on any property or assets of a company or any of its undertakings is registered under section 77, any person acquiring such property, assets, undertakings or part thereof or any share or interest therein shall be deemed to have notice of the charge from the date of such registration.

The section clarifies that if any person acquires a property, assets or undertaking for which a charge is already registered, it would be deemed that he has complete knowledge of charge from the date the charge is registered.

Deemed Notice of Charge

Once the particulars of charge have been registered by the Registrar, the details of creation of charge become a matter of public domain. If any person acquires property or assets of a company or any of its undertakings, which are subject to such charge under Section 77, such person shall be deemed to have notice of the charge from the date of such registration.

All documents filed under the provisions of the Companies Act, open for inspection pursuant to Section 399 of the Companies Act, 2013. This is the effect of doctrine of constructive notice as the registered charge documents become public. This doctrine is limited only to the documents which are registered.

Practical Implications

The person/institution before lending or acquiring property from a Company is deemed to have notice of previous charge on the said property, if any, where any charge is created and also registered. Banks and lending institutions prefer to do a thorough title search before lending money on the security of any asset.

Zenith Limited obtained a term loan of Rs.80 Lakhs from Punjab National Bank Limited by creating a charge on one of its office buildings and the charge was duly registered. Later on, if the building is sold to Sumit, he is deemed to have notice of such charge. In other words, it is presumed that Sumit knew beforehand that the building was mortgaged to the bank for obtaining a loan. He cannot plead against such presumption by contending that he did not know about the charge if he suffers any loss at a later date because of the mortgage.

SATISFACTION OF CHARGES (SECTION 82 R/W RULE 8 OF THE COMPANIES (REGISTRATION OF CHARGES) RULES, 2014

Satisfaction of Charge is another important aspect relating to debts secured by a charge. In case of a full and complete payment of the secured charge registered with the Registrar, the company or charge-holder shall within a period of 30 days from the date of payment or satisfaction in full of any charge registered under Chapter VI of the Companies Act, 2013, give intimation of the same to the Registrar in **Form No. CHG-4** along with the prescribed fees.

The Registrar may, on an application by the company or the charge holder, allow such intimation of payment or satisfaction to be made within a period of 300 days of such payment or satisfaction on payment of such additional fees as may be prescribed.

The duty is cast on the borrower company to intimate to the concerned Registrar of Companies about payment in full of any charge relating to the Company.

In the case of *Karnataka District Central Co-Operative Bank Ltd. vs. Murudeshwar Food & Exports Ltd.* (in liquidation), where there was no material to show that the charge is satisfied and yet the records of the Registrar showed that the loans have been satisfied on the basis of the statement of affair filed by the directors of the Company in liquidation, the Registrar was directed to hold enquiry and delete the entry of satisfaction in the register of charges.

The Company was offered a term loan of 500 crores by a financial institution against the security of entire fixed assets of its two factories situated in Delhi and Gurgaon. After repayment of more than 75% of the loan amount the financial institution agreed to release fixed assets of one of its factory from charge. State whether Company can file part satisfaction of charge or it would amount to modification of charge.

The concept of partial satisfaction of charge is not there. Satisfaction shall be in full only. These amounts to modification of charge and the Company will have to file particulars of modification of charge, for registration.

Recording of satisfaction of charge by Registrar [Section 82(2)]

On receipt of such intimation, the Registrar shall issue a notice to the holder of the charge calling upon him to show cause within such time not exceeding 14 days, as may be specified in such notice, as to why payment or satisfaction in full should not be recorded as intimated to the Registrar.

If no cause is shown, by such holder of the charge, the Registrar shall order that a memorandum of satisfaction

Test Yourself:

On receipt of intimation of satisfaction of charge, the Registrar issues a notice to the holder calling upon him to show cause within such time not exceeding _____ days as to why payment or satisfaction in full should not be recorded as intimated to the Registrar:

(a) 21 (b) 30 (c) 14 (d) 300

shall be entered in the register of charges maintained by the registrar under section 81 and shall inform the company, that he has done so.

If the cause is shown to the Registrar shall record a note to that effect in the register of charges and shall inform the company accordingly.

However, the aforesaid notice shall not be sent, in case intimation to the Registrar is in specified form along with the Letter of the charge holder stating that the amount has been satisfied, which is a mandatory attachment in all cases of **Form No. CHG-4** and is signed by the holder of charge [Proviso to Section 82(2)].

Particular	*Time Period*	*Days*	*Fees*
Satisfaction of Charge with ROC	Within 30 days of Satisfaction	0+30= 30	Normal Fees
If fails to file within 30, days	Within a period of 300 days of such satisfaction	0+30+270= 300	Normal Fees + Additional Fees
If fails to file within 300, days	Filing of form with RD for satisfaction of Charge	0+30+270+--- = ------	Normal Fees + Additional Fees + Condonation fees

Exemption to IFSC Companies w.r.t. Section 82(1)

- *In case of Specified IFSC Public Company, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed. - Notification Date 4th January, 2017.*
- *In case of Specified IFSC Private Company, the Registrar may, on an application by the company, allow such registration to be made within a period of three hundred days of such creation on payment of such additional fees as may be prescribed. -Notification Date 4th January, 2017.*

Certificate of registration of satisfaction of charge

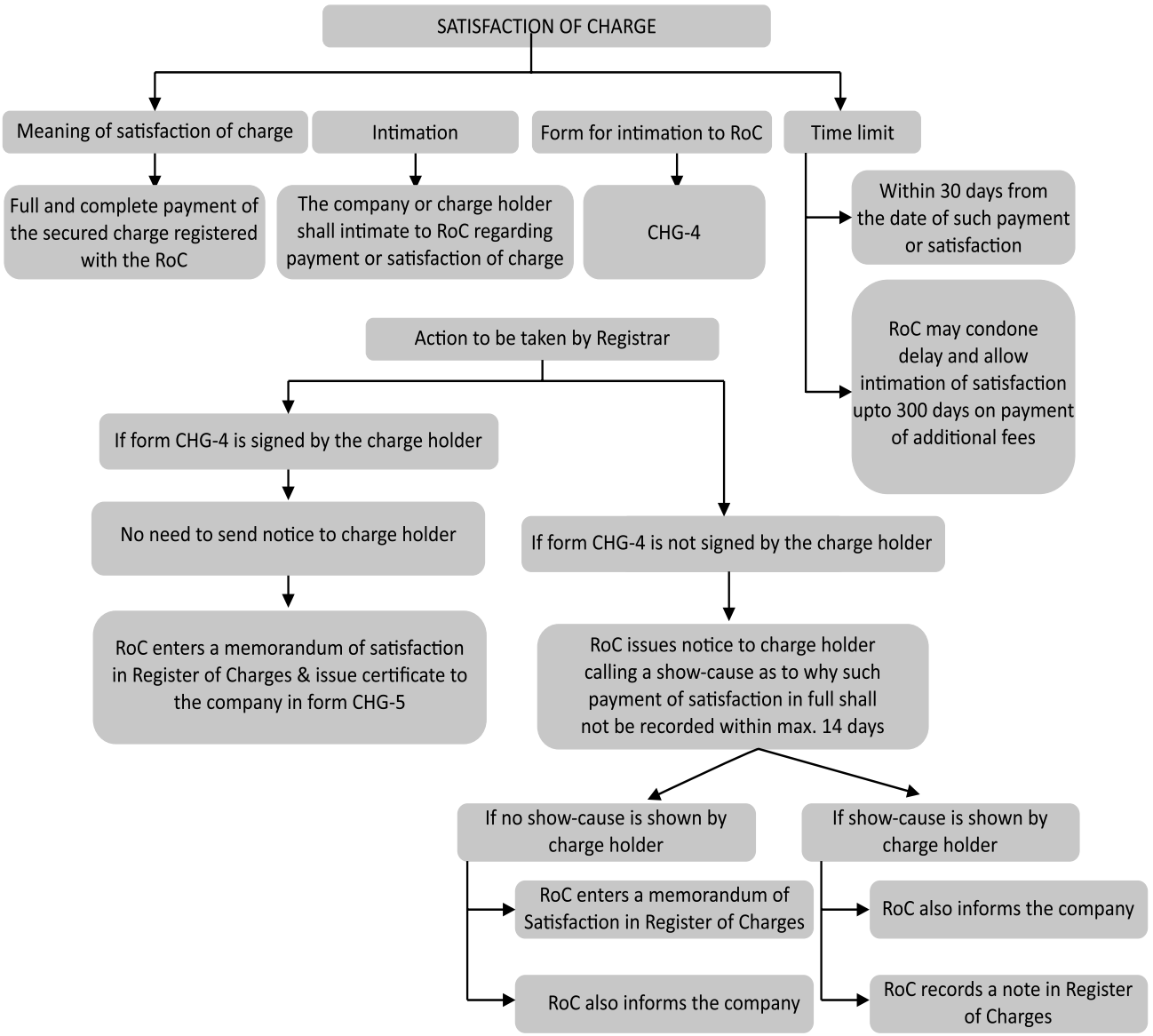
As per Rule 8 of the Companies (Registration of Charges) Rules, 2014 the Registrar enters a memorandum of satisfaction of charge in full in pursuance of section 82 or 83, he shall issue a certificate of registration of satisfaction of charge in **Form No.CHG-5.**

Test Yourself

Xenon Limited hypothecated its plant to Punjab National Bank and availed a term loan. The Company registered the charge with the Registrar of Companies, Delhi. The Company settled the term loan in full. The Company requested the Bank to issue a letter confirming the settlement of the term loan. The Bank did not respond to the request.

State the relevant provisions of the Companies Act, 2013 to register the satisfaction of charge in the above circumstance. State the time frame up to which the Registrar of Companies may allow the Company to intimate satisfaction of charges ?

Summary of provisions of Satisfaction of Charge



Procedure for Satisfaction of Charge

Notice of Board Meeting	▪ Issue not less than 07 (seven) days notice and agenda of a Board Meeting to consider the payment or satisfaction of charge created on the assets or properties of the company.
Board Meeting	▪ Hold a meeting of Board of Directors to consider the letter of satisfaction obtained from charge holder and to take note of the same. ▪ Filing of e-Form CHG-4 with the Registrar of Companies for satisfaction of charge. ▪ Authorise a director or secretary of the company to sign the documents and form related to satisfaction of charges. *Ensure that the payment has been made and satisfied in full against any charge registered with the Registrar of Companies and nothing is due towards that charge.*

Filing of Forms for Satisfaction of charge	**e-Form CHG-4** ▪ The Company is required to intimate the satisfaction in full of any charge registered to the Registrar in Form No.CHG-4 within a period of 30 days from the date of the payment with normal fees. **e-Form CHG-8** ▪ In case the satisfaction of charge is not filed with the Registrar within 30 days, it can be filed within 300 days from the date on such payment of satisfaction with additional fees, along with an application to Central Government for extension of time in filing of satisfaction of charge in Form CHG-8. ▪ The order passed by the Central Government shall be required to be filed with the Registrar in Form No. INC-28 along with the fee as per the conditions stipulated in the said order.
Entries in the Register of charge	**e-Form-CHG-7** ▪ The register of charges maintained by the company in Form No. CHG-7 and enter therein particulars of satisfaction of charge registered with the Registrar on any of the property, assets or undertaking of the company.
Certificate of Satisfaction	Where the ROC is satisfied and enters a memorandum of satisfaction of charge in full, then obtain certificate in Form CHG-5

Signing of charge e-forms by insolvency resolution professional or resolution professional or liquidator for companies under resolution or liquidation – Rule 13

The Form No.CHG-1, CHG-4, CHG-8 and CHG-9 shall be signed by Insolvency resolution professional or resolution professional or liquidator for companies under resolution or liquidation, as the case may be and filed with the Registrar.

Power of registrar to make entries of satisfaction in absence of intimation from the company

There may be times where a company may fail to send intimation of satisfaction of charge to the Registrar but according to section 83 of the Act, Registrar may on receipt of satisfactory evidence of satisfaction register memorandum of satisfaction. The evidences may be –

Conditions	Action of Registrar
The debt for which the charge was given has been paid or satisfied in whole or in part;	The Registrar may enter in the register of charges a memorandum of satisfaction in whole or in part.
Part of the property or undertaking charged has been released from the charge	The Registrar may enter in the register of charges a memorandum of the fact that part of the property or undertaking has been released from the charge.
Part of the property or undertaking ceased to form part of the company's property or undertaking.	The Registrar may enter in the register of charges a memorandum of the fact that part of the property or undertaking has ceased to form part of the company's property or undertaking, as the case may be.

Above action shall be taken by the Registrar, notwithstanding the fact that no intimation has been received by him from the company.

Section 83(2) states that the Registrar shall inform affected parties within 30 days of making the entry in the registrar of charges.

Register of Charges Maintained in ROC's Office (Section 81)

The Registrar of Companies shall maintain a register containing particulars of the charges registered in respect of every company in manner as stated:

- The particulars of charges maintained on the Ministry of Corporate Affairs portal (*www.mca.gov.in/MCA21*) shall be deemed to be the register of charges for the purposes of section 81 of the Act.
- This charge register shall be open to inspection by any person on payment of fee.

The MCA-21 provides the company specific details of the history of all charges created, modified and satisfied since its incorporations. However, sometimes it may be happen that the some charge document were not available online, which has filed in physical mode before the MCA-21, these documents can be viewed by taking physical inspection at the Registrar office.

Intimation of appointment of receiver or manager (Section 84)

Where any person obtains an order for appointment of receiver or manager or if any person appoints such receiver or person under any power contained in any instrument, in relation to a charged property, intimation in the form of notice shall be given by such person to the Company and Registrar	
Cases under which intimation is required	• When any person obtains any order for appointment of a receiver of a property of a company which is subject to a charge. • When any person obtains any order for appointment of a person to manage the property of a company, subject to a charge. • When any person himself appoints any receiver or manager under any power contained in any instrument.
Who shall intimate	• Intimation shall be given by the person who shall obtain such order or the person who himself appointed the receiver or manager as the case may be.
To whom to intimate	• give notice of such appointment to the company and the Registrar
Form for intimation	• Intimation regarding appointment of a person as a receiver of, or of a person to manage, the property, subject to charge, of a company shall be filed with the Registrar in **Form No. CHG-6** along with prescribed fees. • Intimation of appointment shall be given to the company and the Registrar along with a copy of the order or instrument as the case may be.
Time Limit	• Such notice shall be given within a period of 30 days from the date of the passing of the order or of the making of the appointment as the case may be.
Action to be taken by Registrar	On receipt of such notice, the Registrar shall, on payment of the prescribed fees, register particulars of the receiver, person or instrument in the register of charges.

Notice required to be given when receiver/manager ceases to hold such appointment	
Who shall intimate	• Notice shall be given by the person appointed as receiver or manager of a property, subject to charge.
To whom to intimate	• Intimation to be given to the company and the Registrar.
When intimation is to be given	• Intimation to be given when such person ceases to hold such appointment.
Forms	• Intimation to the Registrar shall be given in **Form No. CHG-6** along with prescribed fees.
Actions to be taken by the Registrar	• The Registrar shall register such notice.

COMPANY'S REGISTER OF CHARGES (SECTION 85 R/W RULE 10)

Manner of keeping register of charges

- Every company shall keep at its registered office a register of charges in **Form No. CHG-7** which shall include therein all charges and floating charges registered with the Registrar on any of the property, assets or undertaking of the company and the particulars of any property acquired subject to a charge as well as particulars of any modification of a charge and satisfaction of charge.
- The entries in the register of charges maintained by the company shall be made forthwith after the creation, modification or satisfaction of charge, as the case may be.
- All the entries in the register shall be authenticated by a director or the secretary of the company or any other person authorised by the Board for the purpose.
- The register of charges shall be preserved permanently and the instrument creating a charge or modification thereon shall be preserved for a period of 8 years from the date of satisfaction of charge by the company.

A copy of the instrument creating the charge shall also be kept at the registered office of the company alongwith the register of charges.

Inspection of Charges – Section 85(2)

The register of charges and the instrument of charges kept by the company shall be open for inspection –

(a) by any member or creditor of the company without fees;

(b) by any other person on payment of fee subject to reasonable restriction as the company by its articles impose.

The register is to be open for inspection during business hours. Such inspection shall be subject to reasonable restrictions imposed by the company through its Articles.

Punishment for Contravention (Section 86)

Default	Person Liable	Penalty
Contravention of any provision of Chapter VI (Registration of Charges) of the Companies Act, 2013	Company	• liable to a penalty of Rs. 5 lakhs
	Every Officer of the Company in default	• liable to a penalty of Rs.50,000
Willful furnishing of any false or incorrect information or knowingly suppresses any material information, required to be registered in accordance with the provisions of section 77	Any Person	• liable for action under section 447 (Punishment for Fraud)

Illustration:

Fishers Limited is a company duly incorporated under the Companies Act, 2013 having its registered office at New Delhi. XML is an undertaking of Fishers Limited having its office at Noida. Fishers Limited maintains a register of charges at New Delhi office that includes all charges and floating charges affecting either its own property or assets or that of XML Ltd. Mr. C, the creditor of Fishers Limited wants to inspect the copy of the instrument creating the charge along with the register of charges. The same is available at Noida but not at Registered Office of Fishers Ltd. Is it a contravention of the provisions of the Companies Act, 2013 and punishment is leviable as prescribed u/s 86 of the Companies Act, 2013?

RECTIFICATION BY CENTRAL GOVERNMENT IN REGISTER OF CHARGES

Section 87 read with Rule 12 of the Companies (Registration of Charges) Rules, 2014 provides that the Central Government (Power Delegated to Regional Director w.e.f. 21.05.2014), may on an application filed in **Form No. CHG-8,** on being satisfied that –

(a) The omission to give intimation to the Registrar of the payment or satisfaction of a charge, within the time required under Chapter VI of Companies Act, 2013; or

(b) The omission or misstatement of any particulars, in any filing previously made to the registrar with respect to any charge or modification thereof or with respect to any memorandum of satisfaction or other entry made in pursuance of section 82 or section 83.

was accidental or due to inadvertence or some other sufficient cause or it is not of a nature to prejudice the position of creditors or shareholders of the company, it may, on the application of the company or any person interested and, on such terms, and conditions as it deems just and expedient:

- ✓ direct rectification of the omission or misstatement of any particulars, in any filing, previously recorded with the Registrar with respect to any charge or modification thereof, or with respect to any memorandum of satisfaction or other entry made in pursuance of Section 82 or 83;
- ✓ direct extension of time for satisfaction of charge, if such filing is not made within a period of 300 days from the date of such payment or satisfaction.

The Central Government is empowered to permit rectification only in respect to mis-statement or commission of particulars and does not permit rectification which would amount to determination of validity of a charge and consequent deletion of a charge from the register of charges from register of charges. *[Times Bank Ltd. vs. Shri Sharda Parmeshwari textiles Ltd.]*

CASE STUDY

M/S Shalini Plastic Private vs. Union Of India on 25 July, 2018 High Court of Madhya Pradesh

By this writ petition the petitioner has challenged the part of orders dated 25th September 2017, whereby while allowing the application under Section 87 of Companies Act, the condition of payment of Rs. 94,000/-, 94,000/- and 54,000/- respectively, has been imposed.

The case of petitioner is that it had taken three loans from State Bank of India amounting to Rs. 10,00,000/-, 6,00,000/- & 3,00,000/- respectively against movable/immovable properties not specifically pledged for which a charge was created and filed with ROC (Respondent No:2). The said loan was repaid on 18th May, 2006 but e-form for satisfaction of charges with ROC in terms of Section 82 of Companies Act, 2013 could not be filed within time for the bonafide reasons and on realizing the said mistake, the company immediately filed said satisfaction of charges in three e-forms CHG-4 on 24th May, 2016 mentioning the procedural delay and thereafter petitioner on 18th September, 2017 applied to Central Government (Respondent No:1) for condonation of delay in filing satisfaction of aforementioned charges and for extension of time in terms of Section 87 of Act and while granting the extension of time the condition of payment of Rs. 94,000/-, 94,000/- and 54,000/- respectively for 3 loans has been imposed by the impugned orders.

Learned counsel for petitioner submits that ROC (Respondent No:2) has committed an error in imposing such a high cost whereas the loan amount was not a big amount and that though the discretion is vested with respondent no. 1 under Section 87 of Act but the said discretion was required to be exercised in a just and reasonable manner and cost should not be disproportionate to the default.

As against this learned counsel for respondents has supported the impugned order.

The court held that undisputedly there was a delay in complying with the requirement of filing of e-forms for satisfaction of charge with the respondents. Therefore, petitioner had filed an application for condonation of delay under Section 87 of the Act which reads as under:

In terms of aforesaid provision, respondent no. 1 has the power to extend time for filing of the particulars or for registration of charge etc. on such terms and condition which are just and expedient.

In the present case the petitioner has disclosed that delay had taken place because there was change in entire management of the company, therefore, the default had taken place for the bonafide reason.

The impugned orders reveal that respondent no. 1 has also reached to the conclusion that delay was caused due to inadvertence and has found it to be just and equitable to grant relief of condonation of delay and has accordingly condoned the delay. But while condoning the delay the respondent no. 1 has imposed the condition of payment of Rs. 94,000/- in a case where the loan was of Rs 10,00,000/-, Rs. 94,000/- in another case where the loan was of Rs. 6,00,000/- and Rs. 54,000/- where the loan was of Rs. 3,00,000/-.

Undisputedly the loan amount was already repaid in the year 2006 itself and there was only a default in non complying with the requirement of filing of e-forms for satisfaction of the charge. In these circumstances the condition of payment of such a high amount imposed by respondent no. 1 is not reasonable in terms of Section 87 of the Act. Under Section 87, the condition which is required to be imposed should be just and expedient.

The impugned orders further reveal that for default in respect of loan of Rs. 10,00,000/- and for another default for loan of Rs. 6,00,000/- same condition of payment of Rs. 94,000/- has been imposed where the same should have been proportionate to the nature of default. Hence this court is of the opinion that the amount which is required to be paid in terms of the impugned orders is to be rationalized and to be made just and proper by reducing it.

Hence the impugned orders to that extent stand modified and the writ petition is disposed off.

FORMS FOR CHARGE MANAGEMENT UNDER THE COMPANIES ACT, 2013

S. No.	*E-Form/ Form*	*Purpose*
1	CHG-1	Application for registration of creating or modifying the charge (for other than Debentures)
2	CHG-2	Certificate of registration of charge
3	CHG-3	Certificate of modification of charge
4	CHG-4	Intimation of the satisfaction to the Registrar
5	CHG-5	Certificate of Memorandum of satisfaction of charge
6	CHG-6	Notice of appointment or cessation of receiver or manager
7	CHG-7	Register of charges
8	CHG-8	Application to CG for extension of time for filing of particular of registration of satisfaction of charge or rectification of omission or mis-statement of any particular in respect of creation/modification/satisfaction of charge
9	CHG-9	Creating or modifying the charge for debentures including rectification

Registration of Charges under the SARFAESI Act, 2002 by Banking Company

The Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) is set up under section 20 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). At the request of the Department of Financial Services, Ministry of Finance, the Indian Banks' Association has taken steps to obtain incorporation of the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) licensed under section 25 of the Companies Act, 1956. The said Company shall be maintaining and operating the Central Registry for and on behalf of the Central Government.

The Central Government has issued the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011 and prescribed the Forms to be used for the purpose of filing information for registration in respect of transactions of securitisation, asset reconstruction of financial assets and security interest over property.

The object of setting up the Registration System under Chapter IV of the SARFAESI Act is to create a public data base about encumbrances created on properties to secure loans and advances given by the banks and financial institutions, as also transactions of securitisation or asset reconstruction undertaken pursuant to the provisions of the SARFAESI Act.

The registration of creation of security interest by the securitisation company or reconstruction company or the secured creditor, as the case may be, with the Central Registry as per the provisions of section 23 of the said Act read with Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (Central Registry) Rules, 2011 as amended, is mandatory and is an additional compliance.

The following types of security interest on the CERSAI portal:

a. Particulars of creation, modification or satisfaction of security interest in immovable property by mortgage other than mortgage by deposit of title deeds.

b. Particulars of creation, modification or satisfaction of security interest in hypothecation of plant and machinery, stocks, debts including book debts or receivables, whether existing or future.

c. Particulars of creation, modification or satisfaction of security interest in intangible assets, being know how, patent, copyright, trademark, licence, franchise or any other business or commercial right of similar nature.

d. Particulars of creation, modification or satisfaction of security interest in any 'under construction' residential or commercial or a part thereof by an agreement or instrument other than mortgage.

SEARCH AND STATUS REPORT

A Search and Status Report traces the history of a Company's property and how it has charged / mortgaged its assets with various Banks/Financial Institutions/Lenders over a period of time, before reaching the present bank that has demanded for the Search and Status Report.

The scope of Search and Status report depends upon the requirements of the Bank/Financial Institution/Lender/ Investor concerned. A Search and Status report prepared by a Company Secretary in Practice helps Banks/ Financial Institutions/Lenders/ Investors to take conscious decision regarding the quantum of loan/ credit facility to be sanctioned and investment to be made. It also helps in taking an informed and speedy decision assuring the credit- worthiness or otherwise of the company.

A Search and Status Report as is apparent from, its name contains two aspects. The first being 'search' which involves physical/online inspection of documents and the second activity 'status' which comprises of reporting of the information as made available by the search.

It *inter alia* includes:

- Name of Company
- CIN of the Company
- Registered Office Address of the Company
- Capital Structure of the Company
- Date of Incorporation
- List of Directors of the company since incorporation
- List of Shareholders of the company since incorporation
- Secured Loans
- List of Registered Charges since incorporation etc.
    (i) Charge Id
    (ii) Document Date

(iii) Registration Date

(iv) Creation of Charge

(v) Modification of Charge

(vi) Details of Agreements creating charge

(vii) Details of Bank/Financial Institution/NBFC

(viii) Amount Secured

(ix) Terms & Conditions

(x) Rate of Interest

(xi) Margin

(xii) Repayment

(xiii) Security and other particulars: (At the time of creation)

(xiv) Security and other particulars: (First Modification dated)

(xv) Details of Charges satisfied

(xvi) List of Forms filed on MCA portal

(xvii) The Report may include the other matters also as per the demand of the Bank Officials.

A search report traces the history of a company or the property held by the company – i.e.

(a) who is the original owner of the property;

(b) how it has mortgaged with various banks over a period of time before reaching the present Bank who has demanded the Search Report.

A search report is usually prepared and drafted by Professionals, who after visiting the Registrar's office (Registrar of Companies) and inspecting the property documents, issues the certificate to the Bank stating the facts about the company.

Search Report are the basic tool in the hands of the Banks to know about the viability of their customer who approach the banks for CC Limits, Term Loans or otherwise. As the sole moto of the Banks is to provide the loan to the customers is for earning the interest. Hence the Banks want the current position of the assets being pledged by the companies. And the only way to know whether such property is already pledged to some other bank or not, is the Search Report.

The following basic information about the existing loans taken by the Company is given by the Company Secretary through such reports:

(i) The date of loan taken by the company and the charge created in such respect.

(ii) The name and address of the charge holders.

(iii) The type of charge i.e. whether joint charge or consortium charge.

(iv) The amount of loan.

(v) The property charged / pledged against such loan.

(vi) The terms and conditions of such loan i.e. rate of interest, terms of repayment, margin money and extent of operation.

Examination of documents Registered on MCA 21 portal

The MCA website provides many information relating to the Company.

Some information are available without payment of fees like: Name of the Company, CIN, Authorised and paid up capital, Name of the Directors etc.

The website also provides for the viewing of document by public on payment of requisite fee. Public documents include the following:

a. Incorporation documents;

b. Certificates, including Incoporation certificate and Charge creation, modification and satisfaction certificates;

c. Charge documents;

d. Annual returns and balance sheet;

e. Change in directors; and

f. Other e-forms.

However, there are certain documents which are not allowed for public inspection. For example, no person shall be entitled to inspect or obtain copies of the resolutions filed under section 179(3) of Companies Act, 2013 and rules made thereunder.

MCA-21 offers the facility to view documents and also search and other facilities of public documents. This facility is handy for users and banks and financial institutions while sanctioning loans.

Checklist for preparation of Search Report

(a) Check whether the prescribed particulars of the charge requiring registration were filed with the ROC in e-form no. CHG-1 duly signed by the company as well as the charge-holder and along with the original/ certified copy of the instrument, if any, within 30 days after the date of its creation or within the time permitted by the ROC under Section 77 of the Companies Act, 2013;

(b) In case of issue of debentures of a series, if there has been any charge to the benefit of debenture holders of that series, check whether the required particulars have been filed with the Registrar in e-form no.CHG-9 within 30 days from the date of execution of or the modification of the trust deed;

(c) In case commission, allowance, discount is paid or made in consideration for subscribing, etc., to debentures, check whether the forms included particulars of such commission, etc. has been filed;

(d) Check whether abstract of registration is duly endorsed on every debenture or certificate of debenture stock issued, the payment of which is secured by the charge registered;

(e) Check whether particulars of modification of charges were filed in eform no. CHG-1/CHG-9 duly signed with the ROC within 30 days of the modification or within the extended period;

(g) Check whether a copy of the instrument creating/modifying charge/ a copy of debenture of the series, if any, required to be registered was kept at the registered office;

(h) Where payment or satisfaction of charge registered has been effected in full, check whether intimation thereof has been sent to the ROC in e-form no.CHG-4 duly signed, by the company as well as the chargeholder within 30 days from the date of such payment or satisfaction ;

(i) Check whether Register of charges has been maintained and kept open for inspection;

(j) Check whether the creation/modification/satisfaction of charge has been registered by the ROC and endorsed copies of documents have been obtained;

(k) Check whether instruments creating/modifying charges are kept open for inspection as prescribed.

Search Report compiled on the basis of the scrutiny of the documents filed with MCA is, therefore, related and restricted to only those documents which are available for the inspection on the date(s) when the search is carried out. An index of the charges is prepared at the website of MCA. This index provides, charge ID, the date of filing of the document charge amount secured, name of charge holder and its address.

Search and Status Report requires a thorough study of the particulars relating to the amount secured by the charge and the terms and conditions governing the charge. It is an analysis of the security available to a particular lender for its advances and a comparison of charges created in favour of a particular lender *vis-à-vis* other lenders.

In other words, it does not necessary mean verbatim reporting of the information as made available but also supplemented by observations/comments by the person who furnishes the Report. The Search and Status Report should give exact details of particulars of charges/modifications/ satisfactions as effected, filed and registered from time to time.

Understanding the provisions relating to charges through judicial precedents

1. Registration of Charges does not apply to a charge arising by operation of law

Section 125 of Companies Act 1956 (Currently Section 77) is applicable only to a charge created by a company by a contract, and not to a charge arising by operation of law. *(Praga Tools Ltd vs. Official Liquidator, Bengal Engineering Co. (1984) 56 CC. 214*; *T. V. Sundaram Iyengar & Sons P. Ltd. vs. Official Liquidator, High Court, Madras (1972) 42 CC 359; K. Saradambal vs. Jagannathan and Brothers (Automobile Engineers & Motor Works (P) Ltd. (1972) 42 CC. 359 (Mad). The Managing Director and Ors. vs. The Official Liquidator, High Court of A.P., Hyderabad and Ors. (20.06.2012 - APHC) : MANU/AP/0407/2012*

2. It is obligatory to intimate Registrar in respect of a charge created by partnership which was later converted into a company.

It was held in the case of *Maharashtra State Financial Corpn. vs. Official Liquidator, Sidhu Tyres (P) Ltd. [(1988) 64 Comp Cas 641 (Bom)]* that 'When a charge is created by a partnership which is later converted into a company, registration is not necessary but it is obligatory on directors to bring it to notice of Registrar.

3. Unsecured creditor could not challenge the validity of a charge or claim right over the property on the ground that he incurred the liability prior to its registration.

In the case of *C.K. Siva Sankara Panicker vs. Kerala Financial Corpn.(1980) 50 Comp Cas 817 (Ker)]* it was held that an unsecured creditor could not challenge the validity of a charge or claim right over the property on the ground that he incurred the liability prior to its registration.

4. Guarantees do not require registration

Corporate Guarantee does not create any Charge *per-se*, unless mortgage or hypothecation etc. is created on assets/undertaking. It may be noted that corporate guarantee provided by companies in

the course of its business does not amount to a charge, since the guarantee given in case of a loan or a borrowing is contingent in nature and does not amount to a charge.

In *S. T. Patil and Ors. vs. Registrar of Companies on 13 May, 1997 Equivalent citations: 1998 91 Comp Cas 578 CLB*, the Hon'ble Company Law Board was of view that "Guarantees do not require registration under Section 125 of the Act. It is in this connection, reference may be made to the decision in *Paul and Frank Ltd. vs. Discount Bank (Overseas) Ltd. and the Board of Trade [1967] 37 Comp Cas 76 (Ch D)*, wherein it has been held that contracts of insurance, guarantee, indemnity, etc., do not require registration".

5. An attachment itself does not create any charge in property

In *Kerala State Financial Enterprises Ltd vs. Official Liquidator, High Court of Kerala(2006)*, it was observed that ordinarily a charge should be registered in terms of Section 125 of the Companies Act 1956 (Section 77 of Companies Act 2013). If the charges are not registered, the same would be void against the liquidator or creditors. The question which arises for consideration is as to whether if the properties are attached by a Revenue Recovery Court, Section 125 of the Act would be applicable? An attachment itself does not create any charge in the property. By reason of attachment, no decree is passed.

SPECIMEN RESOLUTIONS

Specimen Board Resolution to approve the creation of charge

The Chairman informed the Board that at the request of the Company, SBI (Bank).....Branch has sanctioned under mentioned credit facilities on the terms and conditions set out in the Bank's sanction letter bearing No. _____ dated _____ and he placed before the Board a copy of the said sanction letter.

He further informed that in terms of the said sanction letter various securities/charges are to be created in favour of Bank.

"**RESOLVED THAT** the Company hereby solicit assent to borrow and avail of the following credit facilities from SBI (Bank).....branch, on the terms and conditions as set out in the Bank's sanction letter bearing No. _____ dated _____., as placed before the Board and that Mr. _____(Director) and Mr._____(Director) be and are hereby authorised to convey the acceptance thereof to the Bank for and on behalf of the company.

RESOLVED FURTHER THAT the Company approves the drafts of the security documents in the form required by the Bank and as placed before the Board and that Mr. _____& Mr._____, Directors be and are hereby authorised to settle and finalise the same for and on behalf of the company and the company do execute the said security documents and other agreements as finalised and that the Common Seal of the company be affixed, if necessary as per the provisions of the Companies Act,2013, to the stamped engrossment of such security documents and agreements in the presence of Mr. _____, Mr. _____, Directors of the Company and Mr. _____ being a secretary of the company / person authorized by the Board in that behalf who do sign the same in token thereon.

RESOLVED FURTHER THAT the Company has created the Mortgage by Deposit of Title Deeds of the Company's property situated at _____ as a security for repayment of the amounts due and payable by

the Company under the said aforesaid credit facilities together with interest, cost, expenses and other charges payable thereunder and that Mr. _____ & Mr. _____, Directors of the Company be and are hereby jointly and severally authorised to deliver and deposit the said title deeds with the Bank.

RESOLVED FURTHER THAT the Company request Mr. _____, Mr. _____ and Mr.. _____ to offer and execute guarantee in favour of the Bank to guarantee and to secure the repayment of the aforementioned credit facilities granted to the company together with interest, cost, expenses and other charges thereon.

RESOLVED FURTHER THAT the company is hereby authorized file the requisite particulars of charges with the Registrar of the Companies, in respect of the said credit facilities after execution of respective documents within the time prescribed by law.

RESOLVED FURTHER THAT certified true copies of the aforesaid resolutions be and are hereby forwarded to the Bank and they be requested to act thereon."

Specimen Board Resolution to approve the modification of charge

"RESOLVED THAT pursuant to the provisions of section 77, 79 and other applicable provisions, if any, of the Companies Act, 2013 read with Rule 3 and 6 of the Companies (Registration of Charges) Rules, 2014, including any amendment thereto, the consent of the Board be and is hereby accorded to modify the charge, which was created on _____ by way of enhancement/reduction of the sum borrowed from SBI (bank) from Rs. _____ to Rs. _____ with interest rate at _____% per annum against the assignment/ hypothecation/mortgage on the property of the company situated at _____.

RESOLVED FURTHER THAT Mr. _____, Director of the company be and is hereby authorised to finalise and execute such deed/ forms/ documents etc. on behalf of the company as may be required to modify the said charge.

RESOLVED FURTHER THAT Mr. _____, Director of the company be and is hereby authorised to file the said documents with the concerned authority and generally to do all such acts, deeds, matters and things as may be considered ancilliary or incidental thereto for giving effect to the said resolution and also to forward the true copy of this resolution to the concerned authorities as may be necessary."

Specimen Board Resolution to take note of the satisfaction or release of charge

"RESOLVED THAT the Board is hereby take the note of charge release letter or letter of satisfaction dated _____ received from _____ SBI (Bank) for the Charge ID _____ having date of creation _____ as registered with the Registrar of Companies (RoC).

RESOLVED FURTHER THAT the Bank be hereby requested to release the title deeds mortgaged with them at the time of obtaining the financial assistance.

RESOLVED FURTHER THAT Mr. _____, Director and Mr. _____ Company Secretary of the company be and is hereby severally authorised file for such satisfaction of charge with the Registrar of Companies (RoC) and generally to do all such acts, deeds, matters and things as may be incidental in this regard."

Specimen Special Resolution under Section 180(3)(c) authorising the Board to borrow for company's business upto a limit beyond paid up capital and free reserves

"RESOLVED THAT pursuant to the provisions of Section 180(1)(c) and other applicable provisions, if any, of the Companies Act, 2013, and subject to such approval as may be necessary, consent of the company be and is hereby accorded to the Board of directors of the company for borrowing, from time to time, such sum

of money as may not exceed Rs. _____ (Rupees.), for the purpose of the business of the company, notwithstanding that the moneys to be borrowed together with the monies already borrowed (apart from temporary loans obtained from the company's bankers in the ordinary course of business) will exceed the aggregate of the paid-up capital of the company, its free reserves, that is to say, the reserves not set apart for any specific purpose and securities premium, provided that the total amount upto which the monies may be borrowed by the Board of directors of the company shall not exceed the aggregate of the paid-up capital, free reserves and securities premium of the company by more than the sum of Rs. _____ (Rupees _____) at any one time.

RESOLVED FURTHER THAT the Board be and is hereby authorized to do all the acts, deeds and things, as it may, in its absolute discretion deem necessary and appropriate to give effect to the above resolution."

Explanatory Statement

The shareholders of the company had, at the extraordinary general meeting of the company held on _____, passed a special resolution under Section 180 (1) (c) for borrowing the maximum amount of Rs. _____ (Rupees _____, upto which the Board of directors of the company could borrow funds from financial institutions and banks in excess of the company's paid-up capital and free reserves and security Premium. However, in view of the increased business activities of the company, the said ceiling of Rs. (Rupees), has been found to be inadequate. The directors are of the opinion that the ceiling of borrowings by the Board be raised to Rs. _____ (Rupees _____).

Hence, the proposed resolution for consideration and approval by the members of the company. None of the directors, key managerial personnel of the company or their relative is concerned or interested, financially or otherwise in the proposed resolution.

Specimen Resolution under Section 180(1)(a) for creating charge on company's assets and properties

"RESOLVED THAT consent of the Company be and is hereby accorded in terms of Section 180(1) (a) and other applicable provisions, if any, of the Companies Act, 2013 or any modification or re-enactment thereof, to mortgaging and/or charging by the Board of directors of the Company by way of equitable and/or legal mortgage on such immovable and movable properties of the Company, both present and future, together with power to takeover the assets of the Company in certain events, to or in favour of and the Industrial Finance Corporation of India Ltd. (IFCI) by way of first *pari passu* Charge to secure the Rupee Term Loans of Rs.1000.00 lacs and Rs.880.00 lacs respectively granted to the Company together with interest at the agreed rate(s), liquidated damages, front end fees, premia on pre payment, costs, charges, expenses and all other moneys payable by the Company under the Loan Agreements, Deeds of Hypothecation and other documents executed/ to be executed by the Company in respect of the Term Loans of IDBI and IFCI".

RESOLVED FURTHER THAT the Board of directors be and is hereby authorised and shall always be deemed to have been authorised to finalise with IDBI and IFCI the documents for creating the aforesaid mortgage and/ or charge and to do all acts, deeds and things as may be necessary for giving effect to the above resolution."

Specimen Special Resolution under Section 180 (1) (a)

RESOLVED THAT consent of the Company be and is hereby accorded in terms of Section 180(1)(a) and other applicable provisions, if any, of the Companies Act, 2013 or any modification or re-enactment thereof, to mortgaging and/or charging by the Board of directors of the Company by way of equitable and/or legal mortgage on such immovable and movable properties of the Company, both present and future, in favour of

State Bank of India, New Delhi the Company's Bankers by way of Second Charge to secure the various fund based/non-fund based credit facilities granted/to be granted to the Company and the interest at the agreed rate, costs, charges, expenses and all other moneys payable by the Company under the Deed(s) of Hypothecation and other documents executed/to be executed by the Company in respect of credit facilities of State Bank of India, in such form and manner as may be acceptable to State Bank of India.

RESOLVED FURTHER THAT the Board of directors be and is hereby authorised and shall always be deemed to have been authorised to finalise with State Bank of India the documents for creating the aforesaid mortgage and/or charge and to do all acts, deeds and things as may be necessary for giving effect to the above resolution."

Explanatory Statement Item No. 1 & 2

Industrial Development Bank of India (IDBI) and The Industrial Finance Corporation of India Ltd. (IFC) have sanctioned Term Loans of Rs. 1000.00 lacs and Rs. 880.00 lacs respectively to the company. These loans are to be secured by First Charge on immovable and movable properties of the Company, both present and future, in the manner, as may be required by IDBI and IFCI. Such mortgage/charge shall rank first pari passu Charge with the Charges already created/to be created in favour of the participating Institutions/ Banks for their assistances.

State Bank of India, New Delhi has also agreed to grant, in principle, various fund based/non-fund based Cash Credit facilities to the Company. According to the conditions of granting such facilities to the Company, these facilities are required to be secured by a second charge by way of equitable and/or legal mortgage on all the immovable and movable properties of the Company, both present and future on such terms as may be agreed to between the Company, State Bank of India and other existing lenders.

Section 180(1)(a) of the Companies Act, 2013 provides, *inter alia*, that the Board of directors of a public company shall not, without the consent of a public company in general meeting, sell, lease or otherwise dispose of the whole, or substantially the whole, of the undertaking(s) of the Company or where the Company owns more than one undertaking, of the whole or substantially the whole of any such undertaking. Mortgaging/charging of the immovable and movable properties of the Company as aforesaid to secure Rupee Term Loans and the various Cash Credit facilities may be regarded as disposal of the whole or substantially the whole of the said undertaking(s) of the Company and therefore requires consent of the Company pursuant to Section 180(1)(a) of the Companies Act, 2013.

The Directors recommend the resolutions for approval of the shareholders as Special Resolutions under Section 180(1)(a) of the Companies Act, 2013.

None of the directors, key managerial personnel of the company or their relative is concerned or interested, financially or otherwise in the proposed resolution.

LESSON ROUND-UP

- "Charge" means an interest or lien created on the property or assets of a company or any of its undertakings or both as security and includes a mortgage.
- A company is required to file e-form CHG-1 (other than Debentures) or CHG-9 (Debentures) through MCA portal giving complete particulars together with the instrument creating charge within 30 days of creation of charge under Section 77 of the Companies Act, 2013.

- Modification of charge is a stage subsequent to the creation of charge. The terms and conditions or limits of charge already created/registered with the concerned Registrar are subsequently changed or modified due to further developments by creation of equitable mortgage on a subsequent date or enhancement or reduction of credit facilities, etc.
- The Registrar shall issue certificate of registration of charge or registration of modification in E-Form CHG-2 & CHG-3 respectively.
- When company repays its secured loan fully to the lender or when property or asset charged has been released from charge then it is known as satisfaction of charges.
- Any person acquiring a property which is subject to charge shall be deemed to have notice of the charge from the date of such registration.
- The company shall give intimation to Registrar of payment or satisfaction in full of any charge within a period of 30 days from the date of such payment or satisfaction. If no intimation is given within 30 days, the Registrar may allow such intimation to be made within 300 days of such payment or satisfaction on payment of prescribed additional fees.
- Every company is required to keep at its registered office a register of all charges as well as a copy of every instrument creating any charge.
- The register of charges and the instrument of charges kept by the company shall be open for inspection –
  - ✓ by any member or creditor of the company without fees;
  - ✓ by any other person on payment of fee subject to reasonable restriction as the company by its articles impose.
- A Search and Status Report as is apparent from, its name contains two aspects. The first being 'search' which involves physical/online inspection of documents and the second activity 'status' which comprises of reporting of the information as made available by the search.

GLOSSARY

***Pari-Passu* Charge:** "*Pari Passu*" charge means that when borrower company goes into dissolution, the assets over which the charge has been created will be distributed in proportion to the creditors' (lenders) respective holdings.

Search and Status Report: Search Report is prepared by Professional (CS/CA/CWA/Advocates) under the Companies Act, 2013 about the company after taking detailed inspection of documents from the Registrar of Companies via Online or Offline (Physical Search) mode.

Crystallisation of Charge: Crystallization is the process by which a floating charge converts into a fixed charge.

Lien: A right to keep possession of property belonging to another person until a debt owed by that person is discharged.

Pledge: It is a bailment of personal property as security for some debt or engagement, redeemable on certain terms, and with an implied power of sale on default.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What is crystallization of floating charges ? State the circumstances under which floating becomes fixed charge?
2. State the particulars to be filed with ROC in case of debentures secured by Charges on assets of the Company.
3. What are the recourses available to charge-holder in case of non-registration of charge?
4. Explain the meaning of Satisfaction of Charge.
5. Write short notes on maintenance of Register of Charge.
6. Explain the power of ROC to make entries of satisfaction of charge in case of non-intimation from the Company.
7. Elucidate the Difference between Second Charge and Pari-Passu Charge.
8. Can the debt be recovered, if the charges are not registered with ROC?
9. Mr. Akash while entering into an agreement with Fintech & Co. for purchasing of a land in Gurgaon, comes to know that title deed of the Company is not free from encumbrances and it cannot be transferred in the name of Mr. Akash. Company claimed that Mr.Akash ought to have had the knowledge of charge created on the property? Explain, whether the contention of the Company is correct ?
10. XYZ Limited has an office building in London. The Company has been granted a term loan of Rs.15 crore from a Bank. The Company wants to mortgage office building of London. Examining the provisions of the Companies Act, 2013, answer the following :
    (i) Whether the company can mortgage the above office building ?
    (ii) Whether a charge can be created for property situated outside India ?
11. A newly appointed Company Secretary of Overseas Ltd. with its headquarter in Kolkata discovered that the Company, four months ago, had created a floating charge on its assets located in Bhutan for raising a new loan and to continue its expansion of business smoothly. There was no filing of form CHG-1 and the officers believe that the charge created related to properties in Bhutan and hence no formalities were needed with ROC in India. Evaluate the stand taken and what are the options available with the Company Secretary now in this regard.
12. Suraj Ltd. has a subscribed capital of Rs.200 crore out of which Rs.100 crore has been paid-up. The Articles of Association of the company has a provision that the company shall have a Reserve Capital of Rs.50 crore which shall be called up only at the time of winding up of the company. Suraj Ltd. desires to borrow from its bankers by creating a charge on the uncalled capital and Reserve Capital. Advise the company.
13. An encumbrance may be created by a charge, pledge or a mortgage. Comment

14. Nirja is a newly appointed company secretarial staff in the office of the Company Secretary of a listed company. She has suggested that an existing floating charge on the fixed assets of the company can be converted into fixed charge by passing only a board resolution and no steps are required in this regard by the lenders.

    Comment.

15. ABC Company Ltd. appointed a company secretary. The board of directors of the company decided to meet to understand the provisions related to satisfaction of charge. The company Secretary briefed the Board and stated that "where a registered charge is paid or satisfied in full, the company shall in Form No: _____, give an intimation to the Registrar". Choose the correct option:

    (a) CHG-4 (b) CHG-9 (c) CHG-2 (d) CHG-7

16. XYZ Ltd. a company registered under the Companies Act, 2013, has failed to register a charge which requires registration under Section 77 and the charge is not registered as per Section 77. What will be the consequence(s) of such non-registration?

    (a) Charge becomes void and punishment under the provisions of company law

    (b) Winding up of company

    (c) Charge becomes void and directors will become liable for imprisonment for 3 years

    (d) None of the above

17. Antariksh Ltd. raised a loan from a State Financial Institution by creating hypothecation of book debts and also future debts of the Company and the charge was not registered with the concerned RoC. State Financial Institution demanded a certificate of registration of charge for the amount of loan so granted by it. The directors of the Company replied to the State Financial institution that the charge need not be registered for hypothecation of book debts. Choose the correct answer:

    (a) Contention of directors of Antariksh Ltd. is incorrect and not tenable

    (b) State Financial Institution can waive off the requirement of registration of charge

    (c) The directors of company will become liable for imprisonment of 5 years

    (d) None of the above

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- *https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==*

Distribution of Profits

Lesson 8

KEY CONCEPTS

■ Divisible Profit ■ Dividend ■ Interim Dividend ■ Final Dividend ■ Entitlement to Dividend ■ Dividend Distribution Policy ■ Unpaid Dividend Account ■ Investor Education Protection Fund ■ Record Date ■ Claim ■ Book Closure

Learning Objectives

To understand:

- Meaning of Profit and ascertainment of Divisible profits
- The meaning and Definition of Dividend
- Types of Dividend
- Types of Companies allowed to pay Dividend
- The legal and procedural aspects relating to distribution of dividend, transfer of unpaid or unclaimed dividend to Unpaid Dividend Account
- The legal and procedural aspects relating to transfer of Unpaid Dividend to Investor Education and Protection Fund (IEPF)

Lesson Outline

- Profit and Ascertainment of Divisible Profit
- Meaning and Definition of Dividend
- Interest vs. Dividend
- Types of Dividend
- Types of Companies allowed to pay Dividend
- Power to declare Dividend
- Source of payment of Dividend
- Declaration of dividend in case of loss or inadequacy of profit
- Dividend Distribution Policy
- Date for determining entitlement to dividend
- Persons entitled to Dividend
- Transfer of profits to reserve
- Declaration of Dividend
- Rate of Dividend
- Mode of Payment of Dividend
- Unpaid Dividend Account
- Investor Education and Protection Fund (IEPF)
- Procedure for Transfer of Unpaid or Unclaimed Dividend to the Investor Education and Protection Fund
- Shares in respect of Unpaid Dividend to be transferred to Investor Education and Protection Fund (IEPF)
- Refund to Claimant from Investor Education and Protection Fund
- Punishment for failure to distribute Dividends
- Procedure of declaration & payment of Interim Dividend
- Procedure of declaration & payment of Final Dividend
- Lesson Round-up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 [Section 123-127, 2(35)]
- The Companies (Declaration and Payment of Dividend) Rules, 2014
- IEPF (Accounting, Audit, Transfer and Refund) Rules, 2016
- The SEBI (LODR) Regulations, 2015

PROFIT AND ASCERTAINMENT OF DIVISIBLE PROFIT

Profit earning and maximisation of shareholders wealth is the main objectives of every business concern.

Generally speaking the profit of a business during a given period is the excess of income over expenditure for the period. The Companies Act, 2013 does not define the term "Profit", which must, therefore, be understood in its natural and proper sense.

- *In Re. Spanish Prospecting Co. Ltd (1911) 1 Ch 92, Moulton L.J. explained the term 'Profit' as under: "Profit implies a comparison between the state of business at two specific dates usually separated by an interval of a year. The fundamental meaning is the amount of gain made by the business during the year. This can only be ascertained by a comparison of the assets of the business at the two dates. If the total assets of the business at the two dates are compared, the increase which they show at the later date as compared with the earlier date (due allowance, of course, being made for capital introduced into or taken out of the business in the mean while) represents, in strict sense, the profits of the business during the period in question".*
- 'Divisible profits' means the profits which the law allows the company to distribute to the shareholders by way of dividend. According to Palmer's Company Law, the terms 'divisible profits' and 'profits in the legal sense' are synonymous. Thus, the profits of a business mean the net proceeds of the concern after deducting the necessary outgoings without which those proceeds could not be earned. [*Bharat Insurance Co. Ltd. v. CIT (1931) 1 Com Cases 192, 196 (Lah)*].
- Dividend in literal terms means a share of profit, whether at a fixed rate or otherwise, allocated to the holder of share in the company as held in *Henry v. Great Northern Railway Company*.

The shareholders contribute to the capital of the company and these shareholders are entitled to a share in the profits of the company. However, not all the profits made by company is to be distributed to the shareholders. Only divisible profits are available for distribution to the shareholders.

Divisible profits are that portion of the profit which can be distributed legally among the shareholders of the company. These profits are distributed by way of dividends, but only after provisions for past losses and reserves have been made.

DECLARATION AND PAYMENT OF DIVIDEND

Meaning and Definition of Dividend

The term 'dividend' takes its root from Latin noun '*dividenda*' which means 'something to be divided'.

As per Black's Law dictionary, dividend is *'A portion of a company's earnings or profits distributed pro rata to its shareholders, usually in the form of 'cash or additional shares'. It is a share allotted to each of several persons entitled to a share in a division of profits or property. Hence, dividend may denote a fund set apart by a company out of its profits, to be apportioned among the shareholders, or the proportional amount falling to each shareholder.*

Therefore, dividend is a return on the share capital subscribed for and paid to its shareholders by a company. In simple words, dividend means the payment made by a company to its shareholders out of its distributable profits.

In the UK Companies Act, 2006, the term 'distribution' is used for denoting payments to members. It is defined in sub-section (1) of section 829 of the UK Companies Act 2006 as follows: 'In this Part "distribution" means every description of distribution of a company's assets to its members, whether in cash or otherwise, subject to the following exceptions.'

Sub-section (2) of the same section provides the exceptions for the same in the form of bonus shares, reduction of share capital, redemption or purchase of shares and distribution of assets on winding up.

The term 'dividend' is defined in clause (35) of section 2 the Companies Act, 2013 (the Act) to mean "dividend" includes any interim dividend.

Therefore, it can be said that the term 'Dividend' per se is not defined under the Act; however, only interim dividend is made part of it.

Secretarial Standard-3 defines dividend so as to mean a distribution of any sums to Members out of profits and wherever permitted out of free reserves available for the purpose.

Dividend implies two things –

(i) payment out of profits, and

(ii) actual release of some assets.

Issue of bonus shares or right shares to the existing members is not considered as dividend because the former does not involve release of any assets and the latter has no relation with the profits of the company. Every trading company has an implied inherent power to distribute its net earnings or profits to the shareholders in the shape of dividends. Power to declare dividends, therefore, need not expressly be given by the Memorandum or Articles of Association. Articles may, however, regulate the manner in which the dividends are to be paid.

The allotment of bonus shares does not entail release of any of the assets of the company. The existing shareholders, instead of receiving any moneys out of the undistributed profits, only receive pro rata fresh shares *[Sivagnanamal v. Thirumagal Mills Ltd., (1948) 18 Comp. Cases 286 AIR 1949 Mad 521]*. There is no distribution of profits among shareholders and hence capitalization of profits in the form of bonus shares would not be construed as Dividend in terms of the Act.

Dividend in light of Judicial precedents

- In the case of *Griffith, Carr v. Griffith [(1879) 12 ChD 655],* it was also held that dividend payment usually occurs periodically. Where profits are distributed outside these periodic dates, these are usually referred to as "bonuses or bonus dividend".
- In the case of *Kantilal Manilal and Ors v. The Commissioner of Income-Tax, Bombay [1961 SCR (2) 584],* "Dividend" in its ordinary meaning is a distributive share of the profits or income of a company given to its shareholders'.
- In the case of *Navnitlal C. Javeri v. K. K. Sen*, *Appellate Assistant Commissioner of Income Tax [1965 SCR (1) 909]*, it was held that '*The essence of an amount paid as dividend is that it has to represent the proportionate amount a particular shareholder is to get on the basis of the shares held by him out of the profits of the company set apart for payment of dividend to shareholders. Any ad hoc payment of money to a shareholder as advance or loan unrelated to his share in the accumulated profits cannot rationally come within the expression "dividend".*

- In *Borland's Trustee v. Steel Brothers & Co. Ltd. L.R. [1901] 1 Ch. 279,* Farwell J. held that "a share in a company cannot properly be likened to a sum of money settled upon and subject to executory limitations to arise in the future; it is rather to be regarded as the interest of the shareholder in the company, measured, for the purposes of liability and dividend, by a sum of money ....." It was suggested that the dividend arises out of the profits accruing from land and is impressed with the same character as the profits and that it does not change its character merely because of the incident that it reaches the hands of the shareholder.

INTEREST VS. DIVIDEND

Interest and dividend are completely different concepts. The key difference between Interest and Dividend is as follows:

Nature of Difference	***Interest***	***Dividend***
Meaning	Interest is the return on borrowed capital	Return on the investment made in the share capital of a company
Nature	It is a charge against profit	It is appropriation of profit
Calculations	It is a liability which has to be discharged even if the company has suffered loss	It is appropriation of profit which is arrived after providing of all expenses including interest
Commitment	Interest is always a commitment which is to be paid by the borrower as per the terms decided between lender and borrower	It is not a commitment
Paid to	The lenders, creditors and debenture holders	Equity Shareholders and Preference Shareholders
Expenditure	Interest on bonds or other debt is an expense of the company. The interest, being an expense, reduces the company's net income and consequently its taxable profits	It is not an expense of the company. The right of preference shareholders to receive dividend is even subject to the availability of distributable profits and this right is not to the receipt of dividend but to preferential treatment if and when dividend is declared
Mandatory	Interest is to be paid even if there is no chance of making profit	To distribute dividend, profits are necessary
Rate	Fixed	Remains constant in the case of preference shares, but fluctuates in case of equity shares.

Types of Companies and provisions related to payment of dividend

Dividend can be paid companies except section 8 companies (i.e. companies with charitable objects etc.) which prohibit the payment of any dividend to its members. The dividend in other types of entities is as follows:

(a) Section 8 Companies: According to Section 8(1) of the Companies Act, 2013 the company having license under Section 8 (Formation of Companies with Charitable Objects etc.) are prohibited from paying any

dividend to its members. Their profits are intended to be applied only in promoting the objects of the Company.

(b) **Nidhi Companies:** In terms of Rule 18 of Nidhi Rules, 2014, a Nidhi shall not declare dividend exceeding 25% in a financial year.

(c) **Producer Companies:** In case of producer companies, dividend is termed as 'Limited Return' as defined in clause (d) of section 378A of the Companies Act, 2013. It is the maximum dividend as the Articles of the producer company may specify. According to Section 378 E of the Companies Act, 2013, in producer Companies, the surplus if any, remaining after making provision for payment of limited return and reserves referred to in section 378ZI, may be disbursed as patronage bonus, amongst the Members, in proportion to their participation in the business of the Producer Company, either in cash or by way of allotment of equity shares, or both, as may be decided by the Members at the general meeting.

'Patronage Bonus', according to clause (i) of section 378A of the Companies Act, 2013, which means payments made by a Producer Company out of its surplus income to the Members in proportion to their respective patronage.

(d) **Companies Limited by Guarantee:** A Company Limited by Guarantee is primarily used for non- profit purposes and the profits are reinvested and used for promoting its non-profit activities. Although the Companies Act, 2013 does not specifically prohibit distribution of dividend in such companies, however, the Articles of such companies usually provides that all the income of the company shall be applied solely towards the promotion of the objects of the Company and that no portion shall be paid or transferred directly or indirectly by way of dividends or bonus or by way of profit to its members.

Types of Dividend

There are two types of Dividend:

(i) Final Dividend

(ii) Interim Dividend

Basis	***Final Dividend***	***Interim Dividend***
Meaning	The Dividend recommended by the Board of Directors and declared by the Members at an Annual General Meeting	Dividend paid by the Company between two annual general meetings
Power to declare Dividend	Recommended by the Board at the board meeting and declared by the Members of the Company	Declared by the Company's Board of Directors
Meetings	Declared in Annual General Meeting of Members	Declared at the Meeting of the Board
Time of Declaration	It is declared after the end of the financial year after the amount of distributable profit has been computed	It is declared on the basis of provincial financial statements or estimates
Frequency of payment	It can be paid only once in a financial year	It can be paid more than once in a financial year

Source of Payment	Paid out of profit earned in the previous financial year	Paid:- (i) out of surplus in the profit and loss account (ii) out of profit of the financial year in which such interim dividend is sought to be declared (iii) profits generated by the Company till the quarter preceding the date of declaration of interim dividend
Quantum of Dividend	Members cannot declare dividend over and above the amount recommended by the Board	It shall not be declared at a rate higher than the average dividends declared by the Company during the immediately preceding three financial years

Power to declare Dividend

Final Dividend

- While approving the financial statements and the appropriation of the profit for the previous financial year, the amount of dividend payable is also determined by board of directors of a company who decide how much to be paid to the shareholders and how much to retain in the business. These amounts vary from year to year depending upon the amount of profit earned by the company.
- The dividend recommended by the board of directors as mentioned in the Directors' Report is declared' at the annual general meeting of the company.
- This constitutes an item of ordinary business to be transacted at every annual general meeting.
- It may be noted that the shareholders may declare dividend which is lesser than the amount recommended by the Board. However, it cannot declare dividend over and above the amount recommended by the Board.

Article 80 of Table F of schedule I states that 'The company in general meeting may declare dividends, but no dividend shall exceed the amount recommended by the Board.

Interim Dividend

- As per Section 123(3), the Board of Directors of a company may declare interim dividend during any financial year or at any time during the period from closure of financial year till holding of the annual general meeting.
- Out of the surplus in the profit and loss account or out of profits of the financial year for which such interim dividend is sought to be declared or out of profits generated in the financial year till the quarter preceding the date of declaration of the interim dividend.
- It is also provided in article 81 of table F that Subject to the provisions of section 123, the Board may from time to time pay to the members such interim dividends as appear to it to be justified by the profits of the company.
- The declaration of interim dividend is dependent on the provisional financial statements or estimates.

Therefore, before approving payment of interim dividend, the directors should satisfy themselves that the profit is available for distribution by way of dividend.

While Final Dividend is recommended by the Board and declared by the Members, approval of Members is not required for declaration of Interim Dividend. Where a company has an Audit Committee, this Committee shall consider the financial results which shall thereafter be submitted to the Board for its consideration and declaration of Interim Dividend.

- In the case of *Raghunandan Neotia v. Swadeshi Cloth dealers Ltd,* it was held that Final Dividend can be declared at the annual general meeting only, the Board of Directors proposes and the members declare the same.
- In the case of *Maharani Lalita Rajya Lakshmi v. Indian Motor Co (Hazaribag) Ltd.*, it was held that no enhancement of rate of dividend than that recommended by the Board is possible.
- In the case of *Tarajan TeaCo. (P) Ltd. v. CIT, it was held that* a dividend declared by the members at an annual general meeting is a debt against the company and is recoverable by the members only after declaration by members and not at the time of recommendation made by the board of directors.
- In the case of *J. Dalmia v. Commissioner of Income Tax, New Delhi*, it was held that power to pay interim dividend is usually vested, by the articles of association, in the directors. For paying interim dividend a resolution of the company is not required: if the directors are authorized by the articles of association they may pay such amount as they think proper having regard to their estimates of the profit made by the Company. Interim dividend is therefore paid pursuant to the resolution of the directors on some day between the ordinary general meetings of the company.
- The declaration of a Dividend need not be only once a year. It may be at any time the directors choose, and there may be several declarations in the course of one year. *[Steel Co. of Canada Ltd. v. Ramsay (1932) 2 Comp. Cases 23 (PC)]*

SS-3 while clarifying the interim dividend provides that while declaring the Interim Dividend, the Board shall consider the financial results for the period for which Interim Dividend is to be declared and should be satisfied that the financial position of the company justifies and supports the declaration of such Dividend. The financial results shall take into account –

(a) Depreciation for the full year,

(b) Tax on profits of the company including deferred tax for full year,

(c) Other anticipated losses for the financial year,

(d) Dividend that would be required to be paid at the fixed rate on preference shares,

(e) The losses incurred, if any, during the current financial year upto the end of the quarter, immediately preceding the date of declaration of Interim Dividend.

Further, in case of clause (e) above, Interim Dividend shall not be declared at a rate higher than average Dividend declared during the immediately preceding three financial years.

Further SS-3 provides that Interim Dividend shall be declared at a meeting of the Board. In the event of a loss or inadequacy of profits during a financial year, no Interim Dividend shall be declared/ paid out of Free Reserves.

SS-3 further provides that where a company has issued equity shares with differential rights as to Dividend, Interim Dividend may, at the option of the Board, be declared on all or any one or more of the classes of such shares in accordance with the terms of issue.

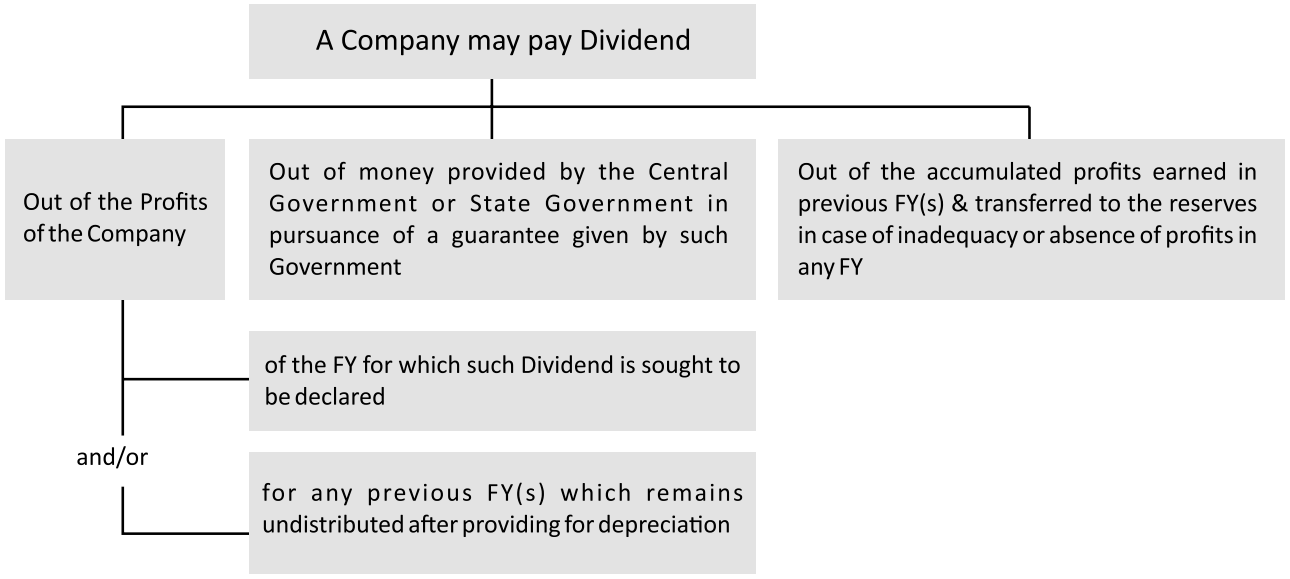
In case Interim Dividend is declared on only one class of equity shares, the Board shall ensure that the profit as shown in the financial results is adequate to meet the Dividend that would have to be paid on the other classes of equity shares in accordance with the terms of issue.

Where a company has issued equity shares with differential rights as to voting only, no differentiation shall be made in the declaration of Interim Dividend on such shares, unless the terms of issue provide otherwise.

Shain Ltd., incurred loss in business upto current quarter of financial year 2021-22. The company has declared dividend at the rate of 12%, 15% and 18% respectively in the immediate preceding three years. Inspite of the loss, the Board of Directors of the company have decided to declare interim dividend @ 15% for the current financial year. Examine the decision of Shain Ltd. stating the provisions of declaration of interim dividend under the Companies Act, 2013 ?

Source of payment of Dividend (Section 123)

Section 51 of the Act, states that a company may, if so authorized by its articles, pay dividend in proportion to the amount paid up on each share.



Sources of declaration of dividend: Section 123(1) of Companies Act 2013 provides that the dividend shall be declared or paid by a company for any financial year only out of —

(a) (i) the profits of the company for that year arrived at after providing for depreciation in accordance with the provisions of sub-section (2), or

(ii) out of the profits of the company for any previous financial year or years arrived at after providing for *depreciation in accordance with the provisions of that sub-section and remaining undistributed, or

(iii) out of both (i) and (ii), or

In computing profits of any amount representing unrealised gains, notional gains or revaluation of assets and any changes in carrying amount of an asset or of a liability on measurement of the asset or the liability at fair values shall be excluded; or,

(b) out of money provided by the Central Government or a State Government for the payment of dividend by the company in pursuance of a guarantee given by that Government.

* *depreciation shall be provided in accordance with the provisions of Schedule II.*

In line with the requirements of fifth proviso to sub-section (1) of Section 123 of the Act, no company shall declare Dividend unless carried over previous losses and depreciation not provided in the previous year or years are set off against profit of the company for the current year.

A company shall also not declare any Dividend, if it has defaulted in –

(a) Redemption of debentures or payment of interest thereon or creation of debenture redemption reserve,

(b) Redemption of preference shares or creation of capital redemption reserve,

(c) Payment of Dividend declared in the current or previous financial year(s), or

(d) Repayment of any term loan to a bank or financial institution or interest thereon, till such time the default is subsisting.

No Dividend shall be declared by the company during the extended time, if any, granted by the Tribunal/ Court for repayment of above liabilities.

No dividend shall be declared or paid by a company from its reserves other than free reserves.

Free reserves as defined under section 2(43) of the Companies Act, 2013 means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that the following shall not be treated as free reserves:—

(1) *any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or*

(2) *any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value.*

Dividend shall not be declared out of the Securities Premium Account or the Capital Redemption Reserve or Revaluation Reserve or Amalgamation Reserve or out of profits on re-issue of forfeited shares or out of profits earned prior to incorporation of the company.

Regulation 43 of the SEBI (LODR) Regulations, 2015 provides that the listed entity shall declare and disclose the dividend on per share basis only. Further, part A of schedule IV regarding the disclosures in financial results as per regulation 33(1) (e) of SEBI (LODR) Regulations, 2015 also mandates disclosure for amount of dividends distributed or proposed for distribution on per share basis.

Illustration:

In view of the provisions of the Companies Act, 2013 relating to 'securities premium', state whether the amount lying in securities premium account of a company can be used for payment of dividend declared by the company at its general meeting ?

For payment of dividend declared by the company at its general meeting. Securities premium Account since not covered by section 123(1) cannot be utilized for the purpose of declaring dividend.

Transfer of profits to reserve

As per Second Proviso to sub-section (1) of Section 123 of the Act provides that a company may, before the declaration of any Dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company.

Therefore, the transfer of profits to reserves is left to the discretion of the Board of Directors of the Company.

A company shall not declare Dividend on its equity shares in case of non-compliance of provisions relating to the acceptance of deposits under the Act, till such time the deposits accepted have been repaid with interest in accordance with the terms and conditions of the agreement entered with the depositors.

Declaration of dividend in case of loss or inadequacy of profit

Third proviso to sub-section (1) of section 123 provides that owing to inadequacy or absence of profits in any financial year, if any company proposes to declare dividend out of the accumulated profits earned by it in previous years and transferred by the company to the free reserves, such declaration of dividend shall not be made except in accordance with such rules as prescribed in this behalf. The conditions for the declaration of dividend in case of inadequacy or absence of profits are prescribed in Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014. Rule 3 specifies that in the event of inadequacy or absence of profits in any year, a company may declare dividend out of free reserves subject to the fulfillment of the prescribed conditions.

As per Rule 3, the conditions for declaration of dividend in the event of inadequacy or absence of profits in any year are as follows:

Rate of Dividend	•It shall not exceed the average of the rates at which dividend was declared by it in 3 years immediately preceding that year. *(This rule shall not apply to a company, which has not declared any dividend in each of the 3 preceding financial year.)*
Amount to be drawn	•Total amount to be drawn from such accumulated profit shall not exceed 1/10 th of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement.
Utilisation of the amount	•The amount so drawn shall first be utilised to set off the losses incurred in the financial year in which dividend is declared before any dividend in respect of equity shares is declared.
Balance of Reserve	•The balance of reserves after such withdrawal shall not fall below 15% of its paid up share capital as appearing in the latest audited financial statement.

Vide notification no. G.S.R. 463(E) dated 05.06.2015, an exemption has been given to a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments. Hence, such companies need not comply with the above conditions.

XYZ Ltd., which has inadequacy of profits, proposes to declare Dividend out of general reserves.

Following are the facts of the case:

- 17,500 preference shares of Rs. 100 each fully paid; (Dividend @ 9%)
- 7,00,000 equity shares of Rs. 10 each
- General reserves: Rs. 21,00,000
- Capital reserves: Rs. 3,50,000
- Securities premium: Rs. 3,50,000
- Surplus (P&L): Rs. 63,000
- Net profit for the year: Rs. 3,57,000
- Average rate of Dividend during the last three years: 15%
- Board of directors of the company wishes to declare 10% Dividend.
- Maximum amount that can be withdrawn : Rs. 10,91,300 [1/10 of (Rs. 17,50,000 + Rs. 70,00,000 + Rs. 21,00,000+63000]
- Permissible withdrawal from the balance of Reserves : Rs. 8,50,500

Calculation:

- 15% of total capital Rs. 87,50,000 to be retained in the Reserves i.e. Rs. 13,12,500
- General Reserves: [Rs. 21,00,000 + 63000 (Surplus-P&L)]
- Maximum amount that can be taken from Reserves: Rs. 8,50,500 (Rs. 21,63,000 – Rs. 13,12,500)
- Available profits : Rs. 2,62,500 (Rs. 63,000 + Rs. 3,57,000 – Rs. 1,57,500); [Rs. 1,57,500 is 9% preference Dividend on 17,500 preference shares of Rs.100 each]
- Dividend desired to be declared by the Board of the company: Rs. 7,00,000
- Profit available for declaration of Dividend : Rs. 2,62,500
- Balance amount that can be withdrawn from Reserves: Rs. 4,37,500 (Rs. 7,00,000 – Rs. 2,62,500).

Hence, company can declare Dividend @ 10%

Illustration:

The profits of X Ltd. for F.Y. 2021-22 are inadequate and considering the different scenarios the declaration of dividend may be as under :

Financial Year	***Dividend paid during the year***		
	Case 1	***Case 2***	***Case 3***
2018-19	10%	Nil	Nil
2019-20	Nil	Nil	12%
2020-21	5%	Nil	Nil
Maximum rate of dividend for the year 2021-22	Average rate of dividend 15/3= 5% [The Company can declare Dividend upto 5% subject to the compliance of other conditions prescribed under the Rules].	*The stipulation regarding average rate of Dividend is not applicable as no Dividend is declared in any of the three preceding financial years. Accordingly, the dividend for 2021-22 may be declared at any rate, subject to the compliance of other conditions prescribed under the Rules. (*Proviso to Rule 3(1) of Companies (Declaration and Payment of Dividend) Rules, 2014 shall not apply to a company, which has not declared any Dividend in each of the three preceding financial year.)	Average of Dividend 12/3= 4% [The Company can declare Dividend upto 4% subject to the compliance of other conditions prescribed under the rules.

Illustration:

The following summarized information is available in respect of a company for the year ended 31st March, 2022:

Equity Share Capital 10,000 shares of the face value of Rs.100 each= Rs. 10 Lakhs

Free Reserve= Rs. 2 Lakhs

Revaluation Reserve= Rs. 1 Lakh

Profit and Loss Account (Dr.)= Rs. 0.35 Lakhs

Net loss for the year 2021-2022= Rs. 0.25 Lakhs

The company has paid dividends to the equity shareholders @ 8%, 10% and 12% during the immediately preceding three financial years. Advise the Board of directors the maximum amount they can pay this year by way of dividends.

Calculation:

In the instant case, the net loss for the year 2021-22 is Rs.25000.

According to Rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014 the following conditions must be fulfilled:

(i) The rate of dividend cannot exceed the average of the rates at which dividend was declared in the three years immediately preceding that year i.e. (8%+10%+12%)/3 = 10%, so in this case, the amount of dividend should not exceed Rs.1 Lakh.

(ii) The total amount to be drawn from such accumulated profits shall not exceed one-tenth of the sum of its paid-up share capital and free reserves as appearing in the latest audited financial statement. Thus the company can draw only upto Rs.1.2 lakh.

(iii) The balance of reserves after such withdrawal shall not fall below 15% of its paid up capital as appearing in the latest audited balance sheet. Accordingly, the maximum that may be withdrawn cannot exceed Rs.50000.

(iv) However, the amount so withdrawn must be used to set-off losses of the current year i.e. Rs.25000.

Therefore, the maximum amount in this instant case that can be paid by way of dividend is Rs.25000.

Illustration:

ABC Ltd. issued equity shares of Rs. 10 fully paid up and declared Dividend thereon. Mr. X and Mr. Y, are the shareholders who paid Rs. 5 towards the call money and Rs. 5 remains unpaid on the date of Dividend declaration.

The Company ABC Ltd. may adjust the amount of Dividend declared on such shares towards the unpaid call money due from Mr. X and Mr. Y.

Illustration:

Following situations depict the adjustment of sum due from a Member in capacity other than a Member:

Case (i): Mr. John is a debtor as well as Member of X Ltd., a public listed company.

X Ltd. declares Dividend of Rs. 5000 on the shares owned by Mr. John and proposes to adjust the said amount against the debt of Rs. 10,000 due from Mr. John. In the given case, X Ltd. may adjust the amount of Dividend only against calls in arrears or any other sums due from Mr. John in the capacity of a Member and not otherwise. Therefore, the amount due from Mr. John in the capacity of trade debtor will not be adjusted and the company need to pay Dividend amount to Mr. John.

Case (ii): In the above example, if X Ltd. is an unlisted company and has adopted regulation 84 of Table F of schedule – I to the Act, then it can only adjust the amount due from Mr. John in relation to the shares of the company and not otherwise.

Regulation 84 of Table F to the Act read as under:

The Board may deduct from any Dividend payable to any member all sums of money, if any, presently payable by him to the company on account of calls or otherwise in relation to the shares of the company.

Therefore, in both the above situations (i) & (ii) the Dividend amount needs to be paid to Mr. John without any adjustment.

Case (iii): In the above example, if X Ltd. is an unlisted company and the Articles of Association provide for adjustment of Dividend amount with the amount due from a Member in a capacity other than that of a Member, then, the Dividend may be adjusted against the amount due from Mr. John.

Dividend Distribution Policy

While considering the financial statements for declaration of Dividend, the Board should take into account the Dividend Policy of the company, if any.

The various determinants of the Dividend Policy ordinarily include:

(a) **Legal and contractual restrictions**: This includes the restrictions/ conditions imposed under the applicable laws or by the financial institutions/banks in the loan agreement;

(b) **Earnings of the company:** Current earnings provide the best index of what a company can pay;

(c) **Cash position and liquidity**: The cash position of a company is an important consideration in paying Dividends, the greater the cash availability and overall liquidity the greater is the ability to pay Dividend;

(d) **Financial needs:** There are many financial needs of a company such as meeting the cost of capital borrowed, non-availability of external capital and making provisions for any expansion or growth plans of the company;

(e) **Tax considerations:** The tax burden is a determining factor in the formulation of a Dividend Policy.

The Board should recommend the Dividend to be declared by the Members in the Annual General Meeting on being satisfied that the company has sufficient profits to be distributed as Dividend, i.e. sufficient profits remain after all charges against the current income (e.g. taxation, depreciation, etc.) and after making provision for past losses, unabsorbed depreciation for past years, transfers to reserves, if any, or for any other purposes as may be warranted and as may be required by the Dividend Policy of the company.

As per Regulation 43A of SEBI (LODR) Regulations, 2015, the top 1000 listed entities based on market capitalization (calculated as on March 31 of every financial year) shall formulate a dividend distribution policy which shall be disclosed on the website of the listed entity and a web-link shall also be provided in their annual reports.

The dividend distribution policy shall include the following parameters:

(a) the circumstances under which the shareholders of the listed entities may or may not expect dividend;

(b) the financial parameters that shall be considered while declaring dividend;

(c) internal and external factors that shall be considered for declaration of dividend;

(d) policy as to how the retained earnings shall be utilized; and

(e) parameters that shall be adopted with regard to various classes of shares.

If the listed entity proposes to declare dividend on the basis of parameters in addition to clauses (a) to (e) or proposes to change such additional parameters or the dividend distribution policy contained in any of the parameters, it shall disclose such changes along with the rationale for the same in its annual report and on its website.

The listed entities other than those specified at sub-regulation (1) of this regulation may disclose their dividend distribution policies on a voluntary basis on their websites and provide a web-link in their annual reports.

Date for determining entitlement to dividend

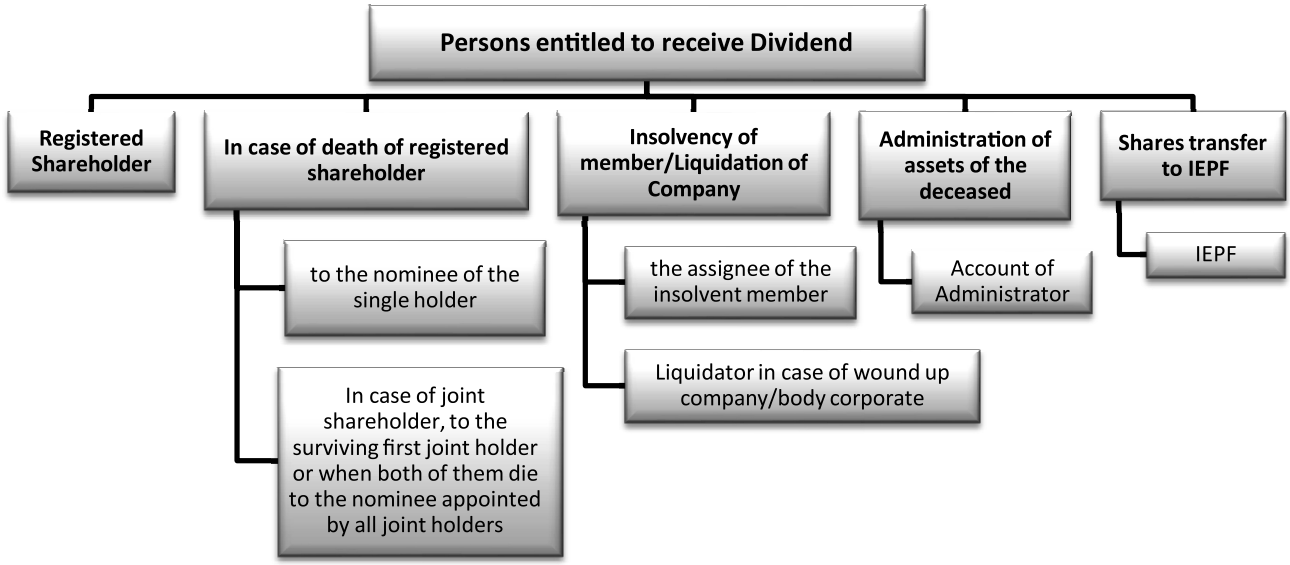
The company may close its registers or fix a record date for deciding the entitlement to receive dividend.

Regulation 60 of SEBI (LODR) Regulations, 2015 provides for fixing of record date for payment of dividend. All shareholders on the record date irrespective of the holding period of shares shall be eligible to receive dividend.

The listed entity shall give notice in advance of atleast seven working days (excluding the date of intimation and the record date) to the recognised stock exchange(s) of the record date or of as many days as the stock exchange(s) may agree to or require specifying the purpose of the record date.

In case of unlisted companies, the company may close its register of members by complying with provision of section 91 of the Act.

Persons entitled to dividend



- Dividend should be paid by the company only to its registered shareholders or to his order or to his Banker and not to any other person. The shareholder has the option to direct the company to pay the dividend due to him to any other person. The company may fix any record date of the determination of entitlement of shareholders for dividend.
- Where the company has received intimation of death of a member, the dividend may be paid by the company to the nominee of the single holder, where shares are held by more than one person jointly and any joint holder dies, to the surviving first joint holder and where shares are held by more than one person jointly and all the joint holders die, to the nominee appointed by all the joint holders.
- In case of insolvency of a member, the dividend may be paid to the assignee of the insolvent member and in case of a company or body corporate which is being wound up, to the liquidator.
- In case of administration of assets of the deceased, dividend is to be paid to the account of administrator.
- In case of shares transfer to IEPF, dividend is to be paid to IEPF.
- When bonus shares are issued ranking pari passu with the existing equity shares, shareholders are entitled to Dividend in respect of such bonus shares also, if the record date for the purpose of payment of Dividend falls after the date of allotment of such bonus shares.

- In the case of *Chunilal Kuhshaldash Patel v. H.K. Adhyaru,* Dividend is payable to the Shareholder whose name appears in the register of members on the relevant date even if, prior to that date, he has sold the shares but the transfer deed in respect thereof has not been lodged with the company.
- In the case of *Hariprasad v. A.C. Traders (P) Ltd*., the transfer of shares on cum-Dividend basis does not entitle the transferee to receive from the company any Dividend declared before such transfer.

Dividend on preference shares

Preference shares carry a preferential right as to Dividend in accordance with the terms of issue. However, this right is subject to the availability of distributable profits. Since the Dividend on preference shares is governed by the terms of issue already approved by the Shareholders, the Board may declare Dividend on such shares in accordance with the terms of issue.

The right of Preference Shareholders to receive Dividend is subject to the availability of distributable profits and it may be noted that this right is not to receipt of Dividend but to preferential treatment if and when Dividend is declared.

Dividend on preference shares can be paid out of free reserve subject to its declaration.

Even where Dividend is declared out of free reserves, in case of absence or inadequacy of profits, Preference Shareholders have priority over equity Shareholders in respect of payment of Dividend. However, when the Board declares Interim Dividend on equity shares, it is not necessary to declare Interim Dividend on preference shares also.

If there are two or more classes of preference shares, the holders of the class which has priority are entitled to their preference Dividend before any Dividend is paid in respect of the other class, if the terms of issue so provide.

However, if the terms of issue are silent, Dividend shall be distributed on pro-rata basis. In the case of Interim Dividend, while Preference Shareholders need not necessarily be paid Dividend before Interim Dividend is paid to equity Shareholders, the Board should take into account such sum as would be necessary to pay Dividend to the Preference Shareholders before consideration of Interim Dividend.

Board of Directors of AVB Limited wants to declare dividend Rs. 15 lakh out of capital profits for the year ended 31st March, 2022, without making a provisions for depreciation. Referring to the provisions of the Companies Act, 2013, you being the Secretary of the Company advise the board whether it can go ahead with its proposal ?

In accordance with the provisions of the Companies Act, 2013, as contained in third proviso to section 123(1), no dividend shall be declared or paid by a company from its reserves other than free reserves.

As per section 2(43) of the Companies Act, 2013, “free reserves” means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend. Further according to section 123(2), for the purposes of declaration of dividend by a company as per section 123(1)(a), depreciation shall be provided in accordance with the provisions of Schedule II.

Therefore, in the given case, AVB Limited can neither declare dividend from capital profit and nor it can declare dividend without making provision for depreciation.

Dividend on Equity shares with differential rights

Where a company issues equity shares with differential rights as to Dividend, the terms of issue of such shares shall govern the rights of each such class of holders as to receipt of Dividend. Subject to the rights of persons, if any, entitled to shares with special rights as to Dividends, all Dividends shall be declared and paid according to the amounts paid or credited as paid on the shares in respect whereof the Dividend is paid, but if and so long as nothing is paid upon any of the shares in the company, Dividends may be declared and paid according to the amounts of the shares. [Regulation 83(i) of Table F of Schedule I to the Act].

Dividend in case of Beneficial Owner

As provided under Section 89(9) of the Companies Act, 2013, the obligation of the company of payment of dividend is towards the member and not towards the beneficial owner. However, the dividend may be paid to a beneficial owner where the shareholder instructs the company to do so. Since, sub-section (5) of Section 123 includes payment of dividend to registered shareholder or "to his order", the company shall pay the dividend according to the instruction given.

While furthering this contention for 'deemed dividend' under Income Tax Act, 1961, the Supreme Court has held in the case of *Rameshwar Lal Sanwarmal vs. Commissioner of Income Tax, Assam* that 'it is difficult to see how a beneficial owner of shares whose name does not appear in the register of shareholders of the company can be said to be "shareholder". It is only the person whose name is entered in the register of shareholders of the company as the holder of the shares who can be said to be a shareholder qua the company, and not the person beneficially entitled to the shares. It is the former who is a "shareholder" within the matrix and scheme of the company law and not the latter.

Therefore, it is only where a loan is advanced by the company to a registered shareholder and the other conditions set out in the Income Tax Act, 1961 are satisfied that the amount of the loan would be liable to be regarded as "deemed dividend". This establishes the position that payments advanced directly to beneficial owner will not assume the character of deemed dividend.

The concept of Deemed Dividend is embedded in Section 2(22)(e) of the Income-tax Act, 1961, where a closely held company extends a loan or an advance to:

a. any of its shareholders who has more than 10% voting power in the company; or

b. to any concern in which such shareholder is substantially interested; or

c. for the individual benefit of such shareholder; or

d. on behalf of such shareholder to the extent the company has accumulated profits, such payment would be deemed as a dividend under Section 2(22).

Illustration:

ABC Pvt Ltd. is a company, the public is not substantially interested in. Mr. X is one of the company shareholders, who hold 20% shares. The company has accumulated profits of Rs. 50 lakhs as on 31 March 2022. The company granted a loan of Rs. 100,000 to Mr. X, by way of an account payee cheque. He repaid the amount on 5 May 2020.

In this case, even if the loan has been repaid by Hari, the loan amount granted to the extent of accumulated profits are treated as deemed dividend.

Distribution of discount coupons to all the Shareholders shall not be treated as deemed Dividend.

Discount coupons given by the company with respect to its products or services, to all the shareholders, should not be treated as Dividend. It is a general practice adopted by the company for promotion of its products or services.

In the case of Gopal & Sons (HUF) v.CIT, Supreme Court

Is loan to HUF who is a shareholder in a closely held company chargeable to tax as deemed dividend?

Facts of the Case:

The assessee is a Hindu Undivided Family (HUF). During the previous year to the Assessment year, the assessee had received certain advances from one M/s G.S. Fertilizers (P) Ltd. (hereinafter referred to as the 'Company'). The Company is the manufacturer and distributor of various grades of NPK Fertilizers and other agricultural inputs. In the audit report and annual return for the relevant period, which was filed by it before the Registrar of Companies (ROC), it was found that the subscribed share capital of the said company was Rs.1,05,75,000/- (i.e. 10,57,500 shares of Rs.10/- each). Out of this, 3,92,500 number of shares were subscribed by the assessee which represented 37.12% of the total shareholding of the Company.

From this fact, the AO concluded that the assessee was both the registered shareholder of the Company and also the beneficial owner of shares, as it was holding more than 10% of voting power. On this basis, after noticing that the audited accounts of the Company was showing a balance of Rs.1,20,10,988/- as "Reserve & Surplus" as on 31st March, 2006, this amount was included in the income of the assessee as deemed dividend. In the appeal filed by the assessee, the aforesaid addition was affirmed by the CIT(A). The Tribunal reversed the CIT(A). The High Court reversed the Tribunal.

Before the Supreme Court, the assessee argued that being a HUF, it was neither the beneficial shareholder nor the registered shareholder. It was further argued that the Company had issued shares in the name of Shri. Gopal Kumar Sanei, Karta of the HUF, and not in the name of the assessee/HUF as shares could not be directly allotted to a HUF. On the basis, it was submitted that provisions of Section 2(22)(e) of the Act cannot be attracted.

Judgment

The Supreme Court held as the shares are issued in the name of the Karta, the HUF is not the 'registered shareholder' and so Section 2(22)(e) will not apply to loans paid to the HUF is not correct because in the annual returns filed with the ROC, the HUF is shown as the registered and beneficial shareholder. In any case, the HUF is the beneficial shareholder. Even if it is assumed that the Karta is the registered shareholder and not the HUF, as any payment to a concern (i.e. the HUF) in which shareholder (i.e., the Karta) has substantial interest is also covered.

Waiver of right to receive Dividend

Receipt of dividend is a right of shareholder and not an obligation. There is no provision under the act to deal with the waiver of dividend. Hence, such provisions may be contained in the articles of the company. Further, such waiver can either be full or partial.

Declaration of Dividend

Dividend being an important decision and having impact on the financial position of the company should be considered at a meeting of the Board and not at a meeting of a committee of the Board or by way of a Resolution passed by circulation.

Unless the Dividend has been recommended by the Board, Members in Annual General Meeting cannot on their own declare any Dividend.

Where a company has an Audit Committee, this Committee shall consider the annual financial statements before submission to the Board. Dividend shall be recommended by the Board after consideration and approval of said financial statements.

The listed entity shall recommend or declare all dividend and/or cash bonuses at least five working days (excluding the date of intimation and the record date) before the record date fixed for the purpose.

Declaration of Dividend to be unconditional

All requisite approvals shall be obtained before declaration of Dividend. Dividend shall not be declared subject to any condition such as the approval of financial institutions/ banks or foreign collaborators or compliance with any other contractual obligation.

The above paragraph pertaining to requisite approval of financial institutions/ banks or foreign collaborators etc. is equally applicable to both Interim and Final Dividend. Dividend should not be declared subject to any condition such as obtaining of approval from financial institutions/banks etc. [Erstwhile Department of Company Affairs (DCA) Circular No. 2/98 dated 13.04.1998)].

Due to inadequacy of profits, the Board of directors of Rise Ltd. decided not to recommend any dividend for the financial year ended 31st March, 2022. Certain shareholders of the company complained to the Tribunal regarding mismanagement of the affairs of the company, since the Board of the company did not recommend any dividend. Explaining the provisions of the Companies Act, 2013, examine whether the contention of the shareholders is tenable ?

Section 241 of the Companies Act, 2013 provides for relief in cases of mismanagement. For a petition under this section to succeed, it must be established that the affairs of the company are being conducted in a manner prejudicial to the interest of the company or public interest or that, by reason of any change in the management or control of the company, it is likely that the affairs of the company will be conducted in that manner. If the court (Tribunal) is convinced, it may with a view to bringing to an end of preventing the matter complained or apprehended, make such order as it thinks fit.

It was held in the case of *Indowind Energy Ltd. v. ICICI Bank Ltd. [2010] 153 Com Cases 394 (CLB)* that non-declaration of dividend would not amount to oppression and mismanagement.

Therefore, applying the above facts and precedent in the given case, it can concluded that the non-payment of dividend does not amount to mismanagement and hence the contention of the shareholders shall not be tenable.

Test Yourself:

Favourite Ltd., an unlisted Company, has the following figures at the end of the last financial year :

Paid-up share capital : Rs.110.00 Crore

Turnover : Rs. 600.00 Crore

Borrowings by way of loans, debentures and deposits : Rs.60.00 Crore

List the conditions to be satisfied for declaration of dividend out of reserves ?

Dividend to be deposited in separate bank account

In terms of sub-section (4) of Section 123 of the Act, the amount of Dividend, including Interim Dividend, shall be deposited in a scheduled bank in a separate account within 5 days from the date of declaration of such Dividend.

Any amount which remains unpaid or unclaimed after the period of 30 days shall be transferred to the Unpaid Dividend Account to be opened by the company.

SS-3 hereby clarifies that the Dividend shall be deposited in a separate bank account within five days from the date of declaration and shall be paid within thirty days of declaration. The intervening holidays, if any, falling during such period shall be included.

By virtue of MCA exemption notification G.S.R.463(E)dated 5th June 2015 the requirement of deposit of Dividend amount in a separate bank account within five days from the date of its declaration, as provided under Section 123(4) shall not apply to a Government Company in which the entire paid up share capital is held by the Central Government or State Government(s) or jointly by both or by one or more Government Company.

Illustration

If the Board of Directors of XYZ Ltd. declared an Interim Dividend on 13th August 2022, then the amount of Dividend should be deposited in a separate bank account within five days from the date of declaration i.e. latest by 18th August 2022 irrespective of the intervening holidays.

Considering the above requirements, there may be following two scenarios:

Scenario 1: Dividend claimed within 30 days

Once a separate bank account is opened by a company for the purpose of payment of Dividend and the entire Dividend is paid from such account and no balance stands in its credit. The same separate bank account may be used for the purpose of deposit of Dividend declared in future years, as long as the entire Dividend is paid / claimed from such account and nothing is left as unpaid Dividend.

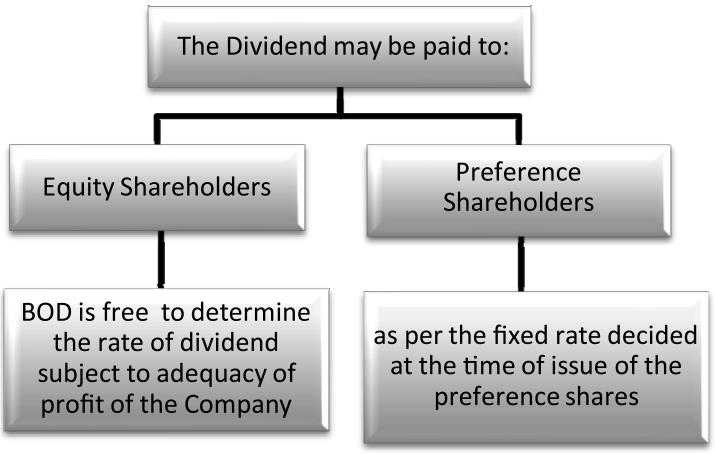
Scenario 2: Dividend remains unpaid or unclaimed after 30 days

In such situation, the nomenclature of the separate account opened by a company may be changed to "Unpaid Dividend Account" after the said period of 30 days instead of opening a different account for transferring the unpaid Dividend. However, in this case a separate bank account needs to be opened for future Dividend declared by the company.

Remittance of Dividend to Non-Resident members

Dividend can be remitted to Non-Resident members provided it is allowed under the terms of the permission given by the Reserve Bank of India (RBI). For remittance of Dividend to non-resident members, the company shall apply to authorised dealer along with the documents as may be required by the authorized dealer for this purpose. The authorized dealer may allow the remittance of Dividend in accordance with the procedure prescribed by the RBI.

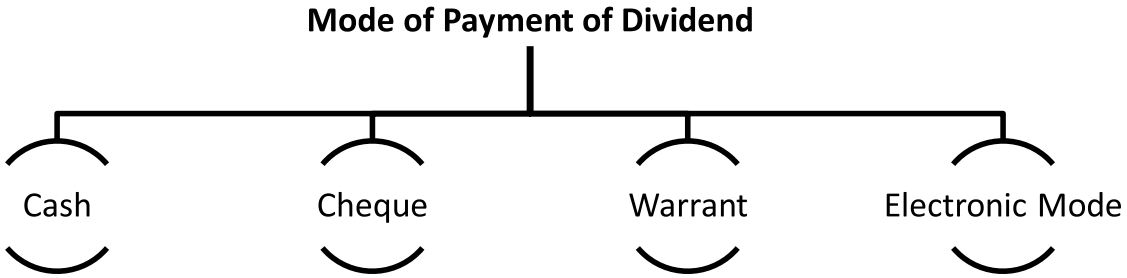
Rate of Dividend



Further, proviso to sub-section (3) of Section 123 of the Act provides that in case the company has incurred loss during the current financial year up to the end of the quarter immediately preceding the date of declaration of Interim Dividend, such Interim Dividend shall not be declared at a rate higher than the average Dividends declared by the company during the immediately preceding three financial years.

However, in case accompany has not declared dividend in the immediately preceding three financial years, the above provision regarding average rate does not apply.

Mode of Payment of Dividend (Section 123(5))



- Dividend can be paid in cash and not in kind.

  Where a company gifts to its shareholders, shares held by it in another company under a scheme, it is nothing but payment of dividend in kind which is expressly prohibited under section 123; hence, such scheme could not have been sanctioned.

- Dividend payable in cash may be paid through payable at par cheque or warrant or in any electronic mode of payment approved by the Reserve Bank of India.
- Closely held companies also use the method of purchasing demand drafts on the name of the shareholders. In such situation dividend would be treated as paid on the date of issue of demand draft by bank by debiting dividend account of the company.
- Where payment of Dividend is not possible through any electronic mode, such Dividend shall be paid by way of cheque payable at par or Dividend warrant.

- The cheque or warrant shall be sent to the registered address of the Member and, in the case of joint holders, to the registered address of the Member named first in the Register of Members or to such person or to such address as the Member or the joint holders have directed, in writing.
- In order to minimize pilferage and fraudulent encashment of Dividend warrants by unauthorised persons, companies should ascertain from the Member, his Bank Account Number and name and address of the Bank branch where he maintains the account and indicate these details on the face of the Dividend warrant. Moreover, companies may also introduce holograms on Dividend warrants as a security measure.
- When payment is made by Dividend warrant, the name of the bank and account number, if available, shall be mentioned in the warrant after the name. In case these are not available, address of the Member shall be printed after the name.
- In case of payment of Dividend through warrant or cheque payable at par, if the amount of Dividend exceeds one thousand and five hundred rupees, the company shall ensure to send such Dividend warrant or cheque either by speed post or registered post to the concerned Member at his registered address.
- Initial validity of the Dividend cheque or warrant shall be for three months.
- The Dividend cheque or warrant shall be accompanied by a statement in writing showing the amount of Dividend paid, Folio no./DP ID and Client ID nos., number of shares held by the concerned Member as on the record date, amount paid up on each share and the financial year to which the Dividend pertains.
- Dividend shall be paid proportionately on the paid-up value of shares.
- Nothing in this Section i.e. 123(5) of the Companies Act, 2013 shall be deemed to prohibit the capitalization of profits or reserves of a company for the purpose of issuing fully paid-up bonus shares or paying up any amount for the time being unpaid on any shares held by the members of the company.
- No Dividend shall bear interest against the company except in case of default in payment of Dividend Dividend warrant/cheque within the prescribed period.

Liability to pay Final Dividend

While analyzing the nature of provisions made for payment of dividend, Supreme Court explained the whole process in the case of *Vazir Sultan Tobacco Co. Ltd.Etc. v. Commissioner of Income-Tax Andhra Pradesh, Hyderabad* and held that *'It is, no doubt, true that the recommendations of the Directors for payment of any dividend does not create any kind of liability for the payment of the said amount. The liability for payment of any amount by way of dividend only arises when the share-holders accept the recommendations and a dividend is declared at the annual general meeting of the Company. It is open to the Directors to modify or withdraw the recommendation with regard to the payment of dividend before the said recommendation is accepted by the sh–re- holders. It is also open to the shareholders not to accept the recommendation of the Directors in its entirety and to modify the same. The legal liability for the payment of any dividend only arises after the share-holders at the annual general meeting have decided to declare a dividend on the basis of the recommendations of the Directors or on the basis of any modification thereof. The liability for the payment of dividend only arises after the dividend has been declared by the share-holders at the annual general meeting and this liability does not relate back to any earlier date on the basis of the recommendations of the directors as the directors do not enjoy any power of declaring the dividend. The amount that may be set apart for payment of any dividend on the basis of the recommendations made by the Directors, cannot be considered to be an amount set apart for meeting a known or existing liability'.*

CASE STUDY

16.10.2017	***Zylog Systems Limited***	***Whole Time Member, Securities and Exchange Board of India***

Facts of the Case:

Zylog Systems Limited ('the company / ZSL') is a company incorporated under the Companies Act, 1956. Securities and Exchange Board of India (SEBI) received several complaints from investors alleging that ZSL has not paid the dividend declared by it. The shares of ZSL were listed on the National Stock Exchange of India Limited (NSE) and the Bombay Stock Exchange Limited (BSE). It was observed that ZSL declared dividend to its shareholders at the rate of Rs.5 per equity share of the face value of Rs.5/- each and the same was approved in the Annual General Meeting held on September 25, 2012. The total amount of dividend declared was Rs.16,44,64,200 (Rupees Sixteen crores forty four lakhs sixty four thousand two hundred only).

On receiving such complaints, SEBI issued a letter dated February 13, 2013 asking the company to furnish information regarding declaration and payment of dividends under the Companies Act, 1956 and reasons for default. ZSL vide its letter to SEBI dated February 20, 2013 submitted that they have not been able to pay dividend to the shareholders due to strain on the liquidity position of the company. ZSL further submitted that Mr. Sudarshan Venkatraman, Mr. Ramanaujam Sesharathnam, Mr. Parthasarathy Srikanth, Mr. Madurai Gajanathan, Mr. S. Rajagopal, Mr. V. K Ramani and Mr. Vasanthakumar Ayyavu Palanichamy were the Directors of the ZSL as on the date of declaration of dividend i.e. September 25, 2012.

Therefore, SEBI issued a common Show Cause Notice (SCN) dated October 20, 2016 to all the directors, calling upon them to show cause as to why suitable directions under Section 11 and 11B of the SEBI Act, 1992 should not be issued against them for violation of Sections 205(1A) and 207 of the Companies Act, 1956. The SCN alleged that the directors of the company had knowledge about the declaration of the dividend and the non-payment of the declared dividend by the company. Thus the directors have failed to comply with the obligations and duties mandated under section 205(1A) of the Companies Act, 1956.

Mr. Madurai Gajanathan (Independent Director), who became the member of the new audit committee brought up the issue of non- payment of statutory dues and dividend before the management again along with chairman of the new audit committee and Mr. Parthasarathy Srikanth. Inspite of the requests and insistence from the side of the audit committee, the dividend was not paid.

SEBI Order:

SEBI disposed off the Show Cause Notices against the Independent Directors.

No dividend to be declared/paid in case of failure of repayment of deposits: Section 123(6) of the Companies Act, 2013 provides that a company which fails to comply with the provisions of sections 73 (prohibition of acceptance of deposits except in the manner provided) and 74 (Repayment of deposits etc. accepted before commencement of the Companies Act 2013) shall not, so long as such failure continues, declare any dividend on its equity shares.

The Board of Directors of Peculiar Ltd. proposes to recommend a final dividend of Rs.25 each to all the equity shareholders of the company. The company seeks your opinion on the following :

(1) The company wants to deposit the dividend amount to co-operative bank.

(2) The company is a defaulter in the repayment of deposits and proposes to repay its all deposit after the payment of dividend within 10 days.

(3) Dividend will be declared out of the capital reserves of the company.

The Peculiar Ltd has to follow below procedure for recommending final dividend:

(1) Referring to section 123(4) of Companies Act, 2013, the amount of the dividend has to be deposited in a scheduled bank. The company should first ensure that said co-operative bank is scheduled bank from the list of scheduled bank available at RBI website, and then it may deposit the dividend amount in the scheduled Co-operative Bank.

(2) Referring to section 123(6) of Companies Act, 2013 a company which fails to comply with the provisions relating to acceptance and repayment of deposits shall not, so long as such failure continues, declare any dividend on its equity shares. Hence Peculiar ltd. cannot declare dividend till the failure persists.

(3) Referring to third proviso to Section 123(1) no dividend shall be declared or paid by a company from its reserves other than free reserves.

Free reserves,as per Section 2(43), means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend :

Provided that –

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves;

Hence dividend cannot be declared out of the capital reserves of the company.

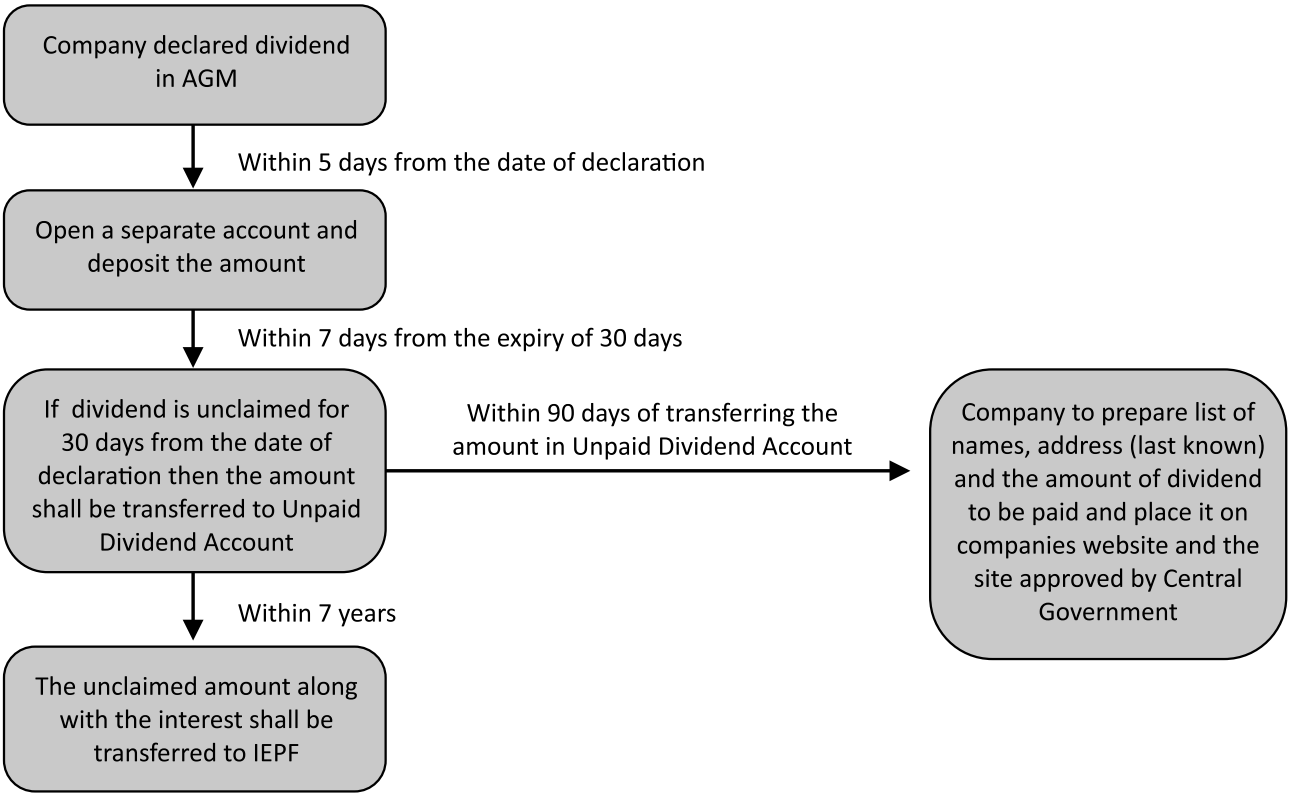
UNPAID DIVIDEND ACCOUNT (SECTION 124)

The company is required to deposit the amount of dividend in a separate bank account in a scheduled bank within 5 days from the date of its declaration. In case dividend has been declared by a company but has not been paid to or claimed by any shareholder entitled to the payment of the dividend within 30 days from the date of declaration, the company shall within 7 days from the date of expiry of the said period of 30 days, transfer the total amount of dividend which remains unpaid or unclaimed to a special bank account to be opened by the company in that behalf in any scheduled bank to be called “Unpaid Dividend Account”.

The company shall, within a period of 90 days of making any transfer of an amount to the Unpaid Dividend Account, prepare a statement containing the names, their last known addresses and the unpaid dividend to be paid to each person and place it on the web-site of the company, if any, and also on any other web-site approved by the Central Government for this purpose, in such form, manner and other particulars as may be prescribed.

Section 124(5) prescribes that, any money transferred to the Unpaid Dividend Account of a company in pursuance of this section which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund and the company shall send a statement in the prescribed form of the details of such transfer to the authority which administers the said Fund and that authority shall issue a receipt to the company as evidence of such transfer.

Explanation.—For the removal of doubts, it is hereby clarified that in case any dividend is paid or claimed for any year during the said period of seven consecutive years, the share shall not be transferred to Investor Education and Protection Fund.



Illustration

The Board of Directors of XYZ Ltd. declared an Interim Dividend on 13th August 2022 and the amount of Dividend was deposited in a separate bank account on 18th August 2022. After a period of 30 days from the date of declaration of Dividend i.e. 12th September 2022, if any amount remains unpaid or unclaimed in the said bank account, then such amount shall be transferred to the 'Unpaid Dividend Account' within next seven days i.e. latest by 19th September 2022.

A company declared dividend on 21st June, 2022. It reports on 22nd July, 2022 that it could not pay dividend to 46 members as they are not traceable for last three years. Advise the company with regard to unpaid dividend under the provisions of the Companies Act, 2013.

According to Section 126(1) of the Companies Act, 2013 where a dividend has been declared by a company but has not been paid or claimed within thirty days from the date of the declaration to any shareholder entitled to the payment of the dividend, the company shall, within seven days from the date of expiry of the said period of thirty days, transfer the total amount of dividend which remains unpaid or unclaimed to a special account to be opened by the company in that behalf in any scheduled bank to be called the Unpaid Dividend Account.

In the given case the company declared dividend on 21st June, 2022, the dividend remains unpaid after 30 days of declaration i.e. 22nd July, 2022. The company is advised to transfer the remaining unpaid or unclaimed dividend to a special account called the Unpaid Dividend Account in any scheduled bank within seven days from the date of expiry of the said period of thirty days. Further any money transferred to the Unpaid Dividend Account of a company which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund.

CASE STUDY

IDP Education Exam Services Private Limited (Adjudication Order No.ROC/D/ADJ order/sec 123/5938 – 5942 dated 11th October 2022)

Consequences of default in depositing the declared dividend in a separate bank account within specified time under the provisions of Companies Act 2013

The company (IDP Education Exam Services Private Limited) is the subsidiary company of its foreign holding company BC Trading International Limited which holds 99.99% of the shares in the company. The company conducted board meeting and declared interim dividend payable to the registered shareholders of the company for the financial year 2020-21 out of the accumulated surplus in the profit and loss account as on 31st March 2020 and the profit of the current year i.e. 2020-21. Pursuant to section 123(4) of the Companies Act 2013, the company was required to deposit the amount of the interim dividend in a scheduled bank in a separate bank account within five days from the date of declaration of the interim dividend by the board of directors. But the company failed to deposit the same within the stipulated time of five days in a separate bank account. However, the company has deposited the interim dividend in a separate bank account with a delay of 7 days, resultantly that company has made default in depositing the amount of interim dividend.

Upon realizing the default committed by the company and its directors, the company has filed an application for compounding under section 441 of the Companies Act 2013 for the violation of section 123(1) of the Companies Act 2013. The Registrar of Companies issued a show cause notice to the company calling for additional information and also fixed a personal hearing on this matter.

The company responded the show cause notice. In the submission made in the reply, the company admitted the default and said that no penalty should be levied on the non-executive directors of the company for violation of section 123(1) of the Companies Act 2013.

Order:

Registrar of Companies observed that IDP Education Exam Services Private Limited is the subsidiary company of its foreign holding company therefore the company does not get covered under the purview of small company**.** Adjudicating Officer came to the conclusions that the company and its directors have made the default in complying with the provisions of Rule 14 (8) of the Companies (Prospectus and allotment of securities) Rules, 2014 of the Companies Act 2013 as private placement offer cum application at different dates were issued before filing the special resolution to the Registrar of Companies. Hence they are liable for penalties under section 450 of the Companies Act 2013. The RoC imposed a penalty on the company and its directors for violation and orderd to pay the specified amount of penalty.

The Investor Education and Protection Fund (IEPF) (Section 125)

For administration of Investor Education and Protection Fund, Government of India has on 7th September, 2016 established Investor Education and Protection Fund Authority under the provisions of section 125 of the Companies Act, 2013.

The Authority is entrusted with the responsibility of administration of the Investor Education Protection Fund (IEPF), make refunds of shares, unclaimed dividends, matured deposits/debentures etc. to investors and to promote awareness among investors.

Section 125(2) of the Companies Act, 2013, prescribes that the following amount shall be credited to the Fund –

(a) the amount given by the Central Government by way of grants after due appropriation made by Parliament by law in this behalf for being utilised for the purposes of the Fund;

(b) donations given to the Fund by the Central Government, State Governments, companies or any other institution for the purposes of the Fund;

(c) the amount in the Unpaid Dividend Account of companies transferred to the Fund under sub-section (5) of section 124;

(d) the amount in the general revenue account of the Central Government which had been transferred to that account under sub-section (5) of section 205A of the Companies Act, 1956 (1 of 1956), as it stood immediately before the commencement of the Companies (Amendment) Act, 1999 (21 of 1999), and remaining unpaid or unclaimed on the commencement of this Act;

(e) the amount lying in the Investor Education and Protection Fund under section 205C of the Companies Act, 1956;

(f) the interest or other income received out of investments made from the Fund;

(g) the amount received under sub-section (4) of section 38;

(h) the application money received by companies for allotment of any securities and due for refund;

(i) matured deposits with companies other than banking companies;

(j) matured debentures with companies;

(k) interest accrued on the amounts referred to in clauses (*h*) to (*j*);

(l) sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation for seven or more years;

(m) redemption amount of preference shares remaining unpaid or unclaimed for seven or more years; and

(n) Other prescribed amounts.

As per Rule 3 of the IEPF Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, there shall be credited to the Fund, the following amounts, namely:-

(i) all amounts payable as mentioned in clause (a) to (n) of sub-section (2) of section 125 of the Companies Act, 2013;

(ii) all shares in accordance with sub-section (6) of section 124 of the Companies Act, 2013;

(iii) all the resultant benefits arising out of shares held by the Authority under clause (b);

(iv) all grants, fees and charges received by the Authority under these rules;

(v) all sums received by the Authority from such other sources as may be decided upon by the Central Government;

(vi) all income earned by the Authority in any year;

(vii) all amounts payable as mentioned in sub-section (3) of section 10B of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, section 10B of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, sub-section (3) of section 38A of the State Bank of India Act, 1955 and section 40A of the State Bank of India (Subsidiary Bank) Act, 1959; and

(viii) all shares held by authority in accordance with Section 90(9) of the Act & the resultant benefits arising out of such shares, without restriction;

(ix) all other sums of money collected by the Authority as envisaged in the Act.

Provided that no such amount referred to in clauses (h) to (j) shall form part of the Fund unless such amount has remained unclaimed and unpaid for a period of seven years from the date it became due for payment.

Rule 5 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, details the procedure for transfer of Unpaid or Unclaimed Dividend to the IEPF. The procedure is explained as under:

(1) The amount of unclaimed or unpaid dividend required to be credited by the companies to the Fund shall be remitted online along with a statement in **Form No. IEPF-1** containing details of such transfer to the Authority within a period of 30 days of such amounts becoming due to be credited to the Fund.

(2) The companies which have transferred any amount referred to in clauses (a) to (d) of sub-section (2) of section 205C of the Companies Act, 1956 (1 of 1956) to Investor Education and Protection Fund or Central Government, but have not filed the statement or have filed the statement in any format other than in excel template, as required under sub-rule (1) of rule 5 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, have to submit details mentioned in sub-rule (1) of rule 5 in **Form No. IEPF-1A** along with excel template within 60 days of notification of these amended rule *[inserted by the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Second Amendment Rules, 2019, Effective from 20th August 2019].*

(3) The amount may also be remitted by Electronic Fund Transfer in such manner, as may be specified by the Central Government.

(4) On receipt of the statement, the Authority shall enter the details of such receipt in a Register maintained physically or electronically by it in respect of each company every year, and reconcile the amount so remitted and collected, with the concerned designated bank on monthly basis.

(5) Each designated bank shall furnish an abstract of such receipts during the month to the Authority within 7 days after the close of every month.

(6) The company shall maintain the record filed under sub-rule 5(1) as above in the same format along with all supporting documents and the Authority shall have the powers to inspect such records.

(7) The provisions of this rule shall be applicable mutatis mutandis in respect of the amounts to be credited to the Fund in pursuance of clauses (h) to (m) of sub-section (2) of section 125.

Name of shareholders to be hosted on website

As per Rule 5(8) of IEPF Rules, 2016, every company shall within a period of 60 days after the holding of Annual General Meeting or the date on which it should have been held as per the provisions of section 96 of the Act, whichever is earlier and every year thereafter till completion of the seven years period, identify the unclaimed amounts, as referred in subsection (2) of section 125 of the Act, as on the date of closure of financial year the account of which are to be adopted in the Annual General Meeting as per sub-section (1) of section 137 of the Act, separately furnish and upload on its own website and also on website of Authority or any other website as may be specified by the Government, a statement or information of unclaimed and unpaid amounts separately for each of the previous seven financial years through **Form No. IEPF-2,** containing following information, namely:-

(a) the names and last known addresses of the persons entitled to receive the sum;

(b) the nature of amount;

(c) the amount to which each person is entitled;

(d) the due date for transfer into the Investor Education and Protection Fund; and

(e) such other information as may be considered necessary.

Section 124(6) also prescribed that all shares, in respect of which dividend has not been paid or claimed for seven consecutive years or more shall be transferred by the company in the name of Investor Education and Protection Fund along with a statement containing such details as prescribed.

Any claimant of shares transferred above shall be entitled to claim the transfer of shares from Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as prescribed.

Rule 6 of IEPF Rules, 2016 prescribes that the shares shall be credited to DEMAT Account of the Authority to be opened by the Authority for the said purpose, within a period of 30 days of such shares becoming due to be transferred to the Fund.

In case the beneficial owner has encashed any dividend warrant or any dividend amount has been credited to bank account of the owner of such shares during the last seven years, such shares shall not be required to be transferred to the Fund even though some dividend warrants may not have been encashed.

Transfer of shares by the companies to the Fund shall be deemed to be transmission of shares and the procedure to be followed for transmission of shares shall be followed by the companies while transferring the shares to the fund.

For the purposes of effecting transfer of such shares, the Board shall authorise the Company Secretary or any other person to sign the necessary documents.

The company shall follow the following procedure while transferring the shares, namely:

(a) The company shall inform, at the latest available address, the shareholder concerned regarding transfer of shares three months before the due date of transfer of shares and also simultaneously publish a notice in the leading newspaper in English and regional language having wide circulation informing the concerned that the names of such shareholders and their folio number or DP ID - Client ID are available on their website duly mentioning the website address.

(b) In case, where there is a specific order of Court or Tribunal or statutory Authority restraining any transfer of such shares and payment of dividend or where such shares are pledged or hypothecated under the provisions of the Depositories Act, 1996 or shares already been transferred as above, the company shall not transfer such shares to the Fund. Further, the company shall furnish details of such shares and unpaid dividend to the Authority in **Form No. IEPF 4** within thirty days from the end of financial year.

(c) For the purposes of effecting the transfer, where the shares are dealt with in a depository-

  (i) the Company shall inform the depository by way of corporate action, where the shareholders have their accounts for transfer in favour of the Authority.

  (ii) on receipt of such intimation, the depository shall effect the transfer of shares in favour of DEMAT account of the Authority.

(d) For the purposes of effecting the transfer shares held in physical form-

  (i) the Company Secretary or the person authorised by the Board shall make an application, on behalf of the concerned shareholder, to the company, for issue of a new share certificate;

  (ii) on receipt of the application under clause (a), a new share certificate for each such shareholder shall be issued and it shall be stated on the face of the certificate that

  "Issued in lieu of share certificate No. for the purpose of transfer to IEPF" and the same be recorded in the register maintained for the purpose;

  (iii) particulars of every share certificate shall be in Form No. SH-1 as specified in the Companies (Share Capital and Debentures) Rules, 2014;

(iv) after issue of a new share certificate, the company shall inform the depository by way of corporate action to convert the share certificates into DEMAT form and transfer in favour of the Authority."

(e) The company shall make such transfers through corporate action and shall preserve copies for its records.

(f) While effecting such transfer, the company shall send a statement to the Authority in Form No. IEPF-4 within thirty days of the corporate action taken under clause (c) of sub-rule (3) of rule 6 containing details of such transfer and the company shall also attach a copy of the public notice published under clause (a) of sub-rule (3) of rule 6 in Form No IEPF-4.

(g) The voting rights on shares transferred to the Fund shall remain frozen until the rightful owner claims the shares. Further for the purpose of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, the shares which have been transferred to the Authority shall not be excluded while calculating the total voting rights.

(h) The company shall maintain all such statements filed under sub-rule (5) in the same format along with all supporting documents and the Authority shall have the powers to inspect such records.

(i) All benefits accruing on such shares like bonus shares, split, consolidation, fraction shares and the like except right issue shall also be credited to such DEMAT account by the company which shall send a statement to the Authority in Form No. IEPF-4 within thirty days of the corporate action containing details of such transfer.

(j) The shares held in such DEMAT account shall not be transferred or dealt with in any manner whatsoever except for the purposes of transferring the shares back to the claimant as and when he approaches the Authority or in accordance with sub-rules (10), (11) and (11A).]

(k) If the company is getting delisted, the Authority shall surrender shares on behalf of the shareholders in accordance with the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009 and the proceeds realised shall be credited to the Fund and a separate ledger account shall be maintained for such proceeds.

(l) In case the company whose shares or securities are held by the Authority is being wound up, the Authority may surrender the securities to receive the amount entitled on behalf of the security holder and credit the amount to the Fund and a separate ledger account shall be maintained for such proceeds.

(m) In case an application for purchase of shares under section 236 is received through the company, the Authority may receive the amount entitled on behalf of the minority shareholders from the company as per procedures provided under sub-section 5 of the said section 236 and credit the amount to the Fund and a separate ledger account shall be maintained for such proceeds:

Provided that Authority before such receipt of money on behalf of such shareholders shall verify that the conditions provided under the relevant section of the Act and rules framed thereunder have been satisfied and shall also call a report from the company on the following, namely:-

(a) whether the acquirer to whom the shares held by the Authority would be transferred has fulfilled the requirements of section 236;

(b) whether the shares have been valued in accordance with the provisions of sub-section (2) of section 236 and the rules made thereunder; and

(c) any other relevant information:

Provided further that the company shall be liable under all circumstances whatsoever to indemnify the Authority in case of any dispute or lawsuit that may be initiated and the Authority shall not be liable to indemnify the minority shareholder or the Company or any other person for any liability arising, leading to any litigation or complaint arising thereof:

Provided also that any claimant entitled to claim transfer of such shares from the Authority under sub-section (6) of section 124 shall only be entitled to the amount received by the Authority on behalf of the minority shareholder without any interest thereon.

(n) Any further dividend received on such shares shall be credited to the Fund and a separate ledger account shall be maintained for such proceeds".

(o) Any amount required to be credited by the companies to the Fund as provided under sub-rules (10), (11) and sub-rule (12) shall be remitted online to the Authority within a period of thirty days from the date such amount becomes due and the details thereof shall be furnished to the Authority in Form No. IEPF-1.

(p) Any amount required to be credited by the companies to the Fund as provided under sub-rule (11A) shall be remitted online to the Authority within a period of thirty days from the date such amount becomes due] and the details thereof shall be furnished to the Authority in Form No. IEPF-7 .

(q) Authority shall furnish its report to the Central Government as and when noncompliance of the rules by companies came to its knowledge."

Procedure for Transfer of shares u/s 90(9) to The Investor Education and Protection Fund

MCA has amended the IEPF (Accounting, Audit, Transfer and Refund) Rules, 2016 w.e.f. 09th June, 2021 to insert new Rule 6A, which provides the manner of transfer of shares as per sub-section (9) of Section 90 to the IEPF authority.

As per the Rule 6A, the shares shall be credited to DEMAT Account of the IEPF Authority within a period of 30 days of such shares due to be transferred to the IEPF Authority with the following important conditions:

Transfer of shares by the companies to the IEPF Authority shall be deemed to be transmission of shares and the procedure to be followed for transmission of shares shall be followed by the companies while transferring the shares to the IEPF Authority.

Such shares shall be transferred to the IEPF Authority without any restrictions and no application shall be filed for claiming back such shares from the IEPF Authority.

The voting rights on shares transferred to the IEPF Fund shall remain frozen. However, for the purpose of the SEBI (SAST) Regulations, 2011, the shares which have been transferred to the IEPF Authority shall not be excluded while calculating the total voting rights.

While under Section 124, shares on which dividend remains unpaid or unclaimed for seven years, are also required to be transferred to IEPF Authority but the significant difference with respect to shares transferred to IEPF Authority under sub-section (9), is that such shares once transferred can't be claimed back, as opposed to shares transferred under Section 124, which can be claimed back from IEPF authority. It is because of the restriction on claiming back the shares transferred to IEPF Authority under sub-section (9) that both the disclosure of significant beneficial ownership and obligation cast on a company, are of great importance.

The company shall follow the following procedure while transferring the shares, namely:-

Where the shares are dealt with in a demat form	***Where the shares are dealt with in physical form***
The company shall inform the depository by way of corporate action, where the shareholders have their accounts for transfer in favour of the Authority.	The Company Secretary or the person authorised by the Board shall make an application, on behalf of the concerned shareholder, to the company, for issue of a new share certificate.
On receipt of such intimation, the depository shall effect the transfer of shares in favour of DEMAT account of the Authority. While effecting such transfer, the company shall send a statement to the Authority in Form No. IEPF-4 within thirty days of the corporate action taken containing details of such transfer and the company shall also attach following documents: ● a copy of order of the Tribunal under sub-section (8) of section 90 of the Act; ● a declaration that no application under sub-section (9) of section 90 of the Act has been made or is pending before the Tribunal.	On receipt of the application above, a new share certificate for each such shareholder shall be issued and it shall be stated on the face of the certificate that "Issued in lieu of share certificate No..... for the purpose of transfer to IEPF under sub section (9) of section 90 of the Act" and the same be recorded in the register maintained for the purpose.
	Particulars of every share certificate shall be in Form No. SH-1 as specified in the Companies (Share Capital and Debentures) Rules, 2014.
	After issue of a new share certificate, the company shall inform the depository by way of corporate action to convert the share certificates into DEMAT form and transfer in favour of the Authority.
	While effecting such transfer, the company shall send a statement to the Authority in Form No. IEPF-4 within thirty days of the corporate action taken containing details of such transfer and the company shall also attach following documents: ● a copy of order of the Tribunal under sub-section (8) of section 90 of the Act; ● a declaration that no application under sub-section (9) of section 90 of the Act has been made or is pending before the Tribunal.

Other Corporate Action or Conditions on such transferred Shares:

In case of bonus shares, split etc.: All benefits accruing on shares transferred to IEPF Authority like bonus shares, split, consolidation, fraction shares and the like except right issue shall also be credited to such DEMAT account by the company which shall send a statement to the IEPF Authority in **Form IEPF-4** within thirty days of the corporate action containing details of such transfer.

In case of Delisting: If the company is getting delisted, the IEPF Authority shall surrender shares on behalf of the shareholders in accordance with the SEBI Delisting Regulations and the proceeds realised shall be credited to the IEPF Fund and a separate ledger account shall be maintained for such proceeds.

In case of Winding-up: In case the company whose shares or securities are held by the IEPF Authority is being wound up, the IEPF Authority may surrender the securities to receive the amount entitled on behalf of the security holder and credit the amount to the IEPF Fund and a separate ledger account shall be maintained for such proceeds.

In case of further dividend: Any further dividend received on such shares shall be credited to the IEPF Fund and a separate ledger account shall be maintained for such proceeds.

Any amount required to be credited by the companies to the Fund as mentioned above shall be remitted online to the Authority and the details thereof shall be furnished to the Authority in Form No. IEPF-1 within thirty days of such amount becoming due to be credited to the Fund.

All such amounts shall be transferred to the Authority without any restrictions and no application shall be filed for claiming back such amounts from the Authority.

Authority shall furnish its report to the Central Government as and when non-compliance of the rules by companies came to its knowledge.

Effect of non-transfer

In terms of sub-section (3) of Section124 of the Act, if a company fails to transfer unpaid/ unclaimed Dividend amount to the Unpaid Dividend Account within 7 days from the expiry of 30 days of declaration, the company shall pay, from the date of such default, interest on so much of the amount as has not been transferred to the said account at the rate of 12% per annum and the interest accruing on such amount shall ensure to the benefit of the Members in proportion to the amount of Dividend remaining unpaid to them.

By virtue of MCA exemption notification G.S.R.465(E) dated 5th June 2015 in case of a Nidhi Company any Dividend payable in cash may be paid by crediting the same to the account of the member, if the Dividend is not claimed within 30 days from the date of declaration of the Dividend.

Entitlement of Dividend from Unpaid Dividend Account

Sub-section (4) of Section 124 of the Act provides that any person claiming to be entitled to any Dividend transferred to the Unpaid Dividend Account of the company may apply to the company for payment of the Dividend.

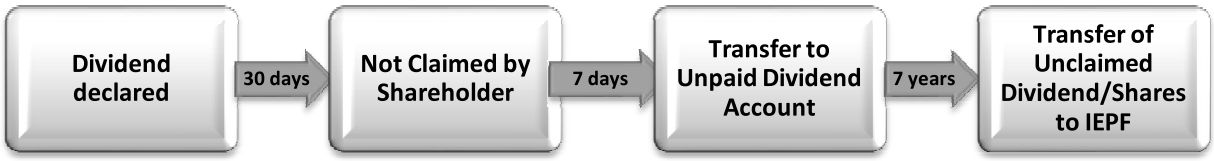
After declaration of Dividend, the company has no beneficial interest in the amount so declared, but is merely a custodian in the nature of a trustee until the amount is paid/transferred to a special account.

The company should enter the details of unpaid or unclaimed Dividend in a register and reconcile the amount of Unpaid or Unclaimed Dividend Account, with the concerned bankers, periodically. A listed company, should ensure such reconciliation through its Share Registrar and the Dividend banker on a fortnightly basis during the initial validity of the Dividend warrants and thereafter on a quarterly basis till transfer of funds to the Investor Education and Protection Fund.

The whole objective of Section 124 is to ensure that the amount of Dividend is fully secured by the company by depositing the same in a separate Dividend account and this objective is fully met if a separate Dividend account is opened and the Dividend amount is transferred to such account. A similar view has also been taken in the case of *Krebs Biochemicals Ltd. v. Registrar of Companies.*

Penalty for default in complying with Section 124

Company	penalty of one lakh rupees and in case of continuing failure, with a further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of ten lakh rupees.
Officer in default	penalty of twenty-five thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.



Illustration

1) On 18th September 2018 XYZ Ltd. transferred unpaid/unclaimed Dividend amounting to Rs. 1 Crore to the 'Unpaid Dividend Account'.

   After settlement of various Dividend claims till 17th September 2025, Rs. 20 lakh remains unpaid / unclaimed in the said account.

   The amount of Rs. 20 Lakh should be transferred to the Investor Education and Protection Fund (IEPF) within the next 30 days i.e. latest by 17th October 2025.

2) Whether the underlying shares of unpaid or unclaimed dividends are required to be transferred to IEPF when the amount of unpaid or unclaimed dividend is being transferred?

   Under the erstwhile Act, there was no requirement to transfer the shares for which the dividend is unpaid or unclaimed to the IEPF. However, with the enforcement of the corresponding section, i.e. 124 (6) under the Act, 2013, every Company is mandatorily required to transfer the underlying shares for which the dividend has remained unpaid or unclaimed for a consecutive period of seven years. Here it is pertinent to note that the foremost condition for transfer of shares is that the dividend on such shares shall be unpaid or unclaimed for a seven consecutive years. Accordingly, as per section 124 (6) of the Act, 2013 the underlying shares of unpaid or unclaimed dividend are also required to be transferred to IEPF apart from the amount of unpaid or unclaimed dividend.

3) Within what time should the shares be transferred to the IEPF?

   As per rule 6 of the IEPF Rules, the shares shall be credited to DEMAT Account opened by the IEPF Authority within thirty days of such shares becoming due to be transferred to the IEPF.

4) Whether one form IEPF-2 is to be filed providing details of unclaimed and unpaid amounts pertaining to all the previous seven years or whether separate forms for each year needs to be filed?

   A statement or information of unclaimed and unpaid amounts separately for each of the previous seven financial years through Form No. IEPF-2 is required to be filed.

The IEPF is to be utilized for :

- The refund in respect of unclaimed dividends, matured deposits, matured debentures, the application money due for refund and interest thereon;
- Promotion of investors' education, awareness and protection;
- Distribution of any disgorged amount among eligible and identifiable applicants for shares or debentures, shareholders, debenture-holders or depositors who have suffered losses due to wrong actions by any person, in accordance with the orders made by the Court which had ordered disgorgement;
- Reimbursement of legal expenses incurred in pursuing class action suits under sections 37 and 245 by members, debenture-holders or depositors as may be sanctioned by the Tribunal;
- Any other purpose incidental thereto, in accordance with such rules as may be prescribed:

Provided that the person whose amounts referred to in clauses (a) to (d) of sub-section (2) of section 205C transferred to Investor Education and Protection Fund, after the expiry of the period of seven years as per provisions of the Companies Act, 1956, shall be entitled to get refund out of the Fund in respect of such claims in accordance with rules made under this section.

Any money transferred to the Unpaid Dividend Account of a company in pursuance of Section 124 of the Companies Act, 2013 which remains unpaid or unclaimed for a period of seven years from the date of such transfer shall be transferred by the company along with interest accrued, if any, thereon to the Investor Education and Protection Fund (IEPF) and the company shall send a statement in the prescribed form of the details of such transfer to the Investor Education and Protection Fund Authority and it shall issue a receipt to the company as evidence of such transfer.

Refund to Claimant from Investor Education and Protection Fund

In terms of Section 124(6) of Companies Act, 2013 and the Rules notified there under, the shares in respect of which dividend has not been paid or claimed for a period of seven consecutive years or more, are required to be transferred by the Company to the IEPF Authority.

Rule 7 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules 2016, details the procedure which may be adopted by any claimant. The procedure is explained as under:

Step 1: Online application to be filed by claimant to Authority

Any person whose shares, unclaimed dividend, matured deposits, matured debentures, application money due for refund, or interest thereon, sale proceeds of fractional shares, redemption proceeds of preference shares etc., has been transferred to the Fund, may claim the shares to the Authority by making an online application in **form IEPF 5** which is available on website *www.iepf.gov.in* along with fees as decided by the Authority.

Step 2: Sending documents to the Company at its registered office

Upon submission, Form-5 shall be transmitted online to nodal officer of the company for verification of claims

Claimant shall send the following documents to the Company at its registered office :

- Print out of duly filled claim form with claimant signature;
- Copy of acknowledgement generated on online submission of e-Form IEPF – 5 bearing a unique serial number (SRN);
- Indemnity Bond (original) with claimant signature;
- Advanced Stamp Receipt (original) with revenue stamp and signature of claimant and witnesses;
- Original matured deposit / debenture / share certificate (in case of securities held in physical form) or copy of transaction statement in case of securities held in Demat Form;
- Copy of Aadhaar Card;
- Proof of entitlement (certificate of share/Interest warrant Application No. etc.);
- Cancelled Cheque leaf;
- Copy of Passport, OCI and PIO card in case of foreigners and NRI; and
- Other optional document, (if any).

Appointment of Nodal Officer

- Every company which has deposited the amount to the fund shall nominate a Nodal Officer for the purposes of verification of claims and coordination with Investor Education and Protection Fund Authority, who shall either be a Director or Chief financial Officer or Company Secretary of the company.
- Company may appoint one or more deputy nodal officer, who shall assist the nodal officer.
- The Nodal Officer shall be solely liable for all actions of any officer appointed as Deputy Nodal Officer.
- In case a company fails to appoint Nodal Officer, every director of the company shall be deemed to be nodal officer and be liable for any failure to comply with requirement of these rules.

Any change in the Nodal Officer or his details shall be communicated to the Authority through **Form No. IEPF-2** within 7 days of such change along with board resolution thereof.

Step 3: Company to send verification report

The company has to send an online verification report to the Authority after verification in the format specified by the Authority along with all the documents submitted by the claimant and shall attach the scanned copy of all the original documents submitted by the claimant in physical form duly certified by its nodal officer along

with the e-verification report along with a scanned copy of both sides of original physical share certificate or original bond or deposit or debenture certificate/s duly cancelled and certified.

- within 30 days from the date of receipt of the claim;
- After 30 days of filing of claim, the company may do so by paying additional fee of Rs.50 for every day subject to maximum of Rs.2500;
- The company shall be liable to maintain the original documents submitted to it by the claimant and shall produce such documents whenever required;
- In case of non-receipt of verification report along with documents by the Authority after the expiry of 60 days from the date of filing of **Form No. IEPF-5**, the Authority may reject Form No. IEPF-5, after sending a communication to the claimant and the concerned company, on the e-mail address of the claimant and the company, to furnish response within a period of 15 days.

Step 4: Authority to refund the amount/shares

After verification of the entitlement of the claimant:

- to the amount claimed, the Authority and then Drawing and Disbursement Officer of the Authority shall present a bill to the Pay and Accounts Office for e-payment as per the guidelines;
- to the shares claimed, the Authority shall issue a refund sanction order with the approval of the Competent Authority and shall credit the shares to the DEMAT account of the claimant to the extent of the claimant's entitlement.

Time period for disposing the claim by Authority

- An application received for refund of any claim duly verified by the concerned company shall be disposed off by the Authority within 60 days from the date of receipt of the verification report from the company, complete in all respects; and
- any delay beyond 60 days shall be recorded in writing specifying the reasons for the delay and the same shall be communicated to the claimant in writing or by electronic means.

Cases where Application is defective or incomplete or further information is required

- Where the Authority, on examining any application for claim,
  - finds it necessary to call for further information; or
  - finds such application or e-form or document to be defective or incomplete in any respect,

  the Authority shall give intimation of such information called for or defects or incompleteness, by e-mail on the email address of the claimant and the company, which has filed such application or eform or document, directing him or it to furnish such information or to rectify such defects or incompleteness or to re-submit such application or e-Form or document within 15 days from the date of receipt of such communication, failing which the Authority may reject the claim or **Form No. IEPF-5**.
- If such information or incompleteness is called from the claimant, he shall file the Form and shall send such documents as called for within 15 days, duly signed by him, to the Nodal Officer of the concerned company at its registered office for verification of the claim and company shall send a revised verification report. Provided further, if any such information or incompleteness is called from the company, the company shall file the revised verification report and shall send such documents as called for within 30 days.

Registering transmission of securities

- In case, claimant is
  - a legal heir or
  - successor or
  - administrator or
  - nominee of the registered share holder,

  the claimant shall ensure to submission of self-attested scanned copy of all prescribed documents online along with the **Form No. IEPF-5**.
- In case of loss of securities held in physical form, the claimant has to ensure to submission of self-attested scanned copy of additional documents detailed in Schedule III of these rules online along with the **Form No. IEPF-5**:

  Provided further that the claimant shall submit in original all these documents duly signed by him, to the Nodal Officer of the concerned company at its registered office for verification of the claim.
- In case, claimant is
  - a legal heir or
  - successor or
  - administrator or
  - nominee of any other registered security or
  - in cases where request of transfer or transmission of shares is received after the transfer of shares by company to the Authority,

  the company shall verify all requisite documents required for registering transfer or transmission and shall issue letter to the claimant indicating his entitlement to the said security and furnish a copy of the same to the Authority while verifying the claim of such claimant through its e-verification report. Further, the authority shall dispose such request of transfer or transmission based on the e-verification report of the company subject to verification of such request.

Liability in case of litigation of Complaint

- The company shall be liable under all circumstances whatsoever to indemnify the Authority in case of any dispute or lawsuit that may be initiated due to any incongruity or inconsistency or disparity in the verification report or otherwise and the Authority shall not be liable to indemnify the security holder or Company for any liability arising out of any discrepancy in verification report submitted etc., leading to any litigation or complaint arising thereof.
- Any fraudulent claim by the claimant shall be deemed to be fraud within the meaning of Section 447 of the Companies Act, 2013 and the claimant shall be liable accordingly.
- If any person deceitfully personates an owner of any security or of any share warrant or coupon issued in pursuance of this Act and thereby files any claim to obtain or attempts to obtain any such security or interest or any such warrant or coupon due to the lawful owner, he shall be punishable under sections 57, 447 and 448 of the Act.

CASE STUDY

Kamala Srinivasan vs. Union of India dated 14th February, 2020, Madras High Court

Fact of the Case:

The instant writ petition challenges the vires of Section 124 (6) of the Companies Act, 2013 and Rule 6 and 7 of the Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016 as unconstitutional being violative of Article 14, 21 and 300 A of the Constitution of India.

The petitioner states that her son R. Murali Srinivasan passed away on 30/8/1993 intestate at Quriyat, Oman, leaving behind the petitioner and his wife. The 'petitioner's son was having shares in a Company called I-Flex Solutions Limited (IFLEX). The said Company was taken over by M/s. Oracle Financial Services Software Limited, fourth respondent herein. These shares were allotted to the petitioner in the year 1992.

Over the years, bonus shares were issued and the petitioner was holding 3200 shares. The market value of the share as on date would be about 1.14 crores. It is also stated that after the 'petitioner's son passed away, the dividends which were not received and as on date, unclaimed dividends is worth Rs.29,92,000/-. It is stated by the petitioner that Section 124 (6) of the Companies Act, 2013 which deals with unclaimed dividends provides that all the shares in respect of which dividends have not been claimed for seven consecutive years or more than shall be transferred by the Company in the name of Investor Education and Protection Fund along with a statement containing such details as may be prescribed. Proviso to sub-Section 6 of Section 124 states that claimant of the shares shall be entitled to claim the transfer of shares from the Investor Education and Protection Fund in accordance with such procedure and on submission of such documents as may be prescribed.

Learned counsel for the petitioner, submitted that there is no rationale behind Section 124(6) of the Act which provides for transfer of shares along with dividend remaining unpaid or unclaimed for a period of 7 years from the Unpaid Dividend account of the company to the Investors Education and Protection Fund (IEPF). He submitted that the erstwhile Companies Act, 1956 did not have any provision which provided for transfer of shares along with unpaid/unclaimed dividend. This was introduced only in the new Companies Act, 2013. He stated that the introduction of the Section does not effectively remedy any mischief which was present under the erstwhile Act. He also stated that no reasons have been given in order to bring out the intent behind its introduction.

Judgment

In light of the facts of the present case, it was observed that the impugned provisions are not "manifestly arbitrary". There is an awoved purpose for bringing this piece of legislation. It has been enacted to ensure that a company does not unjustifiably and unduly enrich themselves, as the depositors have failed to stake claim and have not been paid for a period of seven years from the date the amount became due. There is no reason to hold that the said provisions are unconstitutional or they violate Article 14 or any other provisions of the Constitution. To strike down Section 124(6) and Investor Education and Protection Authority Fund (Accounting, Audit, Transfer and Refund) Rules, 2016, will amount to negating and striking down a worthy and meritorious legislation which is on the whole beneficial and advantageous and in public interest.

It is also equally well settled that just because Rules are cumbersome and it is difficult to carry out the procedure prescribed under the Rules cannot make the Rules violative of Article 14. Section 124(6) has been brought out to ensure that the companies do not profit out of unclaimed dividends. The Rules have been brought out only to ensure that only claims of genuine persons can be entertained. The fact that the procedure to reclaim the shares and the dividend is more expensive and the conditions are more onerous does not make it fall foul of Article 14 of the Constitution of India. In view of the above, writ petition is dismissed. No costs. Consequently, the connected Miscellaneous Petitions are closed.

CASE LAW

In the case of *India Awake for Transparency vs. UOI* on 5 December, 2017, Delhi High Court clarified that Section 124(6) does not result in a statutory vesting of any property. The IEPF merely enforces a transfer of shares from a company that has yielded unclaimed dividends for a consecutive period of 7 years to the IEPF, and the said authority of the fund after the transfer of such shares holds the shares as a custodian, or in any manner prescribed thereof. Therefore, the court hereby holds that the writ petition filed by the plaintiff for strict enforcement of the Investor Education and Protection Fund Authority rules is to be dismissed.

Various Forms of IEPF

Form Name	*Purpose of Filing*	*Due date of filing E-Form*
IEPF-1	Statement of amounts credited to IEPF or transfer of amounts on account of shares transferred to the fund	Within 30 days of such amount becoming due to be credited to the fund
IEPF-1A	Statement of amounts credited to Investor Education and Protection Fund	The time limit as per rule 5(4A) is 60 days from the date of notification of amended rules
IEPF-2	Statement of unclaimed and unpaid amounts and details of Nodal officer	Within a period of 60 days after the holding of AGM or the date on which it should have been held as per the provisions of section 96 of the Act, whichever is earlier and every year thereafter till completion of the 7 years period. Any change in the Nodal Officer or his details shall be communicated to the Authority through Form No. IEPF-2 within seven days of such change along with board resolution thereof.
IEPF-4	Statement of shares transferred and information of shares & unclaimed or unpaid dividend not transferred to the IEPF	within thirty days of the corporate action taken containing details of such transfer/ within thirty days of transfer of shares under sub-section (9) of section 90 of the Act to the Fund
IEPF-5 **Web Form**	Application to the Authority for claiming unpaid amounts and shares out of Investor Education and Protection Fund	Any time

Revocation of Dividend

Dividend once declared becomes a debt to the company and therefore cannot be revoked once declared.

In Re: Kishinchand Chellaram v. Commissioner of Income Tax [SC] 1980 AIR 211 1981 SCC (1) 720

Dividends – Declared dividend credited to the accounts of shareholders, whether company later on reversed the declaration of dividend - Whether dividend declared and credited to the accounts of the shareholders could be reversed

Brief facts: Though this case relate to income tax on dividends at the hands of the shareholders, the crucial and interesting question which arose, to decide the correctness or otherwise of the taxation, was "Whether dividend declared and credited to the account of the shareholders could be reversed by the company by passing a resolution to that effect later on?"

The Appellants Kishinchand Chellaram, Shewakram Kishinchand, Lokumal Kishinchand and Murli Tabilram were the shareholders of the company Chellsons Pvt Ltd at the material time. The company declared dividend for the year 1941-42, 1942-43 and 1943-44 and also credited the dividend amount to the shareholders account.

On December 4, 1947, at an Extraordinary General Meeting another resolution purporting to reverse the earlier resolutions that declared dividends was passed by the company. The ITO considered the dividends as the income of the shareholders and assessed as such. However, the appellants contended that the dividends were not their income as it was reversed by the company. Being unsuccessful they carried their dispute through First appellate authority, Tribunal,High court and ultimately it came before the Supreme Court.

Decision: Appeal dismissed.

Reason: If dividend is declared and the amount is credited or paid to the share-holders as dividend, so the character of the credit or payment cannot be altered by a subsequent resolution so as to alter the incidence of tax which attaches to that amount.

Dividend when proposed does not become a debt. The right of Members to claim Dividend arises only after the Dividend is declared either by the company in an Annual General Meeting or, in the case of Interim Dividend, by the Directors in a Board Meeting. Until and unless it is so declared, no Member has any claim against the company in respect thereof, even though the company may have sufficient profits [*Bacha F. Guzdar v Commissioner of Income Tax 1955 AIR SC 740].*

Members cannot compel the company by any process of law to declare Dividend *[C.W. Spencer v. ITO, (1957) 27 Comp. Cases 15, 25 (Mad)].*

A Dividend once declared becomes a debt due to the Members and hence cannot be revoked. It gives rise to an enforceable obligation or creates a debt enforceable immediately or in the future.

Preservation of Dividend Cheques, Warrants and Dividend Registers

Where the company has given an undertaking to the Bank for preservation or safe keeping of paid Dividend cheques or warrants for a specified period, the said instruments shall be preserved for such specified period or eight years from the date of the instrument, whichever is longer.

The Dividend warrants returned to the company by the banks should be preserved by the company for a period of eight years for the purpose of any cross reference on any request for duplicate warrants. Even defaced, torn or decrepit Dividend warrants surrendered to the company should be so preserved.

The Dividend warrants returned to the company undelivered, should also be preserved for a period of eight years.

The Dividend cheques or warrants so preserved shall be destroyed only with the approval of the Board or in accordance with the policy approved by the Board for this purpose.

Disclosures

Prior intimation in case of a listed company

As per regulation 29 of SEBI (LODR) Regulations, 2015, the listed entity shall give two working (excluding the date of intimation and date of the meeting) days prior intimation to stock exchange about the meeting of the board of directors in which declaration/ recommendation of dividend is to be considered.

As per regulation 42 of SEBI (LODR) Regulations, 2015, the listed entity shall intimate the record date to all the stock exchange(s) where it is listed at least seven working days (excluding the date of intimation and the record date) in advance for the purpose of declaration of dividend.

Notes to Accounts forming part of the financial statements of the Company shall disclose the aggregate amount of Dividend proposed to be distributed to equity and Preference Shareholders for the financial year and the related amount of Dividend per share.

Arrears of fixed cumulative Dividend on preference shares shall also be disclosed separately.

The Balance Sheet of the company shall also disclose under the head 'Current Liabilities and Provisions', the amount lying in the Unpaid Dividend Account together with interest accrued thereon, if any. According to Schedule III to the Act, the disclosure requirement in the Balance Sheet should be as under: (i) In case of

Disclosure in Board's report

In accordance with clause (k) of sub-section (3) of section 134, the Board of Directors must state in its Report the amount of dividend, if any, which it recommends for declaration. The dividend recommended by the Board of directors in the Board's Report must be declared at the annual general meeting of the company before obligation to pay is constituted. This constitutes an item of ordinary business to be transacted at every annual general meeting.

The amount of Interim Dividend, if any, paid during the financial year and final Dividend recommended by the Board of directors shall be disclosed in the Board's Report.

The Annual Report of the company shall disclose the total amount lying in the Unpaid Dividend Account of the company in respect of the last seven years and when such unpaid Dividend is due for transfer to the Fund. The amount of Dividend, if any, transferred by the company to the Investor Education and Protection Fund during the year shall also be disclosed.

Test Yourself:

1) In case a company declares dividend, what shall be the last date of payment of dividend?
2) Can a company which has inadequate profits or has incurred loss in the immediately preceding financial year declare final dividend out of the accumulated profits of the previous financial years? Also, is there any restriction on the rate of dividend?
3) Can dividend be declared to certain class of shareholders only?
4) Whether shareholder can give right to director of the Company to pay his dividend to any third person?

5) In case of Transfer of shares, shares are still not registered on the name of the transferee then who will be entitled to receive the dividend on the point of view of the Company?

6) In case of shares held in electronic mode, who will be entitled to receive dividend?

7) Whether Company can declare dividend in EGM instead of AGM?

8) Whether dividend will be payable on call money paid in advance?

9) Whether Company has to open the Demat A/c of the IEPF Authority or the Authority would open it?

10) Whether the underlying shares of unpaid or unclaimed dividends are required to be transferred to IEPF when the amount of unpaid or unclaimed dividend is being transferred?

11) Whether it is mandatory to transfer the unclaimed or unpaid dividend amount and the underlying shares for the same on the same day to the IEPF?

12) What are the consequences in case a company defaults in transferring the unpaid/unclaimed dividend amount to the Unpaid Dividend Account?

13) Does the shareholder ceases to be owner once the shares are transferred to the IEPF?

14) Can claimant file more than one consolidated claim in respect of a company in a financial year?

15) What will happen if online verification report for IEPF-5 is not sent by the company within thirty days of filing of claim?

16) What details should be published in newspaper to be published 3 months prior to transfer of shares?

17) What are the consequences in case a company defaults in transferring the unpaid/unclaimed dividend amount to the Unpaid Dividend Account?

18) Up to what time the records mentioned under rule 5 (6) (c) of the IEPF Rules, 2016 are to be maintained and kept by the Companies?

19) Whether the shares will be transferred in case the pledge is revoked?

20) What is the purpose of e-Form IEPF-5?

21) Who is a Nodal officer (IEPF)?

RIGHT TO DIVIDEND, RIGHTS SHARES AND BONUS SHARES TO BE HELD IN ABEYANCE PENDING REGISTRATION OF TRANSFER OF SHARES (SECTION 126)

Section 126 of the Companies Act, 2013 provides that where any instrument of transfer of shares has been delivered to any company for registration and the transfer of such shares has not been registered by the company, it shall, notwithstanding anything contained in any other provision of this Act,—

(a) transfer the dividend in relation to such shares to the Unpaid Dividend Account referred to in section 124 unless the company is authorised by the registered holder of such shares in writing to pay such dividend to the transferee specified in such instrument of transfer; and

(b) keep in abeyance in relation to such shares, any offer of rights shares under clause (a) of sub-section (1) of section 62 and any issue of fully paid-up bonus shares in pursuance of first proviso to sub-section (5) of section 123.

PUNISHMENT FOR FAILURE TO DISTRIBUTE DIVIDENDS (SECTION 127)

Default	when a dividend has been declared by a company but has not been paid or the warrant in respect thereof has not been posted within 30 days from the date of declaration.
Punishment	• every director of the company (if he is knowingly a party to the default), be punishable with imprisonment which may extend to two years and with fine which shall not be less than Rs.1000 for every day during which such default continues; and • the company shall be liable to pay simple interest at the rate of 18 % per annum during the period for which such default continues.
Circumstances under which no offences under this section is deemed to be committed	No offence under this section shall be deemed to have been committed:– (a) where the dividend could not be paid by reason of the operation of any law; (b) where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him; (c) where there is a dispute regarding the right to receive the dividend; (d) where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or (e) where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this section was not due to any default on the part of the company.
In case of Nidhi Company	Section 127 shall apply, subject to the modification that where the dividend payable to a member is one hundred rupees or less, it shall be sufficient compliance of the provisions of the section, if the declaration of dividend is announced in the local language in one local newspaper of wide circulation and announcement of the said declaration is also displayed on the notice board of the Nidhis for at least three months. – *Notification dated 5th June, 2015.*

Illustration:

Board of directors of Charming Entertainment Ltd. in its meeting held on 16th August, 2022 declared an interim dividend on its paid-up equity share capital. Now, the Board wants to revoke the said declaration in its next Board meeting scheduled on 3rd November, 2022. You as a Company Secretary of the company, advise the Board with the relevant provisions of the Companies Act, 2013, whether the Board of directors can do so ?

Dividend which includes interim dividend as per Section 2 (35) of Companies Act, 2013, is a due from the company once it is properly declared. Interim dividend is declared by the Board of Directors and once it is declared, it thus becomes due from the company. Section 123(4) further provides that the amount of the dividend, including interim dividend, shall be deposited in a scheduled bank in a separate account within five days from the date of declaration of such dividend. If the articles of the company do not authorize so, it has to be amended accordingly.

Section 127 of the Companies Act, 2013 provides for penalty to directors for any default in not paying dividend within 30 days from the date of declaration. However, no offence under this section shall be deemed to have been committed:

- Where the dividend could not be paid by reason of the operation of any law;
- Where a shareholder has given directions to the company regarding the payment of the dividend and those directions cannot be complied with and the same has been communicated to him;
- Where there is a dispute regarding the right to receive the dividend;
- Where the dividend has been lawfully adjusted by the company against any sum due to it from the shareholder; or
- Where, for any other reason, the failure to pay the dividend or to post the warrant within the period under this Section was not due to any default on the part of the company.

In the given case, interim dividend has to be paid and cannot be revoked once it is declared as the exceptions given above do not apply in the given case.

PROCEDURE FOR DECLARATION AND PAYMENT OF INTERIM DIVIDEND

Verification from company's Articles of Association	The Articles must provide power to pay Interim dividend and Board must be authorized to declare Interim dividend; if not, then alter the Articles of Association accordingly.
Notice of Board Meeting	Issue not less than 7 days notice or a shorter notice in case of urgent business for holding a meeting of the Board of Directors of the company to consider the matter. It must state time, date and venue of the meeting and details of the business to be transacted there at and be sent to all the directors for the time being in India and to all other directors, at their usual address in India.
Prior intimation to Stock Exchange in case of listed companies	Notify Stock exchange(s) where the securities of the company are listed, at least 2 working days (excluding the date of intimation and date of the meeting) in advance of the date of the meeting of its Board of Directors at which the recommendation of interim dividend is to be considered. *[Regulation 29 of SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015].*
Matters with regard to the declaration and payment of an interim dividend to be discussed in Board Meeting	The Board of Directors considers in detail all the matters with regard to the declaration and payment of an interim dividend including: (a) Before declaring an interim dividend, the directors must satisfy themselves that the financial position of the company allows the payment of such a dividend out of profits available for distribution. (b) The company must have earned adequate profits to pay interim dividend after providing for depreciation for the full year. (c) In case, a company is incurring loss as per financials of latest quarter, interim dividend shall not be higher than average dividend declared by the company during last three financial years.

	(d) quantum of dividend, (e) entitlement, (f) publication of notice in newspaper for closure of share transfer register and register of members of company at least 7 days before the proposed closure (applicable for listed companies), (g) closure of register of members for the purpose of payment of interim dividend or fixation of record date, (h) opening of a separate bank account, (i) printing of dividend warrants, (j) authority for signing the dividend warrants and pass appropriate resolutions covering all these aspects of the matter, (k) posting of the dividend warrants, (l) pass a suitable resolution for declaration and payment of interim dividend on equity shares of the company, and (m) Interim dividend on preference shares: Generally, dividend on preference shares is paid annually. However, the dividend at a fixed rate on the preference shares can be paid more than once during a year, in proportion to the period of completion of current financial period over the whole financial year, by declaring it as interim dividend, in the Board Meeting by the Board of Directors. A suitable resolution should be passed to the effect that the dividend will be paid to the registered preference shareholders whose names appear in the register of preference shareholders as on the date of commencement of closure of share transfer books.
Disclosures to stock exchange	In case of a listed company, immediately within 30 minutes of the conclusion of the Board meeting, but only after the close of the market hours, intimate the stock exchanges with regard to the Board's decision about declaration and payment of interim dividend with the prescribed financial information is also required to be given to the concerned stock exchange(s) *[Regulation 30 of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015].*
Compliances for the Listed Company	In case of listed company: (i) Publish notice of book closure in a newspaper circulating in the district in which the registered office of the company is situated at least seven days before the date of commencement of book closure. (ii) To give notice in advance of at least 7 working days (excluding the date of intimation and the record date) or as many days as the stock exchange may prescribe, before the closure of transfer books or record date, specifying the purpose of Record Date. The company shall recommend or declare all dividend at least 5 working days (excluding the date of intimation and the record date) before the record date fixed for the purpose.

	(iii) Time gap between two book closures and record date would be at least 30 days. (iv) To declare and disclose the dividend on per share basis only.
Closure of Register of Members	Close the register of members and the share transfer register of the company.
Board Meeting for registration of Transfer/ Transmission of shares	Hold a Board/committee meeting for approving registration of transfer/transmission of the shares of the company, which have been lodged with the company prior to the commencement of book closure. In compliance with the Board resolution, register transfer/transmission of shares lodged with the company prior to the date of commencement of the closure of the register of members and dispatch the share certificates to the transferees after endorsing the shares in their names.
Separate Bank Account	Open the "Interim Dividend Account of. Ltd." with the bank as resolved by the Board and deposit the amount of dividend payable in the account with in 5 days of declaration and give a copy of the Board resolution containing instructions regarding opening of the account and give the authority to Bank to honour the dividend warrants when presented.
Mode of Payment of Dividend	If the company is listed, then for payment of dividend it has to mandatorily use, either directly or through its Registrars to an Issue and Share Transfer Agent (RTI & STA), any RBI (Reserve Bank of India) approved electronic mode of payment such as Electronic Clearing Services (ECS) [LECS (Local ECS)/ RECS (Regional ECS)/NECS (National ECS)], National Electronic Fund Transfer (NEFT), etc. In order to enable usage of electronic payment instruments, the company (or its RTI & STA) shall maintain requisite bank details of its investors as under- (a) For investors that hold securities in Demat mode, company or its RTI & STA shall seek relevant bank details from the depositories. To this end, vide circular SEBI/MRD/DEP/Cir-3/06 dated February 21, 2006 and letter MRD/ DEP/PP/123624/2008 dated April 23, 2008, depositories have been advised to ensure that correct account particulars of investors are available in the database of depositories. (b) For investors that hold physical share/debenture certificates, company or its RTI & STA shall take necessary steps to maintain updated bank details of the investors at its end. (c) In cases where either the bank details such as MICR (Magnetic Ink Character Recognition), IFSC (Indian Financial System Code), etc. that are required for making electronic payment are not available or the electronic payment instructions have failed or have been rejected by the bank, company or its RTI & STA may use physical payment instruments for making cash payments to the investors. Company shall mandatorily print the bank account details of the investors on such payment instruments. (d) Depositories are directed to provide to companies (or to their RTI & STA) updated bank details of their investors. [Refer SEBI Circular No. CIR/MRD/ DP/10/2013 dated March 21, 2013].

Taxability of Dividend	W.e.f. Assessment year 2021-22, the domestic company isn't required to pay dividend distribution tax on any amount declared, distributed or paid by such company by way of dividend. Dividend received from domestic company is taxable in hands of shareholders.
Dividend Warrants	Make arrangements with the bank and in collaboration with other banks if required, for payment of the Dividend Warrants at par at the centers as determined by the Stock Exchanges in case of listed company.
Statement of Dividend	Prepare a statement of dividend in respect of each share-holder containing the following details: (a) Name and address of the shareholder with ledger folio No.; (b) No. of shares held; (c) Dividend payable.
Printing of Dividend Warrants	To have sufficient number of dividend warrants printed in consultation with the company's banker appointed for the purpose of dividend. To get approval of RBI for printing the warrants with MICR facility. Get the dividend warrants filled in and signed by the persons authorized by the Board. Where an instrument of transfer has been received by company prior to book closure but transfer of such shares has not been registered when the dividend warrants were posted, then keep the amount of dividend in special A/c called "Unpaid Dividend Account" opened unless the registered holder of these shares authorizes company in writing to pay dividend to the transferee specified in the said instrument of transfer.
Dispatch of Dividend Warrants	Dispatch dividend warrants within thirty days of the declaration of dividend. In case of joint shareholders, dispatch the dividend warrant to the first named shareholder. Send sufficient number of cancelled dividend warrant forms with MICR code allotted by the RBI, to the bank for circulation to the branches where the dividend warrants will be payable at par. Instructions to all the specified branches of the bank that dividend should be paid at par should be sent by the Bank.
Publication of Notice	Publish a Company notice in a newspaper circulating in the district in which the registered office of the company is situated to the effect that dividend warrants have been posted and advising those members of the company who do not receive them within a period of fifteen days, to get in touch with the company for appropriate action (in the case of listed companies, as a good practice). Issue bank drafts and/or cheques to those members who inform that they received the dividend warrants after the expiry of their currency period or their dividend warrants were lost in transit after satisfying that the same have not been encashed.

Unpaid/Unclaimed Dividend	Arrange for transfer of unpaid or unclaimed dividend to a special account named "Unpaid dividend A/c within 7 days after expiry of the period of 30 days of declaration of final dividend.
Confirmation at AGM	Confirm the interim dividend in the next Annual General Meeting.

PROCEDURE FOR DECLARATION AND PAYMENT OF FINAL DIVIDEND

The following steps are required to be taken by a company in respect of declaration and payment of final dividend:

Notice of Board Meeting	Issue notice for holding a meeting of the Board of directors of the company to consider the matter. It must contain time, date and venue of the meeting and details of the business to be transacted there at and must be sent to all the directors for the time being in India and to all other directors, at their usual address in India.
Prior intimation to Stock Exchange	In case of listed companies notify stock exchange(s) where the securities of the company are listed, at least 2 working days in advance of the date of the meeting of its Board of Directors at which the recommendation of final dividend is to be considered. *[Regulation 29 of SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015].*
Conduct of Board Meeting	Hold Board meeting for the purpose of passing the following resolutions: (a) approving the annual accounts (balance sheet and profit and loss account of the company for the year ended on 31st March.); (b) recommending the quantum of final dividend to be declared at the next annual general meeting and the source of funds for the payment there of, i.e.: (i) out of profits of the company after providing for depreciation for the current financial year and also for earlier years, if not already provided and amount to be transferred from the current profits to reserves; or (ii) out of reserves in accordance with the provisions of Rule 3 of the Companies (Declaration and Payment of Dividend), Rules, 2014. (c) fixing time, date and venue for holding the next annual general meeting of the company, *inter alia*, for declaration of dividend recommended by the Board; (d) approving notice for the annual general meeting and authorizing the company secretary or any competent person if company does not have a company secretary to issue the notice of the AGM on behalf of the Board of directors of the company to all the members, directors and auditors of the company and other persons entitled to receive the same. (e) determining the date of closure of the register of members and the share transfer register of the company as per requirements of Section 91 of the Companies Act and SEBI (LODR) Regulations, 2015 (in the case of listed companies) signed by the company with the stock exchanges where the

	securities of the company are listed. In the case of listed companies, the date of commencement of closure of the transfer books should not be on a day following a holiday. The dates so fixed should also not clash with the clearance programme in the stock exchanges. It is advisable to consult in advance the regional stock exchange and then fix the dates for closure of books.
Transfer to Reserve	The company may transfer to reserves such percentage as it consider appropriate of the current profits.
Disclosures to Stock Exchange after Conclusion of Board Meeting	In case of a listed company, immediately within 30 minutes of the conclusion of the Board meeting, intimate the stock exchanges with regard to the Board's decision about declaration and payment of dividend and the amounts appropriated from reserves, capital profits, accumulated profits of past years or other special source to provide wholly or partly for the dividend *[Regulations 29 and 30 of SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015]*
Notice of Book Closure	Publish notice of book closure in a newspaper circulating in the district in which the registered office of the company is situated at least seven days before the date of commencement of book closure. In case of listed companies: (i) To give notice in advance of at least 7 working days (excluding the date of intimation and the record date) or as many days as the stock exchange may prescribe, before the closure of transfer books or record date, specifying the purpose of Record Date *[Regulation 42 of the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015].* The company shall recommend or declare all dividend at least five working days (excluding the date of intimation and the record date) before the record date fixed for the purpose. (ii) Time gap between two book closures would be at least 30 days *[Regulation 42(4) of SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015].*
Declaration of Dividend	To declare and disclose the dividend on per share basis only. The listed entity shall not forfeit unclaimed dividends before the claim becomes barred by law and such forfeiture of effected, shall be annulled in appropriate cases. *(Regulation 43 of Listing Regulations read with section 51 of Companies Act, 2013).*
Closure Register of Members	Close the register of members and the share transfer register of the company.
Disclosure in Board Report	The amount of dividend as recommended by the Board of directors shall be shown in the Directors' Report as appropriation of profits for the financial year to which the Report relates. The same amount is shown in the Balance Sheet as at the end of the related financial year as "Proposed Dividend" under the head "Current Liabilities & Provisions", Sub-head "Provisions".

Board/Committee Meeting for Approving Registration of Transfer/ Transmission of the Shares	Hold a Board/committee meeting for approving registration of transfer/ transmission of the shares of the company, which have been lodged with the company prior to the commencement of book closure. In compliance with the Board resolution, register transfer/transmission of shares lodged with the company prior to the date of commencement of the closure of the register of members and mail the share certificates to the transferees after endorsing the shares in their names.
Declaration of Dividend at AGM	Hold the annual general meeting and pass an ordinary resolution declaring the payment of dividend to the shareholders of the company as per recommendation of the Board. The shareholders cannot declare the final dividend at a rate higher than the one recommended by the Board. However, they may declare the final dividend at a rate lower than the one recommended by the Board. The following should be noted in this regard: (a) Once a company has declared a dividend for a financial year at an annual general meeting, it cannot declare further dividend at an extraordinary general meeting in relation to the same financial year; it is beyond the powers of the company to do so, although the Companies Act does not prohibit the declaration of a dividend at a general meeting other than an annual general meeting. (b) In the case of preference shares, dividend is always paid at a fixed rate. However, in the case of equity shares, a dividend must be declared and paid according to the amounts paid or credited as paid on the shares, i.e., according to the paid-up value of the shares. (c) All dividends shall be apportioned and paid proportionately to the amounts paid or credited as paid on the shares during any portion or portions of the period in respect of which the dividend is paid; but if any share is issued on terms providing that it shall rank for dividend as from a particular date such share shall rank for dividend accordingly. [Schedule I, Table F, Article 83(3)].
Statement of Dividend	Prepare a statement of dividend in respect of each shareholder containing the following details: (a) Name and address of the shareholder with ledger folio no. (b) No. of shares held. (c) Dividend payable.
Separate Bank Account	Open a separate bank account for making dividend payment and credit the said bank account with the total amount of dividend payable within 5 days of declaration of dividend.
Mode of Payment	If the company is listed, then for payment of dividend it has to mandatorily use, either directly or through its Registrars to an Issue and Share Transfer Agent (RTI & STA), any RBI (Reserve Bank of India) approved electronic mode of payment such as Electronic Clearing Services (ECS) [LECS (Local ECS)/ RECS (Regional ECS)/ NECS (National ECS)], National Electronic Fund Transfer (NEFT), etc.

	In order to enable usage of electronic payment instruments, the company (or its RTI & STA) shall maintain requisite bank details of its investors as per SEBI Circular No. CIR/MRD/DP/10/2013 dated March 21, 2013 in the manner as stated aforesaid under the procedure for declaration and payment of interim dividend.
Taxability Of Dividend	W.e.f. Assessment year 2021-22, the domestic company isn't required to pay dividend distribution tax on any amount declared, distributed or paid by such company by way of dividend. Dividend received from domestic company is taxable in hands of shareholders.
Printing of Dividend Warrants	To have sufficient number of dividend warrants printed in consultation with the company's banker appointed for the purpose of dividend. To get approval of the RBI for printing the warrants with MICR facility. Get the dividend warrants filled in and signed by the persons authorized by the Board.
	No RBI approval required for payment of dividend to shareholders abroad, in case of investment made on repatriation basis.
	Prepare two copies of the list of members with names and addresses only for mailing purposes–one to cut and paste on envelopes which could even be printed on self sticking labels and the other for securing receipt from the Post Office.
	Where an instrument of transfer has been received by company prior to book closure but transfer of such shares has not been registered when the dividend warrants were posted, then keep the amount of dividend in special A/c called "Unpaid Dividend Account" unless the registered holder of these shares, authorizes company in writing to pay dividend to the transferee specified in the said instrument of transfer. (Section 126 of Companies Act, 2013)
Dispatch of Dividend Warrants	Dispatch dividend warrants within 30 days of the declaration of dividend. In case of joint shareholders, dispatch the dividend warrant to the first named shareholder.
	Send sufficient number of cancelled dividend warrant forms with MICR code allotted by the RBI, to the bank or circulation to the branches where the dividend warrants will be payable at par.
Instructions to all the Specified Branches of the Bank	Instructions to all the specified branches of the bank that dividend should be paid at par should be sent by the Bank.
Notice In Newspaper	Publish a Company notice in a newspaper circulating in the district in which the registered office of the company is situated to the effect that dividend warrants have been posted and advising those members of the company who do not receive them within a period of fifteen days, to get in touch with the company for appropriate action (in the case of listed companies, as a good practice). Issue bank drafts and/or cheques to those members who inform that they received the dividend warrants after the expiry of their currency period or their dividend warrants were lost in transit after satisfying that the same have not been encashed.
Unpaid or Unclaimed Dividend	Arrange for transfer of unpaid or unclaimed dividend to a special account named "Unpaid dividend A/c"within 7 days after expiry of the period of 30 days of declaration of final dividend.

PROCEDURE FOR DECLARATION OF DIVIDEND OUT OF RESERVES

The procedure is as follows:

(1) Give notice to all the directors of the company for holding a Board meeting. In the meeting, take decision to declare dividend out of company's reserves because of inadequacy or absence of profits and also fix the date, time and place of the Annual General Meeting. Authorise the Company Secretary or any competent person if company does not have a company secretary to issue the notice of the AGM on behalf of the Board of directors of the company to all the members, directors and auditors of the company and other persons entitled to receive the same.

(2) Ensure that the Companies (Declaration and Payment of Dividend), Rules 2014 are complied with.

(3) While calculating the profits of the previous years, take only the net profit after tax.

(4) Ensure that while computing the amount of profits, the amount transferred from the Development Rebate Reserve is included and all items of capital reserves including reserves created by revaluation of assets are excluded.

(5) In the case of listed companies, inform the Stock Exchange with which the shares of the company are listed within 30 minutes of closure of Board meeting about decision to recommend declaration of dividend out of Company's Reserves. [Regulation 30 of SEBI (LODR) Regulations, 2015].

(6) Issue notices in writing at least 21 days before the date of the Annual General Meeting and hold the meeting and pass the necessary resolution.

(7) In the case of listed companies, forward copies of the notice and a copy of the proceeding of the general meeting to the Stock Exchange.

(8) Open a separate bank account for making dividend payment and credit the said bank account with the total amount of dividend payable within five days of declaration of dividend.

(9) Issue dividend warrants within 30 days from the date of declaration of dividend. Rest of the procedural steps are same as in case of payment of final dividend.

Secretarial Standard on Dividend (SS-3)

The "Secretarial Standard on Dividend" (SS-3), formulated by the Secretarial Standards Board (SSB) of the Institute of Company Secretaries of India (ICSI) and issued by the Council of the ICSI, has been effective from 1st January 2018. Adherence to SS-3 is recommendatory.

SS-3 prescribes a set of principles in relation to the declaration and payment of Dividend and matters related thereto on equity as well as preference share capital in accordance with the provisions of the Companies Act, 2013 and are in respect of Dividend as it relates to a going concern. These are equally applicable to Final as well as Interim Dividend unless otherwise stated.

The principles enunciated in this Standard are in conformity with the provisions of the Companies Act, 2013 (Act). In addition, the provisions of the Securities Contracts (Regulation) Act, 1956 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are applicable to listed companies. Any specific provision relating to Dividend in the Income tax Act, 1961 or under any other statute shall also be applicable. If due to subsequent changes in the Act or other applicable laws, a particular Standard or any part thereof becomes inconsistent with the Act or other applicable laws, the provisions of the Act or such applicable laws shall prevail.

SS-3 shall not apply to a company limited by guarantee not having share capital and does not deal with Dividend, if any, declared by companies under liquidation.

SPECIMEN RESOLUTION/ANNEXURES

ANNEXURE-I

Specimen Board Resolution for Declaration of Interim Dividend on Equity Shares

RESOLVED THAT an Interim Dividend of Rs. _____ (at the rate of ___ percent) on each fully paid-up equity share of Rs. _____ of the Company amounting to Rs. _____ be paid out of the profits of the Company for the half year ended _____ 2022 to those Members of the Company whose names would appear on the Register of Members of the Company on the _____ day of _____ 2022 being the Record date for payment of Interim Dividend.

RESOLVED FURTHER THAT a separate bank account be opened in the name of the Company with ..... Bank at its Branch at _____ and a sum of Rs. _____, being the total Interim Dividend amount, be deposited in the said account within five days from the date of declaration.

RESOLVED FURTHER THAT Mr. _____, Director and Mr. _____, Company Secretary be and are hereby jointly authorized to open the bank account by signing the account opening form and by furnishing to the said bank the required papers, documents and information and completing all other required formalities for the purpose of opening the bank account and to make arrangements with the said bank for the payment at par, of the Interim Dividend within thirty days from the date of declaration.

RESOLVED FURTHER THAT Mr. _____, Director and Mr. _____, Company Secretary of the company, be and are hereby authorised to jointly sign the Dividend warrants to be issued on the said bank and the said bank be and is hereby authorised to honour the Interim Dividend warrants jointly signed by the said authorised signatories, as and when presented for encashment.

ANNEXURE-II

Specimen Board Resolution for Declaring Interim Dividend on Preference Shares

"**RESOLVED THAT** in accordance with the provisions of Section 123 and other applicable provisions, if any, of the Companies Act, 2013 and the Companies (Declaration and Payment of Dividend) Rules, 2014, dividend at the fixed rate of 8 per cent per annum on the (no. of shares) cumulative redeemable preference shares of Rs.100 each of the company, for the six months commencing from July 1, 20__ and ending on December 31, 20__ aggregating Rs. _____ [Rupees (in words)], be paid to the registered holders thereof whose names would appear on the register of holders of the said shares on the _____ 20__, the date of commencement of the closure of the share transfer books of the company."

"RESOLVED FURTHER THAT a bank account to be designated as "Interim Preference Dividend (20.....) Account of.....Limited" be opened in the name of the company with _____ Bank at its Branch at _____ and a sum of Rs. [Rupees (in words)], being the total interim dividend amount, be deposited in the said account within five days."

"RESOLVED FURTHER THAT Shri _____, Managing Director and the Company Secretary, Shri _____ be and is hereby authorized to open the bank account by signing the account opening form and by furnishing to the said bank the required papers, documents, information etc. and completing all other required formalities for the purpose of opening the bank account and to make arrangements with the said bank for the payment at par, of the interim dividend within 30 days from the date of this resolution."

"RESOLVED FURTHER THAT Shri _____, Managing director and Shri _____ Company Secretary of the Company for the time being, be and are hereby authorised to jointly sign the dividend warrants to be

issued on the said bank and the said bank be and is hereby authorized to honour the interim dividend warrants jointly signed by the said authorized signatories, as and when presented for encashment."

Name of Company: _____ Registered Office: _____

ANNEXURE-III

Specimen of Board Resolution Recommending Payment of Dividend on Equity Shares out of Profits

RESOLVED THAT in accordance with the provisions of Section 123 and other applicable provisions of the Companies Act, 2013 and Rules made thereunder, the Board of Directors of the Company hereby recommends a Dividend of Rs _____ (at the rate of __ percent) per equity share out of the profits of the Company for the year ended on 31st March 20__, on the _____ fully paid up equity shares of the Company absorbing Rs. _____ out of the profits.

RESOLVED FURTHER THAT, subject to declaration by the Members of the Company at the ensuing Annual General Meeting, the Dividend be paid to the registered holders of the equity shares whose names would appear on the Register of Members on _____ day of _____ being the Record date for payment of Dividend.

RESOLVED FURTHER THAT, subject to the declaration by the Members of the Company at the ensuing Annual General Meeting, Mr. _____, Director, and Mr. _____, Company Secretary be and are hereby jointly authorised to take necessary steps including opening of the bank account with the _____ at its Branch at _____ by signing the account opening form and by furnishing to the said bank the required papers, documents and information, and completing all other required formalities for the purpose of opening the bank account and to make arrangements with the said bank for the payment at par, of the Dividend within thirty days from the date of declaration of Dividend by the members at the Annual General Meeting.

RESOLVED FURTHER THAT Mr. _____, Director and Mr. _____, Company Secretary of the company, be and are hereby authorised to jointly sign the dividend warrants to be issued on the said bank and the said bank be and is hereby authorised to honour the Dividend warrants jointly signed by the said authorised signatories, as and when presented for encashment.

ANNEXURE-IV

Model Dividend Distribution Policy

The Board of Directors ("Board") of _____ (name of the Company) at its meeting held on _____ has approved and adopted the Dividend Distribution Policy ("Policy") as required in terms of Regulation 43A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("Listing Regulations").

Effective Date The Policy shall become effective from the date of its adoption by the Board i.e. _____ (DD/MM/YYYY).

Need and Objective of the Policy The Securities and Exchange Board of India ("SEBI"), vide its Notification dated 8th July 2016, amended the Listing Regulations by inserting Regulation 43A in order to make it mandatory for the top 1000 listed companies (based on their market capitalization calculated as on the 31st day of March every year) to have the above Policy in place.

Considering the above and recognising the need to lay down a broad framework for deciding the matters pertaining to distribution of Dividend and / or retaining the profits of the Company, the Board of the Company has laid down and adopted this policy.

The Policy reflects the intent of the Company to reward its shareholders by sharing a portion of its profits after retaining sufficient funds for the growth of the Company. The Policy sets out the circumstances and different factors for consideration by the Board at the time of taking such decisions.

The Policy shall not apply to determination and declaration of Dividend on preference shares as the same will be as per the terms of issue approved by the shareholders.

I. GENERAL POLICY ON DIVIDEND

The Board shall determine the Dividend pay-out in a particular year after taking into consideration the operating and financial performance of the Company, the advice of executive management and other relevant factors.

II. CONSIDERATIONS RELEVANT FOR DECISION ON DIVIDEND

The Board shall consider the following, while taking decisions of a Dividend pay-out during a particular year-

Statutory requirements The Company shall observe the relevant statutory requirements including transfer of a certain portion of the profits to any specific reserve(s), as may be applicable to the Company at the time of taking a decision with regard to declaration / recommendation of Dividend or retention of profits.

Inadequacy of profits If during any financial year the profits of the Company are inadequate, the Board may decide not to declare Dividends for that financial year.

Contractual obligations The decision regarding dividend pay-out shall take into consideration the restrictions and covenants contained in the agreements as may be entered into by the Company with financial institutions / other lenders of the Company from time to time.

Prudential requirements The following strategic matters shall also be considered-

- to ascertain the needs for capital conservation and appreciation;
- to build sufficient reserves of retained earnings;
- to augment long term financial strength; and
- to build a pool of internally generated funds to provide long-term resources as well as resource raising potential for the Company.

Proposals for major capital expenditures, etc. The Board should also take into consideration the need for replacement of capital assets, expansion and modernization or augmentation of capital stock, including any major capital expenditure proposals and the provision of depreciation on such new assets.

Expectations of Stakeholders The Board, while considering the decision of Dividend pay-out or retention of a certain amount or the entire profits of the Company for the year, shall, as far as possible, consider the expectations of the major stakeholders as also the small shareholders of the Company who generally expect a regular Dividend payout.

III. OTHER PARAMETERS

In addition to above parameters, the decision of Dividend payout or retention of profits shall also be based on the following

Operating cash flow of the Company If the Company cannot generate adequate operating cash flow, it may need to rely on outside funding to meet its financial obligations and sometimes to run the day-to-day operations. The Board should consider the same before taking its decision whether to declare Dividend or retain its profits. Taxation and other regulatory concerns

– Dividend distribution tax as may be applicable at the time of declaration of Dividend.

– Any restrictions on payment of Dividends by virtue of any regulation as may be applicable to the Company at the time of declaration of Dividend.

Macroeconomic conditions Considering the state of the Country's economy, the policy decisions that may be formulated by the Government and other similar conditions prevailing in the international market which may have a bearing on or affect the business of the Company, the management may consider retaining a larger part of the profits to have sufficient reserves to meet unforeseen circumstances.

IV. PARAMETERS FOR VARIOUS CLASSES OF SHARES

- The factors and parameters for declaration of Dividend to different class of shares of the Company shall be the same as stated above.
- The payment of Dividend shall be based on the respective rights attached to each class of shares as per their terms of issue.
- Dividends shall be paid out of the Company's distributable profits and / or free reserves and shall be allocated among the shareholders on a pro-rata basis according to the type and class of shares held.
- Dividend when declared shall be first paid / apportioned to the preference shareholders of the Company as per the terms and conditions of their issue.

V. MANNER OF DIVIDEND PAYOUT

The declaration and payment of Dividends will be as per the laws and regulations applicable to the company.

VI. DISCLOSURE ON DEVIATION

Declaration of Dividend on the basis of parameters other than those stated in this Policy or resulting in amendment of any element stated in this Policy will be regarded as deviation.

Any such deviation, when deemed to be necessary in the interest of the Company, in extraordinary circumstances, shall be disclosed in the Company's Board's Report along with the rationale thereof.

VII. AMENDMENT

The Board of Directors may review the policy to give effect to any statutory amendments or otherwise. The amended Policy shall be placed on the website of the company immediately after its approval from the Board.

LESSON ROUND-UP

- Under Section 2(35) of the Companies Act, 2013, 'dividend' includes any interim dividend.
- Dividend is the share of the company's profit distributed among the members.
- The Board may declare interim dividend during any financial year out of the surplus in the Profit and Loss Account at any time between two AGM of the company.
- Final Dividend means a Dividend declared at the Annual General Meeting of the company.
- In case of inadequacy of profits the company can declare the dividend with accordance with the Rule 3 of Companies (Declaration and Payment of Dividend) Rules 2014.
- The amount of dividend shall be deposited in a schedule bank in a separate account within 5 days from the date of declaration.

- Dividend may be paid by cheque or warrant or in any electronic mode to the shareholders entitled to the payment of dividend.
- Where the dividend is not paid or claimed within 30 days, the company shall, within 7 days transfer the amount to Unpaid Dividend Account which shall be opened in a scheduled bank.
- In case of any default in transferring the amount, the company shall be liable to pay interest on the amount as has not been transferred.
- The amount remaining unpaid/unclaimed along with interest accrued thereon for 7 years and the shares shall be transferred to Investor Education and Protection Fund.
- In case any dividend is paid or claimed for any year during the said period of seven consecutive years, the shares shall not be transferred to the Investor Education and Protection Fund.

GLOSSARY

Divisible Profit: Profit or a portion of profit that can be legally distributed as a dividend to the shareholders is known as Divisible Profit.

Dividend: A dividend is a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders.

Interim Dividend: Dividend declared in between two Annual General Meetings.

Final Dividend: Dividend recommended by the Board of Directors and declared by the members at an Annual General Meeting

Book Closure: Register of Members or other security holders are closed for the purpose of dividend distribution (See section 91 of the Companies Act,2013)

Demat Account: A Demat Account is an account that allows investors to hold their shares in an electronic form. Stocks in Demat account remain in dematerialized form. Dematerialization is the process of converting physical shares into electronic format.

Dividend Warrant: An order of payment (such as a cheque payable to a shareholder) in which a dividend is paid.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Define the term 'Dividend'. State briefly the provisions related to declaration of dividend under the Companies Act 2013.

   State the procedure for transfer of unpaid or unclaimed dividend to the Investor Education and Protection Fund. Explain the law relating to declaration and payment of Final Dividend?
2. Distinguish between 'Interim Dividend' and 'Final Dividend'.
3. Write short notes on the following:-
   (i) Investor Education and Protection Fund (IEPF).
   (ii) Punishment of failure to distribute dividend.

4. Draft a resolution:
   (a) to declare the interim dividend on Equity Shares.
   (b) to declare the interim dividend on Preference Shares.
   (c) To recommend payment of dividend on Equity Shares out of reserves.
6. The Board of Directors of Peculiar Ltd. proposes to recommend a final dividend of Rs. 25 each to all the equity shareholders of the company. The company seeks your opinion on the following :
   (1) The company wants to deposit the dividend amount to co-operative bank.
   (2) The company is a defaulter in the repayment of deposits and proposes to repay its all deposit after the payment of dividend within 10 days.
   (3) Dividend will be declared out of the capital reserves of the company.
   (4) The company wants to pay such dividend through the cash counter by way of cash voucher.
7. Nozama International Ltd has a consistent dividend policy in the past 5 years paying 10% dividend, and although during the current year it sustained a loss but it wanted to keep up its reputation and declared 12% dividend to its shareholders. Referring to the provisions of the Companies Act, 2013, advise the company as to how this can be done.
8. An individual deceitfully impersonated himself as the transferee and got the shares transferred in his name. He also received the accruals like bonus, dividend etc. on such shares.After sometime this fraud by the individual was noticed and the Secretary argued that Company law did not have provisions to punish the person but under Criminal Law, a case can be filed to punish the individual. The directors accepted this suggestion. Offer your comments as an expert in Company Law.
9. PQR Ltd. wants to declare interim dividend during the financial year 2019-20. The company incurred losses for the first quarter ended 30th June, 2019 of the current year. Can the company declare interim dividend ? What are the check points you should keep in mind as Secretarial Auditor in respect of declaration of dividend ?
10. Examine the validity of the following :
    (a) XYZ Ltd wants to declare the dividend out of the current year profit without adjusting the previous year's carry forwarded losses and depreciation.
    (b) Board of Directors of XYZ Ltd wants to declare interim dividend after the end of financial year.
11. A Ltd. made a public offer of its securities by issuing a prospectus, in which it was stated that the company has a track record of dividend payment without any interruption for the previous ten years. When the facts were verified, it was found that the company had in fact incurred significant losses for a period of two years immediately preceding the previous five years and this fact has not explicitly stated in the prospectus. The dividend was actually paid out of windfall capital profits for those two years. Whether the Managing director who issued the prospectus will incur any liability.
12. Subhash is a debtor as well as a member of JUMBO Ltd., a listed company. The company declares a dividend of Rs. 2500 on the shares owned by Subhash and proposes to adjust the said amount against the debt of Rs.5000 due from him. ls this adjustment valid ? Would your answer differ if JUMBO is a Private limited company ?

13. Rahul has to claim certain shares and unclaimed dividend from Ocean Ltd which has transferred it to Investor Education and Protection Fund (IEPF). Discuss the procedure to be followed by Rahul in terms of relevant rules notified in this regard.
14. Deep Ltd. declared dividend but failed to make payment to shareholders. Advise the company about the consequences for such a default. Please also list out the circumstances under which a company is not deemed to have committed an offence with regard to non-payment of dividend.
15. While adopting accounts for the year, the Board of directors of Prima Ltd. decided to consider the interim dividend @ 12% as final dividend and did not consider transfer of profit to reserves. Explain whether decisions of the Board were justified referring to relevant provisions.
16. Pluto Limited has a paid-up equity share capital of Rs.10 crore comprised of : (a) 80 lakh equity shares of Rs.10 each fully paid up (b) 40 lakh equity shares of Rs.10 each on which only Rs. 5 per share is paid up. The company wants to pay dividend in proportion to the amount paid up, even though the articles of the company is silent on this, ls it tenable ?
17. PTC Ltd., wants to declare final dividend. The company did not earn profits in last three years. Can the final dividend be declared and paid in such a situation? Choose the provisions in this regard:
    (a) PTC Ltd may declare and pay final dividend out of the free reserve, in accordance with rule 3 of the Companies (Declaration and Payment of Dividend) Rules, 2014
    (b) PTC Ltd cannot declare and pay final dividend till it earns profits
    (c) PTC Ltd may declare and pay final dividend out of the free reserve, in accordance with rule 5 of the Companies (Share Capital and Debentures) Rules, 2014
    (d) PTC Ltd can declare and pay final dividend after seeking approval from audit committee.
18. Jagat is a debtor as well as a member of SITARA Ltd., a listed company. The company declares a dividend of Rs. 2500 on the shares owned by Subhash and proposes to adjust the said amount against the debt of Rs.5000 due from him. ls this adjustment valid ? Choose the correct line:
    (a) the amount due from Jagat in the capacity of trade debtor will not be adjusted and the company need to pay dividend amount to Jagat
    (b) the amount due from Jagat in the capacity of trade debtor will be adjusted and the company need not to pay dividend amount to Jagat
    (c) the amount due from Jagat in the capacity of trade debtor will be adjusted with the approval of audit committee
    (d) None of these

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- Bare Act- The Companies Act, 2013
- Secretarial Standard (SS-3)
- ICSI Guidance note on Dividend

OTHER REFERENCES (Including Websites/Video Links)

- http://www.iepf.gov.in/
- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

Accounts & Auditors

Lesson 9

KEY CONCEPTS

■ Free Reserves ■ Securities ■ Body Corporate ■ Related Party ■ Inter-Corporate Loan ■ Related Party Transaction ■ Arm's length basis ■ Ordinary Course of Business ■ Omnibus Approval ■ Place of Profit

Learning Objectives

To understand:

- Keeping books of account
- Inspection of books of account and other provisions for Financial Statement & Consolidated Financial Statements
- Accounting Standards
- Provisions for audit and auditors, their appointment, qualifications, resignation, removal, duties and liabilities
- Provisions related to Cost Audit, Secretarial Audit and Internal Audit

Lesson Outline

- Books of Accounts
- Financial Statements
- National Financial Reporting Authority
- Auditors - Appointment, Resignation and Procedure relating to Removal, Qualification and Disqualification
- Auditors-Rights, Duties and Liabilities
- Audit and Auditor's Report
- Cost Audit
- Secretarial Audit
- Internal Audit
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 128 to 148, 177, 204)
- The Companies (Accounts) Rules, 2014
- The Companies (Indian Accounting Standards) Rules, 2015
- The Companies (Audit and Auditors) Rules, 2014
- The SEBI (LODR) Regulations, 2015

BOOKS OF ACCOUNTS

All business establishments and companies are required to keep a record of their day to day business and financial transactions in order to know the result of their operations. The said record is referred to as "book of accounts". For preparation of annual accounts, the maintenance of proper books of account is a must. Section 128 of the Companies Act, 2013 contains the provisions for books of account etc. to be kept by company. The terms "books of accounts", "book and papers" "financial statement" and "financial year" have been defined under the Companies Act, 2013 as below:

IMPORTANT DEFINITIONS [SECTION 2]

- **"Book and paper" and "Book or paper" -** As per section 2(12) of the Act, "book and paper" and "book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.
- **"Books of Account" -** As per section 2 (13) of the Act, "books of account" includes records maintained in respect of –
  - (i) all sums of money received and expended by a company and matters in relation to which the receipts and expenditure take place;
  - (ii) all sales and purchases of goods and services by the company;
  - (iii) the assets and liabilities of the company; and
  - (iv) the items of cost as may be prescribed under section 148 of the Act in the case of a company which belongs to any class of companies specified under that section.
- **"Financial Statement**" - As per section 2(40) of the Act, financial statement in relation to a company, includes:
  - (i) a balance sheet as at the end of the financial year;
  - (ii) a profit and loss account, or in the case of a company carrying on any activity not for profit, an income and expenditure account for the financial year;
  - (iii) cash flow statement for the financial year;
  - (iv) a statement of changes in equity, if applicable; and
  - (v) any explanatory note annexed to, or forming part of, any document referred to in sub-clause (i) to sub- clause (iv).
- **"Financial Year"** - According to section 2(41) of the Act "financial year", in relation to any company or body corporate, means the period ending on the 31st day of March every year, and where it has been incorporated on or after the 1st day of January of a year, the period ending on the 31st day of March of the following year, in respect whereof financial statement of the company or body corporate is made up:

Provided that where a company or body corporate, which is a holding company or a subsidiary or associate company of a company incorporated outside India and is required to follow a different financial year for consolidation of its accounts outside India, the Central Government may, on an application made by that company or body corporate in such form and manner as may be prescribed, allow any period as its financial year, whether or not that period is a year:

Provided further that any application pending before the Tribunal as on the date of commencement of the Companies (Amendment) Act, 2019, shall be disposed of by the Tribunal in accordance with the provisions applicable to it before such commencement.

Provided also that a company or body corporate, existing on the commencement of this Act, shall, within a period of two years from such commencement, align its financial year as per the provisions of this clause.

CASE LAW

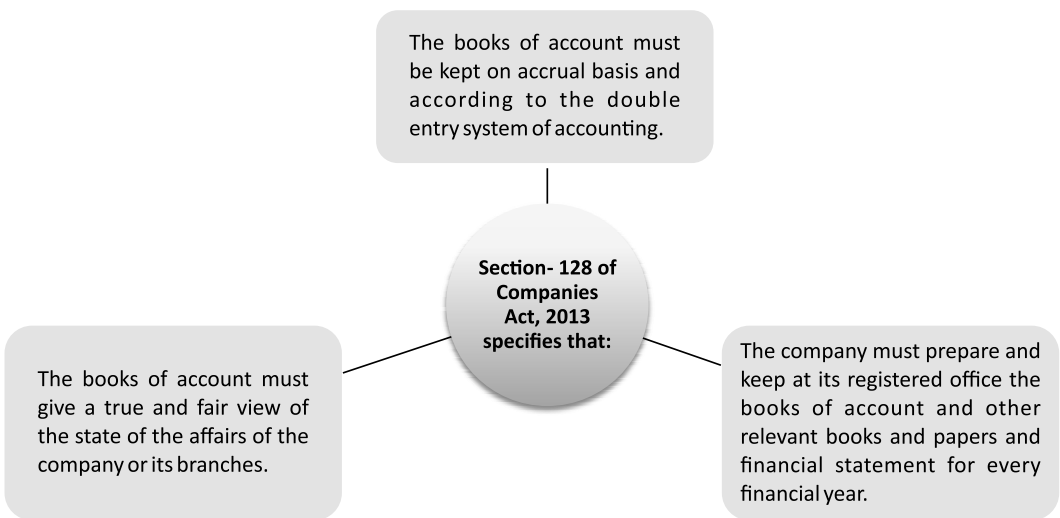
In Re. Universal Robots (India) Private Limited C.A. No.109/2(41)/CB/2016 NCLT Bengaluru Bench, it was held that subject to approval of Tribunal, subsidiary company of a foreign company could follow any financial year to align with the financial year of foreign company holding company for consolidation of accounts.

In the case of *Aris Global Software Pvt. Ltd CB/2016 NCLT Bengaluru Bench*, it was held that proviso to section 2(41) of the Act enable subsidiary company to have a different financial year in tune with financial year of its holding company and therefore, petitioner subsidiary company was to be permitted to follow the financial year commencing from January 01st and ending on December 31st in tune with its holding company for purpose of consolidation of accounts.

- **"Branch Office" -** According to section 2(14), branch office in relation to a company, means any establishment described as such by the company.

REQUIREMENT OF KEEPING BOOKS OF ACCOUNTS (SECTION 128)

Every company shall prepare and keep at its registered office books of account and other relevant books and papers and financial statement for every financial year.



CASE LAW

In *J. K. Industries Ltd. & Anr. vs. Union of India & Ors. [(2008) 143 Comp Cases 325]*, the Supreme Court explained the concept of 'accrual accounting' as follows:

"In the conventional sense, amounts which become receivable/recoverable are shown as income actually received and the liabilities incurred are shown as amounts actually disbursed in a given year. Therefore, under the aforestated system of accounting, entries are posted in the books of accounts on the date of the transaction, i.e., on the date on which rights accrue or liabilities are incurred, irrespective of the date of payment. In such cases, a company has to account for its income or loss as per the above system and not otherwise, if that company has adopted mercantile system of accounting which is also known as accrual system of accounting. However, accrual does not mean confinement of items of revenue/expenditure to a given year. As stated above, mergers and acquisitions are undertaken to defer revenue expenditure over future years by invoking matching principles. Therefore, the said principle form an important part of accrual accounting."

PLACE OF KEEPING BOOKS OF ACCOUNT

Section 128(1) of the Act requires every company to prepare and keep the books of account and other relevant books and papers and financial statements at its registered office. However, all or any of the books of accounts may be kept at such other place in India as the Board of directors may decide. When the Board so decides, the company is required within 7 days of such decision to file with the Registrar of Companies a notice in writing giving full address of that other place. Such intimation is to be made in **e-form AOC-5** to the RoC.

Test Yourself:

Question: ABC Ltd. is having its branch office in Jodhpur, Udaipur and Bhiwadi. Is maintenance of books required at all the branch offices? What is required by Registered office regarding maintenance of Books of Account of branch offices?

Answer: As per section 128 of Companies Act, 2013, every branch office should maintain proper books of account. Proper summarized returns periodically are to be sent by the branch office to the Company at its registered office.

MAINTENANCE OF BOOKS OF ACCOUNT IN ELECTRONIC FORM (RULE 3 OF THE COMPANIES (ACCOUNTS) RULES, 2014)

The Rule 3 of the Companies (Accounts) Rules, 2014 provides the manner in which the books of accounts needs to be kept. The important provisions with respect to maintenance of books of accounts in electronic form are given below:

- The maintenance of books of account or other relevant papers in electronic mode is permitted. Such books of accounts or other relevant books and papers maintained in electronic mode shall remain accessible in India, at all times so as to be usable for subsequent use.

  As per the Information Technology Act, 2000, "Electronic form" with reference to information means any information generated, sent, received or stored in media, magnetic, optical, computer memory, micro film, computer generated micro fiche or similar device.

  Further, "Electronic record" means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche.

- For the financial year commencing on or after the 1st day of April, 2023, every company which uses accounting software for maintaining its books of account, shall use only such accounting software which has a feature of recording audit trail of each and every transaction, creating an edit log of each change made in books of account along with the date when such changes were made and ensuring that the audit trail cannot be disabled.
- The information contained in the records shall be retained completely in the format in which they were originally generated, sent or received, or in a format which shall present accurately the information generated, sent or received and the information contained in the electronic records shall remain complete and unaltered.
- The information received from branch offices shall not be altered in any manner and shall be kept where it shall depict what was originally received from the branches.
- The information in the electronic record of the document shall be capable of being displayed in a legible form.
- There shall be a proper system for storage, retrieval, display or printout of the electronic records as the Audit Committee or the Board may deem appropriate and such records shall not be disposed of or rendered unusable, unless permitted by law:

  However, the back-up of the books of account and other books and papers of the company maintained in electronic mode, including at a place outside India, if any, shall be kept in servers physically located in India on a daily basis.
- The company shall intimate to the Registrar on an annual basis at the time of filing of financial statement -

  (a) the name of the service provider;

  (b) the internet protocol address of service provider;

  (c) the location of the service provider (wherever applicable);

  (d) where the books of account and other books and papers are maintained on cloud, such address as provided by the service provider.
- Where the service provider is located outside India, the name and address of the person in control of the books of account and other books and papers in India.

BOOKS OF ACCOUNT IN RESPECT OF BRANCH OFFICE

The branches of the company, if any, in India or outside India shall also keep the books of account in the same manner as specified in sub- section (1) of Section 128 of the Act, for the transaction effected at the branch office. The books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours.

The inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors. Where an inspection is made, the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give.

Further proper summarized return of the books of account of the company kept and maintained outside India shall be sent to the registered office at quarterly intervals, which shall be kept and maintained at the registered office of the company and which shall be kept open to directors for inspection.

Illustration:

ABC Company Ltd, has its registered office in Delhi and the Branch office in California. The proper books of accounts relating to the transactions effected at the branch office in California are kept at that office and proper summarized returns periodically (quarterly) are sent by that branch office to the company at its registered office.

Illustration:

ABC Company Ltd, has its registered office in Delhi and branch office in Mumbai .The proper books of accounts relating to the transactions effected at the branch office in Mumbai are kept at that office and proper summarized returns periodically are sent by that branch office to the company at its registered office.

Where any other financial information maintained outside the country is required by a director, the director shall furnish a request to the company setting out the full details of the financial information sought and the period for which the information is sought.

The company shall produce such financial information to the director within 15 days of the date of receipt of the written request. The financial information required by the director shall be sought for by the director himself and not by or through his holder of power of attorney or agent or any representative.

CASE LAW

In *Vakharia v. Supreme General Films Exchange Co. Ltd. (1948)* the judge stated that "..... a person can exercise his right of inspection through his agent only if he is unable effectively to take inspection has any substance in it. Of course it may be that in a proper case it is open to the party opposing inspection to show that the person seeking inspection is guided by improper motives, and if he succeeded in doing so the Court may refuse inspection through an agent. The principles that apply to the right of inspection of a partner are to my mind equally applicable to the right of inspection conferred on a director under Section 130(2) of the Indian Companies Act.

PRESERVATION OF BOOKS OF ACCOUNTS

The books of account of every company shall be kept in good order for a period related to not less than eight financial years immediately preceding a financial year, or where the company had been in existence for a period less than eight years, in respect of all the preceding years along with the vouchers relevant to any entry in such books of account. [Section 128(5)]

However, where an investigation has been ordered in respect of the company, the Central Government may direct that the books of account may be kept for such longer period as it may deem fit.

Illustration:

M/s ABC Limited is registered as a company in the year 2000. In Financial year 2021-22, it must keep the books of accounts from FY 2012-13 to FY 2020-21.

PERSONS RESPONSIBLE TO MAINTAIN BOOKS

According to section 128(6) of the Act, the following persons are responsible to take all reasonable steps to secure Compliance by the company with the requirement of maintenance of books of accounts etc.

(i) Managing Director;

(ii) Whole-Time Director, in charge of finance;

(iii) Chief Financial Officer; or

(iv) Any other person of a company charged by the Board with duty of complying with provisions of section 128 of the Act.

PENALTY

In case the aforementioned persons referred to in Section 128(6) of the Act (i.e. MD, WTD, CFO etc.) contravene such provisions, they shall in respect of each offence, be punishable with fine which shall not be less than: fifty thousand rupees, but which may extend to five lakh rupees.

FINANCIAL STATEMENT [SECTION 129]

The financial statements shall give a true and fair view of the state of affairs of the company or companies in the form as provided for different class or classes in Schedule III and shall comply with accounting standards notified under section 133 of the Companies Act.

However, insurance companies, banking company, companies engaged in generation/ supply of electricity or any other class of companies shall make financial statements in the form as has been specified in or under the Act governing such class of companies [Proviso to Section 129(1)].

The financial statement shall be laid in the annual general meeting of that financial year [Section 129(2)].

> Any reference to the financial statement shall include any notes annexed to or forming part of such financial statement, giving information required to be given and allowed to be given in the form of such notes under the Companies Act, 2013.

Financial Statement Examples

Balance Sheet | **Income Statement** | **Cash Flow Statement** | **Statement of Profit & Loss**

FINANCIAL STATEMENT MUST GIVE TRUE AND FAIR VIEW

As per provisions of sub-sections (1) and (2) of Section 128, every financial statement of the company must give true and fair view of the state of affairs of the company at the end of financial year. True and Fair view in respect of financial statement means-

- Financial statements and items contained should comply with accounting standards notified under section 133 of the Companies Act;
- Financial statement shall be in form or forms as provided for different class or classes of companies in Schedule III;
- In case of financial statement of any insurance or 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, shall not be treated as not disclosing a true and fair view of the state of affairs of the company, merely by the reason of the fact that they do not disclose –
  - ✓ in the case of an insurance company, any matters which are not required to be disclosed by the Insurance Act, 1938, or the Insurance Regulatory and Development Authority Act, 1999;
  - ✓ in the case of a banking company, any matters which are not required to be disclosed by the Banking Regulation Act, 1949;
  - ✓ in the case of a company engaged in the generation or supply of electricity, any matters which are not required to be disclosed by the Electricity Act, 2003;
  - ✓ in the case of a company governed by any other law for the time being in force, any matters which are not required to be disclosed by that law.

Where the financial statements of a company do not comply with the accounting standards referred to in Section 129 (1), the company shall disclose in its financial statements, the deviation from the accounting standards, the reasons for such deviation and the financial effects, if any, arising out of such deviation.

At every annual general meeting of a company, the Board of Directors of the company shall lay before such meeting financial statements for the financial year.

PERSONS RESPONSIBLE FOR COMPLIANCE

The persons responsible to take all reasonable steps to secure compliance by the company with the requirement of Section 129(7) of the Act, are:

- Managing Director;
- Whole-Time Director in charge of finance;
- CFO;
- Other person of a company charged by the Board with the duty of complying with the requirements of section 129.

Where any of the aforementioned officers are absent, all the directors shall be responsible and punishable.

As per MCA vide General Circular No. 08/2014 dated 4th April 2014, the financial statements & reports (Board/ Auditor) in respect to the Financial Year, commenced before 01/04/2014 shall be governed by the Companies Act, 1956. However, the provisions of the Companies Act, 2013 shall apply to those companies in respect to the FY commencing on or after 01/04/2014.

PENALTY

The Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of this section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

In case persons referred to in section 129 (7) fail to take reasonable steps to secure compliance or contravene provisions of Section 129 of the Act, they shall in respect of each offence be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees or with both.

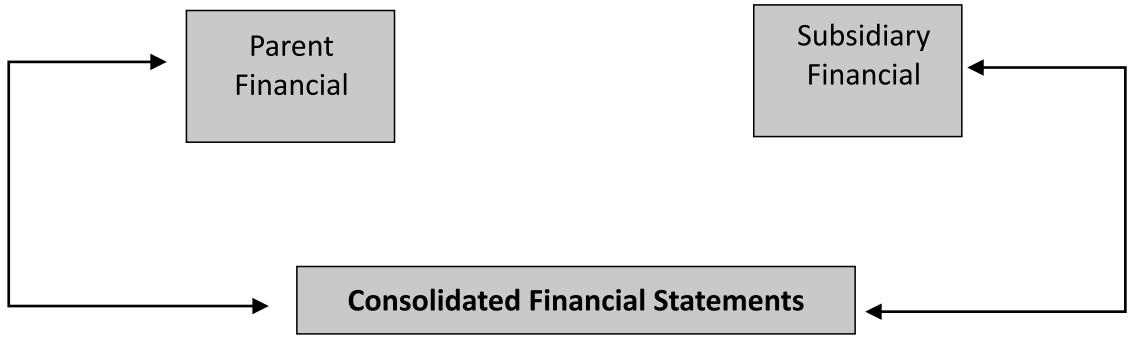
In case of Government Company - Section 129 shall not apply to the extent of application of Accounting Standard 17 (Segment Reporting) to the companies engaged in defense production. - Notification dated 5th June, 2015.

FORM OF FINANCIAL STATEMENTS (SCHEDULE III)

The financial statements shall be in the form or forms as may be provided for different class or classes of companies. Schedule III contains general instructions for preparation of balance sheet and statement of profit and loss account.

CONSOLIDATED FINANCIAL STATEMENTS

The Companies Act, 2013 has made preparation of consolidated accounts mandatory for all companies including unlisted companies and private companies having one or more subsidiaries or associates or joint ventures.



According to sub-section 3 of the section 129 of the Companies Act, 2013, where a company has one or more subsidiaries or associates. It shall, in addition to its financial statements for the financial year, prepare a consolidated financial statement of the company and of all the subsidiaries and associates companies in the same form and manner as that of its own and in accordance with applicable accounting standard, which shall also be laid before the annual general meeting of the company along with the laying of its financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary/ies or associate/s or joint venture/s in **Form AOC-1** (Rule 5 of the Companies (Accounts) Rules, 2014).

Illustration:

ABC International has Rs. 5,000,000 of income and Rs. 3,000,000 of assets mentioned in its financial statement. However, ABC International also governs five subsidiaries, which has an income of Rs. 50,000,000 and assets of Rs. 82,000,000. It is not correct to just reveal the parent company financial statements when it's consolidated outcome states a Rs. 55 million company and governs Rs. 85 million of assets.

As per Indian Accounting Standard 21, the parent company shall prepare a consolidated financial statement for its group enterprise. Parent means an enterprise having one or more subsidiaries and a group of enterprise.

MANNER OF CONSOLIDATION OF ACCOUNTS [RULE 6 OF THE COMPANIES (ACCOUNTS) RULES, 2014

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and the applicable accounting standards.

Provided that in case of a company covered under sub-section (3) of section 129 of the Act, which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Provided further that nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:-

(i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

PERIODICAL FINANCIAL STATEMENTS (SECTION 129A)

The Central Government may, require such class or classes of unlisted companies, as may be prescribed,—

(a) to prepare the financial results of the company on such periodical basis and in such form as may be prescribed;

(b) to obtain approval of the Board of Directors and complete audit or limited review of such periodical financial results in such manner as may be prescribed; and

(c) file a copy with the Registrar within a period of 30 days of completion of the relevant period with such fees as may be prescribed.

RE-OPENING OF ACCOUNTS ON COURT'S OR TRIBUNAL'S ORDERS (SECTION 130)

Section 130 of the Act, provides for provisions relating to re-opening or re-casting of books of accounts of the company. Accordingly,

(i) A company shall not re-open its books of account and shall not recast its financial statements, unless an application to the tribunal or by court of competent jurisdiction, in this regard is made by any one or more of the following -

(a) the Central Government, or

(b) the Income-tax authorities, or

(c) the Securities and Exchange Board of India (SEBI), or

(d) any other statutory regulatory body or authority or any person concerned, and

(e) An order in this regard is made by a court of competent jurisdiction or the Tribunal.

(ii) The re- opening and recasting of financial statements is permitted only for the following reasons –

(a) the relevant earlier accounts were prepared in a fraudulent manner; or

(b) The affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

(iii) The Tribunal shall give the notice to-

(a) the Central Government,

(b) the Income-tax authorities,

(c) the Securities and Exchange Board,

(d) any other statutory regulatory body or authority concerned or any other person concerned and shall take into consideration the representations, if any, made by Central Government or the authorities, Securities and Exchange Board or the body or authority concerned or any other person concerned before passing any order under this section.

(iv) The accounts so revised or re-cast under this section shall be final.

No order shall be made under Section 130 (1) in respect of re-opening of books of account relating to a period earlier than eight financial years immediately preceding the current financial year.

Provided that where a direction has been issued by the Central Government under the proviso to sub-section of section 128 for keeping of books of account for a period longer than eight years, the books of account may be ordered to be re-opened within such longer period.

CASE LAW

In the matter of *Hari Sankaran (Appellant) vs. Union of India & Ors. (Respondents)* (The Supreme Court of India) dated 04/06/2019

NCLAT order of allowing re-opening of books and re-casting of financial statements of IL&FS is valid

The Supreme Court of India *inter-alia* observed that the Tribunal may, under Section 130 of the Act, pass an order of re-opening of accounts if it is of opinion that (i) the relevant earlier accounts were prepared in a fraudulent manner; or (ii) the affairs of the company were mismanaged during the relevant period casting a doubt on the reliability of the financial statements. Thus, the Tribunal would be justified in passing the order under Section 130 of the Act upon fulfillment of either of the said two conditions.

In view of the above referred legal position in addition to the reports of SFIO & ICAI, the specific observations made by the learned Tribunal while passing the order under Section 241/242 of the Companies Act and considering the fact that the Central Government has entrusted the investigation of the affairs of the company to SFIO in exercise of powers under Section 242 of the Companies Act, the Apex Court observed that it cannot be said that the conditions precedent while invoking the powers under Section 130 of the Act are not satisfied.

The Supreme Court of India upheld the order passed by NCLAT under Section 130 of the Companies Act for re- opening of the books of accounts and re-casting the financial statements of the Infrastructure Leasing & Financial Services Limited; IL&FS Financial Services Limited and IL&FS Transportation Networks Limited for the last five years, viz. from Financial Year 2012-13 to the Financial Year 2017-18 in larger public interest.

VOLUNTARY REVISION OF FINANCIAL STATEMENTS OR BOARD'S REPORT [SECTION 131]

Section 131 of the Act, allows the directors to prepare revised financial statement or a revised Board's report in respect of any of the three preceding financial years after obtaining approval of the Tribunal, if it appears to them that the company's financial statement or the Board's Report has not been complied with the requirements of Section 129 or Section 134 of the Act.

The Tribunal shall give notice to the Central Government and the Income-tax authorities and shall take into consideration the representations, if any, made by that Government or the authorities before passing any order under this section.

Such revised financial statement or report shall not be prepared or filed more than once in a financial year.

The detailed reasons for revision of such financial statement or report shall also be disclosed in the Board's report in the relevant financial year in which such revision is being made.

Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in general meeting, the revisions must be confined to—

(a) the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or section 134 of the Act; and

(b) the making of any necessary consequential alternation.

CASE LAW

It was held that in case of *American Road Technology & Solutions Pvt. Ltd. vs. Central Government CP No.43/BB/2020 NCLT Bengaluru Bench*, where company filed application for revision of financial statement in financial year 2017-2018, three preceding years for purpose of revision of financial statements would be 2016-2017, 2015-2016 and 2014-2015 (which was one of year in which incorrect financial reporting has been detected and in respect of which approval for revision has been sought), since, true and fair picture of company's finances would not emerge for financial year 2014-2015 unless financial statements for 2012-2013 and 2013-2014 were also revised, application for revision of financial statements for years 2012 to 2015 was allowed.

SIGNING OF FINANCIAL STATEMENT [SECTION 134]

The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director, if any, and the Chief

Executive Officer, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

The auditors' report shall be attached to every financial statement. A report by its Board of Directors shall also be attached to statements laid before a company in general meeting.

Test Yourself:

Question: Is it mandatory to sign financial statement from the company secretary?

Answer: As per Section 134(1), the company in which the Whole-time Company Secretary is appointed, then it is mandatory that the Financial Statement is signed from the Whole-time Company Secretary. Further if the company appointed Chief Executive Officer or Chief Financial Officer then the financial statement shall also be signed from them.

RIGHT OF MEMBER TO COPIES OF AUDITED FINANCIAL STATEMENT [SECTION 136]

According to section 136 of the Act, a copy of financial statements including consolidated financial statement, if any, auditor's report along with every other document required by law to be annexed or attached to the financial statements which are to be laid before a company in its general meeting, shall be sent to every member of the Company, every trustee for the debenture holder and all other persons who are so entitled, not less than twenty one days before the date of the meeting.

The copies of the documents can be sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by members –

(a) In case of the company having share capital, majority in number entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(b) In case of company not having share capital, not less than ninety-five per cent of the total voting power exercisable at the meeting.

Exceptions:

In case of section 8 company - A copy of financial statements including consolidated financial statement, if any, auditor's report along with every other document required by law to be annexed or attached to the financial statements which are to be laid before a company in its general meeting, shall be sent to every member of the Company, to every trustee for the debenture holder and all other persons who are so entitled, not less than fourteen days before the date of the meeting – *Notification dated 5th June, 2015*.

In case of Nidhi company - Section 136 (1) shall apply, subject to the modification that, in the case of members who do not individually or jointly hold shares of more than one thousand rupees in face value or more than one per cent, of the total paid-up share capital whichever is less, it shall be sufficient compliance with the provisions of the section if an intimation is sent by public notice in newspaper circulated in the district in which the Registered Office of the Nidhi is situated stating the date, time and venue of Annual General Meeting and the financial statement with its enclosures can be inspected at the registered office of the company, and the financial statement with enclosures are affixed in the Notice Board of the company and a member is entitled to vote either in person or through proxy – *Notification dated 5th June, 2015*.

OBLIGATION OF LISTED COMPANY

In the case of a company whose shares are listed on a recognized stock exchange, provisions of section 136 shall be deemed to have been complied with, if the copies of the documents are made available for inspection at its registered office, during working hours, for a period of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form [**Form AOC-3**] or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty-one days before the date of the meeting.

The Companies which are required to comply with Companies (Indian Accounting standards) Rules, 2015 shall forward their statement in **Form AOC-3A**.

MANNER OF CIRCULATION OF FINANCIAL STATEMENTS IN CERTAIN CASES – RULE 11 OF THE COMPANIES (ACCOUNTS) RULES, 2014

Further in case of all listed companies and such public companies which have a net worth of more than one crore rupees and turnover of more than ten crore rupees, the financial statements may be sent-

(a) By electronic mode to such members whose shareholding is in dematerialized format and whose email ids are registered with Depository for communication purposes;

(b) Where shareholding is held otherwise than by dematerialized format, to such members who have positively consented in writing for receiving by electronic mode; and

(c) By dispatch of physical copies through any recognized mode of delivery as specified under section 20 of the Companies Act, 2013, in all other cases.

Every listed company is also required to place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

- According to Regulation 29 of SEBI (LODR) Regulations, 2015, the listed entity shall give prior intimation to stock exchange about the meeting of the board of directors regarding financial results viz. quarterly, half yearly, or annual, as the case may be.
- Intimation shall be given at least five days in advance (excluding the date of the intimation and date of the meeting), and such intimation shall include the date of such meeting of board of directors.
- Every listed company having a subsidiary or subsidiaries shall place separate audited accounts in respect of each of subsidiary on its website, if any.
- A listed company which has a subsidiary incorporated outside India (herein referred to as "foreign subsidiary")—
  - (a) where such foreign subsidiary is statutorily required to prepare consolidated financial statement under any law of the country of its incorporation, the requirement of this proviso shall be met if consolidated financial statement of such foreign subsidiary is placed on the website of the listed company;
  - (b) where such foreign subsidiary is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the holding Indian listed company may place such unaudited financial statement on its website and where such financial statement is in a language other than English, a translated copy of the financial statement in English shall also be placed on the website.

FINANCIAL STATEMENTS OF SUBSIDIARIES

Every company having a subsidiary or subsidiaries shall provide a copy of separate audited or unaudited financial statements, as the case may be, as prepared in respect of each of its subsidiary to any member of the company who asks for it.

RIGHT TO INSPECT

Every company shall be under an obligation to allow every member or trustee of the holder of any debentures issued by the company to inspect the financial statements and documents to be attached thereto at its registered office during business hours.

In case if the listed company has sent the salient features of financial statements to members and debenture trustees in prescribed form then copy of financial statements including consolidated financial statement, if any, auditor's report along with every other document required by law to be annexed or attached to the financial statements shall be available for inspection at its registered office during working hours for a period of 21 days before the date of meeting.

PENAL PROVISIONS

If any default is made in complying with the provisions of Section 136 of the Act, the company shall be liable to a penalty of –

(i) Twenty-five thousand rupees; and

(ii) Every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

COPY OF FINANCIAL STATEMENT TO BE FILED WITH REGISTRAR [SECTION 137]

Section 137 of the Act, requires every company to file the financial statements including consolidated financial statement together with Form AOC- 4 and AOC-4 (CFS) with the Registrar of Companies (RoC) within 30 days from the day on which the annual general meeting held and adopted the financial statements with such fees or additional fee as specified in Companies (Registration Offices and Fees) Rules, 2014.

If the financial statements are not adopted at the annual general meeting or adjourned annual general meeting, such unadopted financial statements along with the required documents be filed with the RoC with in thirty days of the date of annual general meeting. The RoC shall take them in his record as provisional, until the adoption at annual general meeting.

Financial statements adopted in the adjourned annual general meeting shall be filed with the Registrar within thirty days of the date of such adjourned annual general meeting with such fees or such additional fees as may be prescribed.

The One Person Company shall file the copy of financial statements duly adopted by its member within a period of one hundred and eighty days from the closure of financial year.

The company shall also attach the accounts of subsidiaries incorporated outside India and which have not established their place of business in India with the financial statements.

Provided also that in the case of a subsidiary which has been incorporated outside India (herein referred to as "foreign subsidiary"), which is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the requirements of the fourth proviso (accounts of subsidiaries) shall be met if the holding Indian company files such unaudited financial statement along with a declaration to this effect and where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.

Where the annual general meeting of a company for any year has not been held, the financial statements along with the documents required to be attached, duly signed along with the statement of facts and reasons for not holding the annual general meeting shall be filed with the Registrar within thirty days of the last date before which the annual general meeting should have been held and in such manner, with such fees or additional fees as prescribed.

The class of companies as may be notified by the Central Government from time to time, shall mandatorily file their financial statement in Extensible Business Reporting Language (XBRL) format and the Central Government may specify the manner of such filing under such notification for such class of companies [Rule 12(2) of the Companies (Accounts) Rules, 2014].

RULE 3 OF THE COMPANIES (FILING OF DOCUMENTS AND FORMS IN XBRL) RULES, 2015

The following class of companies shall file their financial statements and other documents under section 137 of the Act with the Registrar in e-Form AOC-4 XBRL:

(i) companies listed with stock exchanges in India and their Indian subsidiaries;

(ii) companies having paid up capital of five crore rupees or above;

(iii) companies having turnover of one hundred crore rupees or above;

(iv) all companies which are required to prepare their financial statements in accordance with Companies (Indian Accounting Standards) Rules, 2015.

Provided that the companies preparing their financial statements under the Companies (Accounting Standards) Rules, 2006 shall file the statements using the Taxonomy provided in Annexure-II and companies preparing their financial statements under Companies (Indian Accounting Standards) Rules, 2015, shall file the statements using the Taxonomy provided in Annexure-II A of the Companies (Filing of Documents and Forms in XBRL) Rules, 2015.

Further non-banking financial companies, housing finance companies and companies engaged in the business of banking and insurance sector are exempted from filing of financial statements under these rules.

The companies which have filed their financial statements under sub-rule (1) of Rule 3 of XBRL Rules, shall continue to file their financial statements and other documents though they may not fall under the class of companies specified therein in succeeding years.

The companies which have filed their financial statements under the erstwhile rules, namely the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2011, shall continue to file their financial statements and other documents as prescribed in Rule 3(1) of XBRL Rules though they do not fall under the class of companies specified therein.

PENALTY FOR NON COMPLIANCE

If company fails to comply with the requirement of submission of financial statement with RoC:

- the company shall be liable to a penalty of: Rs.10,000 and in case of continuing failure, with a further penalty of Rs.100 for each day during which such failure continues, subject to a maximum of Rs. 2 lakhs, and
- the Managing Director and the Chief Financial Officer of the company, if any, and, in the absence of the Managing Director and the Chief Financial Officer, any other director who is charged by the Board with the responsibility of complying with the provisions of section 137, and, in the absence of any such director, all the directors of the company, shall be liable to a penalty of Rs.10,000 and in case of continuing failure, with further penalty of Rs.100 for each day after the first during which such failure continues, subject to a maximum of Rs.50,000.

NATIONAL FINANCIAL REPORTING AUTHORITY (NFRA)

Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Authority for Financial Reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards. It was constituted on 01st October, 2018. The erstwhile Companies Act, 1956 has empowered the Central Government to form a Committee for recommendations on Accounting Standards which is National Advisory Committee on Accounting Standards (NACAS). This has now been renamed with enhanced independent oversight powers and authority as National Financial Reporting Authority (NFRA).The National Financial Reporting Authority performs its functions through such divisions as may be prescribed.

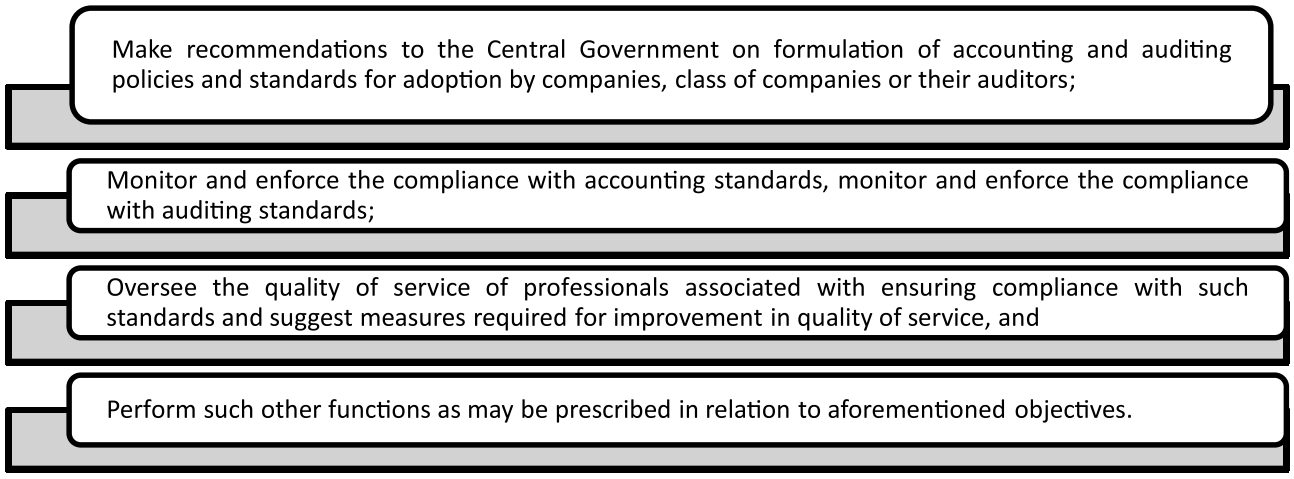
NFRA is responsible for monitoring and enforcing compliance of auditing and accounting standards and for that purpose, oversee the quality of professions associated with ensuring such compliances. The Authority has power to investigate professional and other misconducts which may be committed by Chartered Accountancy members and firms. There is also a provision for appellate authority.

The National Financial Reporting Authority is a quasi – judicial body to regulate matters related to accounting and auditing. With increasing demand of non–financial reporting, it may be referred to as a National level business Reporting Authority to regulate standards of all kind of reporting- financial as well as non–financial, by the companies in future.

National Financial Reporting Authority shall give its recommendations on accounting standards and auditing standards. It shall only recommend and it is the Central Government who shall prescribe such standards.

OBJECTIVES OF NFRA

The objectives of National Financial Reporting Authority *inter alia* shall be as follows:



CONSTITUTION OF NFRA

The constitution of National Financial Reporting Authority (NFRA), which is supposed to be constituted as an oversight regulatory body to recommend accounting and auditing standards, is governed by sub-section and (4) of section 132 of the Act. Accordingly,

(i) It consists of a chairperson, who shall be a person of eminence & having expertise in accountancy, auditing, finance, or law, to be nominated by Central Government, and such other prescribed members not exceeding 15 consisting of part-time and full-time members as prescribed.

(ii) Each division of the National Financial Reporting Authority shall be presided over by the Chairperson or a full-time Member authorized by the Chairperson.

(iii) There shall be an executive body of the National Financial Reporting Authority consisting of the Chairperson and full-time Members of such Authority for efficient discharge of its functions under sub-section (2) of Section 132 of the Act [other than clause (a)] and sub-section (4) of Section 132 of the Act. Provided that the terms and conditions and the manner of appointment of the chairperson and members shall be such as prescribed.

(iv) The chairperson and all members shall make a declaration in prescribed form about no conflict of interest or lack of independence in respect of their appointment. The chairperson and all full–time members shall not be associated with any audit firm or related consultancy firm during course of their appointment and two years after ceasing to hold such appointment.

(v) The Central Government may appoint a secretary and such other employees as it may consider necessary for the efficient performance of functions by the National Financial Reporting Authority under the Companies Act, 2013 and the terms and conditions of service of the secretary and employees shall be such as prescribed.

(vi) The head office of National Financial Reporting Authority is at New Delhi and it may, meet at such other places in India, as it deems fit.

(vii) The National Financial Reporting Authority shall meet at such times and places and shall observe such rules of procedure in regard to the transaction of business at its meetings in such manner as prescribed.

MAINTENANCE OF BOOKS AND ACCOUNTS

The National Financial Reporting Authority shall cause to be maintained such books of account and other books in relation to its accounts in such form and in such manner as the Central Government may, in consultation with the Comptroller and Auditor-General of India prescribe.

AUDIT OF NFRA AND ANNUAL REPORT TO CENTRAL GOVERNMENT

The accounts of the National Financial Reporting Authority is required be audited by the Comptroller and Auditor General of India at such intervals as may be specified by him and such accounts as certified by the Comptroller and Auditor General of India together with the audit report thereon shall be forwarded annually to the Central Government by the National Financial Reporting Authority.

The National Financial Reporting Authority shall prepare in such form and at such time for each financial year as may be prescribed its annual report giving a full account of its activities during the financial year and forward a copy thereof to the Central Government and the Central Government shall cause the annual report and the audit report given by the Comptroller and Auditor General of India to be laid before each House of Parliament.

JURISDICTION, POWERS OF AND IMPOSITION OF PENALTIES BY NFRA

The National Financial Reporting Authority have the power to investigate, either *suo moto* or on a reference made to it by the Central Government, for such class of bodies corporate or persons, in such manner as prescribed into the matters of professional or other misconduct committed by any member or firm of chartered accountants, registered under the Chartered Accountants Act, 1949.

Provide that no other institute or body shall initiate or continue any proceedings in such matters of misconduct where the National Financial Reporting Authority has initiated an investigation under Section 132 of the Companies Act, 2013.

Powers of National Financial Reporting Authority:

1. **Power of investigation:** NFRA has the power to investigate either on suo-moto or on reference by Central Government for such class of body corporates or persons as may be prescribed into the matter of professional or other misconduct committed by any member or firm of Chartered Accountants registered under the Chartered Accountants Act, 1949.

2. **Power of civil court:** The Authority shall have powers as are vested in a civil court under Code of Civil Procedure, 1908 in respect of following matters:

   (a) Discovery and production of books of accounts and other documents at such place and at such time as may be specified by the National Financial Reporting Authority;

   (b) Summoning and enforcing the attendance of persons and examining them on oath;

   (c) Inspection of any books, registers and other documents of any person;

   (d) Issuing commission for examination of witness or documents.

3. **Power of imposing a penalty or debarring a member for professional or other misconduct:** Where professional or other misconduct is proved, the Authority shall have powers to make an order in relation to:

   A. Imposing penalty of:

      (i) not less than one lakh rupees which may extend to five times of the fees received in case of individuals; and

      (ii) not less than five lakh rupees which may extend to ten times of the fees received in case of firms.

   B. Debarring member or the firm from:

      (i) being appointed as an auditor or internal auditor or undertaking any audit in respect of financial statements or internal audit of the functions and activities of any company or body corporate; or

      (ii) Performing any valuation as provided under section 247;

for a minimum period of six months or such higher period not exceeding ten years as may be determined by the National Financial Reporting Authority.

APPEALS AND APPELLATE AUTHORITY

Any person aggrieved by any order of the National Financial Reporting Authority may prefer appeal before the Appellate Tribunal in prescribed manner and on payment of such fee as prescribed.

CENTRAL GOVERNMENT TO PRESCRIBE ACCOUNTING STANDARDS- [SECTION 133]

The Central Government may prescribe the standards of accounting or any addendum thereto, as recommended by the Institute of Chartered Accountants of India, constituted under section 3 of the Chartered Accountants Act, 1949, in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. The Ministry has subsequently clarified that till the Standards of Accounting or any addendum thereto is prescribed by Central Government in consultation and recommendation of the National Financial Reporting Authority, the existing Accounting Standards notified under the Companies Act 1956 shall continue to apply.

On 6th February 2015 the Ministry of Corporate Affairs (MCA), the Central Government, in consultation with the National Advisory Committee on Accounting Standards (NACAS), notified the Companies (Indian Accounting Standards) Rules, 2015. These rules came into force on 1st April 2015.

As a result of this notification, notifying the Companies (Indian Accounting Standards) Rules, 2015, there shall be two separate sets of Accounting Standards –

1. Indian accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015.
2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.

Indian Accounting Standards (Ind AS)

Indian Accounting Standards (Ind AS) are the accounting standards prescribed under Section 133 of the Companies Act, 2013. Indian Accounting Standards (Ind AS) are specified in the Annexure to the Companies (Indian Accounting Standards) Rules, 2015. These accounting standards are converged with corresponding International Financial Reporting Standards.

Applicability under Rule 3 of the Companies (Indian Accounting Standards) Rules, 2015

1. Indian Accounting Standards (Ind AS) as specified in the Annexure to Companies (Indian Accounting Standards) Rules, 2015.	• Applicable to classes of company specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.
2. Accounting standards as specified in Annexure to the Companies (Accounting Standards) Rules, 2006.	• Applicable to the companies other than the classes of companies specified in Rule 4(1) of the Companies (Indian Accounting Standards) Rules, 2015.

Applicability	***w.e.f.***
Mandatory basis for the accounting periods beginning on or after April 1, 2016 with the comparatives for the periods ending on 31st March, 2016, or thereafter.	Rule 4(1)(ii)- The following companies shall mandatorily comply with Ind AS namely:- • Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange (except SME Exchange) in India or outside India and having net worth of rupees five hundred crore or more; • Unlisted companies having net worth of rupees five hundred crore or more; • holding, subsidiary, joint venture or associate companies of companies covered above.

Mandatory basis for the accounting periods beginning on or after April 1, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter.	Rule 4(1)(iii)- The following companies shall comply Ind AS namely:- ● Companies whose equity or debt securities are listed or are in the process of being listed on any stock exchange (except SME Exchange)in India or outside India and having net worth of less than rupees five hundred crore; ● Unlisted companies having net worth of rupees two hundred and fifty crore or more but less than rupees five hundred crore; ● holding, subsidiary, joint venture or associate companies of companies covered above.
In case of NBFCs, for accounting periods beginning on or after the 1st April, 2018, with comparatives for the periods ending on 31st March, 2018, or thereafter.	Rule (4)(1)(iv)(a)The following NBFCs shall comply with the Ind (AS): (A) NBFCs having net worth of rupees five hundred crore or more; (B) holding, subsidiary, joint venture or associate companies of companies covered under item (A).
In case of NBFCs, for accounting periods beginning on or after the 1st April, 2019, with comparatives for the periods ending on 31stMarch, 2019, or thereafter.	Rule (4)(1)(iv)(b)The following NBFCs shall comply with the Ind (AS): (A) NBFCs whose equity or debt securities are listed or in the process of listing on any stock exchange in India or outside India and having net worth less than rupees five hundred crore; (B) NBFCs, that are unlisted companies, having net worth of rupees two-hundred and fifty crore or more but less than rupees five hundred crore; and (C) holding, subsidiary, joint venture or associate companies of companies covered under item or item (B).

Companies exempted under Rule 5 of the Companies (Indian Accounting Standards) Rules, 2015

The Companies (Indian Accounting Standards) Rules, 2015 shall not be applicable on Banking Companies and Insurance Companies. The Banking Companies and Insurance Companies shall apply the Ind AS as notified by the Reserve Bank of India (RBI) and Insurance Regulatory Development Authority (IRDA) respectively. An insurer or insurance company shall however, provide Ind AS compliant financial statement data for the purposes of preparation of consolidated financial statements by its parent or investor or venturer, as required by the parent or investor or venturer to comply with the requirements of these rules.

The Companies (Accounting Standards) Rules, 2021 for Small and Medium sized Companies

The MCA vide notification dated June 23, 2021 has notified the Companies (Accounting Standards) Rules, 2021 for Small and Medium sized companies (SMCs), with which the turnover and borrowing limits has been revised as well as disclosure requirements has been made less onerous for SMCs.

The revised definition of "Small and Medium Sized Company" (SMC) means, a company-

(i) whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;

(ii) which is not a bank, financial institution or an insurance company;

(iii) whose turnover (excluding other income) does not exceed two hundred and fifty crore rupees in the immediately preceding accounting year;

(iv) which does not have borrowings (including public deposits) in excess of fifty crore rupees at any time during the immediately preceding accounting year; and

(v) which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation.- For the purposes of this clause, a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

The main objective was to mirror the existing accounting standards under the Companies Act, 1956, in the 2013 Act, and while doing so, the SMC definition, which has since been revised, has also been revised in the accounting standards.

AUDITORS- APPOINTMENT, RESIGNATION AND PROCEDURE RELATING TO REMOVAL, QUALIFICATION AND DISQUALIFICATION

An auditor is a person who is authorized to review and verify the accuracy of financial records and ensure that the financial statements represent true and fair view of the state of affairs of the company. The Auditor protects businesses from fraud, point out discrepancies in accounting methods and, on occasion, work on a consultancy basis, helping organizations to spot ways to boost operational efficiency. The Auditors work in various capacities within different industries.

APPOINTMENT OF AUDITORS (SECTION-139)

The Board of Directors of a company shall appoint an individual or firm as the first auditor of a company, other than a Government company, within 30 days from the date of registration of the company. In the case of failure of the Board to appoint the first auditor, it shall inform the members of the company, who shall within 90 days at an extraordinary general meeting appoint such auditor and such auditor shall hold office till the conclusion of the first annual general meeting of the company.

Every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold the office from the conclusion of that meeting till the conclusion of sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

If at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

MANNER AND PROCEDURE OF SELECTION AND APPOINTMENT OF AUDITORS

In case of a company that is required to constitute an Audit Committee under section 177 of the Act, such committee, and, in cases where such a committee is not required to be constituted, the Board shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company.

- While considering the appointment of auditor, the Audit Committee or the Board, as the case may be, shall consider any pending proceeding relating to professional matters of conduct against the proposed auditor before the ICAI or any competent authority or any Court. Further they may call for such other information from the proposed auditor as it may deem fit.
- Where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the AGM for appointment.
- If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of auditor to the members in the AGM otherwise; it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- Thereafter if the Audit Committee decides not to reconsider its original recommendation, then Board shall record reasons for its disagreement with the Audit committee and send its own recommendation for consideration of the members in the AGM and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the AGM.
- The auditor appointed in the AGM meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

CONDITIONS FOR APPOINTMENT AND NOTICE TO REGISTRAR [RULE 4 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014

As per second proviso of section 139(1) of the Act read with rule 4 stipulates that written consent of the auditor must be taken before appointment. The auditor appointed shall submit a certificate that:

a) the individual/firm is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;

b) the proposed appointment is as per the term provided under the Act;

c) the proposed appointment is within the limits laid down by or under the authority of the Act;

d) The list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

The Certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Act.

The Company shall inform the auditor concerned of his or its appointment and also file a notice of such appointment with the Registrar in Form ADT-1 within 15 days of the meeting in which the auditor is appointed.

APPOINTMENT OF AUDITOR IN GOVERNMENT COMPANY- SECTION 139(5) & 139(7)

The appointment of auditor in Government Company or government controlled (directly/indirectly) company shall be held in accordance with the following provisions:

The First auditor shall be appointed by the Comptroller and Auditor General within 60 days from the date of incorporation and in case of failure to do so, the Board shall appoint auditor within next 30 days and on failure to do so by Board of Directors, it shall inform the members, who shall appoint the auditor within 60 days at an extraordinary general meeting (EGM), such auditor shall hold office till conclusion of first Annual General Meeting.

In case of subsequent auditor for existing Government Companies, the Comptroller & Auditor General shall appoint the auditor within a period of 180 days from the commencement of the financial year and the auditor so appointed shall hold his position till the conclusion of the Annual General Meeting.

MANDATORY ROTATION OF AUDITORS

The Companies Act, 2013 has introduced the system of rotation of auditors under section 139 (2) of the Act and Rule 5 which is applicable to-

- all listed companies;
- all unlisted public companies having paid up share capital of rupees 10 crore or more;
- all private limited companies having paid up share capital of rupees 50 crore or more;
- all companies having paid up share capital of below threshold limit mentioned in (a) and (b) above, but having public borrowings from financial institutions, banks or public deposits of rupees 50 crore or more;
- The concept of rotation of auditors shall not apply to one person companies and small companies;
- All the companies mentioned above shall not appoint or re-appoint an individual as an auditor of the company for more than one term of 5 consecutive years. An individual auditor, who has completed his term of 5 consecutive years, shall not be eligible for re-appointment as auditor in the same company for 5 years from the date of completion;
- All the companies mentioned above shall not appoint or re-appoint an audit firm as an auditor of the company for more than two terms of 5 consecutive years. An audit firm which has completed its two terms of 5 consecutive years shall not be eligible for re-appointment as auditor in the same company for 5 years from the completion of such terms.

Example:

M/s AD & Associates was auditor of M/s ABC Limited (Listed Company) and has rendered his services for 5 years. The firm is not eligible for reappointment. Even in case where, Mr. D, partner of M/s AD & Associates is also partner of M/s SD & Co. Therefore M/s SD & Co. cannot be appointed as auditor of M/s ABC Limited.

As on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years.

The right of the company to remove the auditor or the right of the auditor to resign from such office of the company is not affected by this sub-section. Thus, an auditor can resign or be removed by the shareholders before completion of his term as discussed above. The firm shall include a Limited Liability Partnership incorporated under the Limited Liability Partnership Act, 2008.

ROTATION OF AUDITORS [SECTION 139(3)]

Members of a company subject to provisions of the Act, can provide for following by passing a resolution:

(a) In the audit firm appointed by it, the auditing partner and his team shall be rotated at such intervals as may be resolved by members; or

(b) The audit shall be conducted by more than one auditor.

ROTATION OF AUDITORS ON EXPIRY OF THEIR TERM [SECTION 139 (4) AND RULE 6 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]

Rotation of auditors on expiry of auditor's term then same procedure will be followed as required for appointment of auditors. The procedure is as under:-

1. The Audit Committee shall recommend to the Board, the name of an individual auditor or of an audit firm who may replace the incumbent auditor on expiry of the term of such incumbent.
2. Where a company is required to constitute an Audit Committee, the Board shall consider the recommendation of such committee, and in other cases, the Board shall itself consider the matter of rotation of auditors and make its recommendation for appointment of the next auditor by the members in annual general meeting.

For the purpose of rotation, the period for which the auditor is holding office prior to the commencement of this Act will also be counted in calculating the period of 5 years or 10 years as the case may be. The incoming auditor/audit firm shall not be eligible if such auditor/audit firm is associated with the outgoing auditor/audit firm under the same network of audit firms i.e. includes the firms operating/ functioning under the same brand name, trade name or common control, hitherto or in future.

If a partner, who is in charge of an audit firm and also certifies the financial statements of the company, retires from the said firm and joins another firm of chartered accountants, such other firm shall also be ineligible to be appointed for a period of five years.

Where a company has appointed two or more persons as joint auditors, the company may follow the rotation of auditors in such a manner that both or all of the joint auditors, as the case may be, do not complete their term in the same year.

RE-APPOINTMENT OF RETIRING AUDITOR [SECTION 139 (9)]

At any annual general meeting, a retiring auditor shall be reappointed as auditor of the company except under the following circumstances:

(a) He is not qualified for re-appointment;

(b) He has given the company a notice in writing of his unwillingness to be re-appointed; and

(c) A special resolution has not been passed at that meeting appointing somebody else instead of him or providing expressly that retiring auditor shall not be re-appointed.

Section 139 (10) lays that where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

CASUAL VACANCY IN THE OFFICE OF AUDITOR [SECTION 139 (8)]

The provisions for filling of casual vacancy in the office of auditor are as follows:

(a) The Board of the company shall have power to fill the casual vacancy in the office of auditor within 30 days.

(b) In case casual vacancy has occurred due to resignation of auditor, such appointment should also be approved by the company in general meeting convened within 3 months of the recommendation of the Board and auditor shall hold the office till the conclusion of the next annual general meeting.

(c) In case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor General of India, such vacancy should be filled by the Comptroller and Auditor General of India within 30 days. In case the Comptroller and Auditor General of India does not fill the vacancy within the said period, the Board of Directors shall fill the vacancy within next 30 days.

(d) Appointment of auditors to fill casual vacancy shall be made after taking into account the recommendation of the audit committee.

Summary			
Particulars	***Non-Government Company/Non Specified Class of Companies***	***Listed/Specified Class of Companies***	***Government Company***
Appointment of 1st Auditor after Incorporation	By BOD (Within 30 days from the date of Registration.) Or By Members at EGM (Within-90 days of Information) First auditor shall hold office till the conclusion of the first AGM	BY BOD (Within-30 days from the date of Registration.) Or By Members at EGM (Within-90 days of Information) First auditor shall hold office till the conclusion of the first AGM	BY CAG (Within-60 days from the date of Registration.) Or In case the CAG does not appoint such auditor within the given period BOD (within-30 days) Or In case of failure of the BoD to appoint such auditor within the given period Member at EGM (Within-60 days of Information) First auditor shall hold office till the conclusion of the first AGM
Subsequent Auditor The written consent and a certificate (appointment shall be in accordance with the conditions) from the auditor.	By Members To hold office till conclusion of every 6th AGM.	By Members (for maximum one term of 5/10 consecutive years) Cooling off period of 5 years before next re-appointment	By CAG (Within-180 days from 1st April)

Casual Vacancy due to • Resignation • Other Reasons	Approved by Members within 3 months of recommendation of Board and hold office till next AGM. BOD within 30 days	Approved by Members within 3 months of recommendation of Board and hold office till next AGM. BOD within 30 days	By CAG within 30 days Or By BOD within next 30 days

Illustrations:

A. In case of Non-Government Companies:

Mr. A is appointed as auditor of M/s XYZ Limited (Non-government Company) on 01st January, 2021. Casual Vacancy is caused due to his resignation on 1st August, 2021.

In this case, casual vacancy shall be filled by the Board till 30th September, 2021. The same must be approved by the company within 3 months of the recommendations of the board.

B. In case of Government Company:

Mr. A is appointed as auditor of M/s XYZ Limited (Government Company) on 01st January, 2021. Casual Vacancy is caused due to his resignation on 1st August, 2021.

In this case, casual vacancy shall be filled by the Comptroller and Auditor General of India till 30th September, 2021.

APPOINTMENT OF AUDITOR OTHER THAN RETIRING AUDITOR BY SPECIAL NOTICE [SECTION 140 (4)]

Special notice shall be required from members proposing to move a resolution at the next annual general meeting to appoint a person other than the retiring auditor or to provide that the retiring auditor shall not be re- appointed.

Such special notice shall not be required in case where the retiring auditor has completed a consecutive tenure of five years or, as the case may be, ten years, as provided under sub-section (2) of section 139. Following points are relevant for the purpose of special notice:

(i) Company, on receipt of such special notice for removing auditor, should forthwith send a copy of the same to the retiring auditor.

(ii) If the auditor makes a representation in writing to the company and requests for its notification to the members, the company shall:

  (a) state the fact of representation in any notice of resolution, and

  (b) Send copy of representation to members to whom notice of meeting is sent, whether before or after the receipt of representation by the company,

  (c) If the copy of representation is not so sent, copy thereof should be filed with the Registrar.

(iii) Such representation should be of a reasonable length and not too long.

(iv) For circulation to members, it should not be received by the company too late.

(v) Auditor may require the company to read out the representation in the meeting if it is not so notified to members because it was too late or because of company's default.

Provided that if the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by this sub- section are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

POWERS OF TRIBUNAL [SECTION-140 (5)]

A National Company Law Tribunal (NCLT) can either:

on *suo-moto*; or	on an application from Central Government; or	on an application from person concerned.

Can direct the company to change the auditor if it is satisfied that the Auditor of a Company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers.

In the case of application being made by the Central Government and the NCLT being satisfied that change of auditor is required, it shall within 15 days of the receipt of such application, make an order that the Auditor shall not function as an auditor of the company and the Central Government may appoint another auditor in his place. This will happen only when an application is made by the Central Government and not by any other person.

Where the auditor, whether individual or firm, against whom the final order as aforementioned is passed by the NCLT under this section, he shall not be eligible to be appointed as an auditor of any company for a period of 5 years from the date of passing of such order. Further, the auditor shall also be liable for action under Section 447 of the Act which provides for punishments for frauds.

It has been clarified by way of explanation that in case a firm is appointed as auditor of the company, the liability shall be of the firm and every partner or partners who acted in fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers shall be liable and not be eligible to be appointed as auditor of any company for a period of 5 years.

CASE LAW

In the case of *Union of India and another vs. Deloitte Haskins and Sells LLP & Anr.,* Supreme Court Criminal appeal nos. 2305-2307 of 2022, 03.05.2023 the Apex Court held that the subsequent resignation of an auditor after the application is filed under section 140(5) by itself shall not terminate the proceedings under section 140(5). Resignation and/or removal of an auditor cannot be said to be an end of the proceedings under section 140(5).

The Supreme Court upheld the constitutional validity of Section 140(5) of the Companies Act, 2013 and held that the provision is "neither discriminatory, arbitrary and/or violative of Articles 14, 19(1)(g) of the Constitution of India". It is required to be noted that the role of auditors cannot be equated with directors and/or management. Auditors play very important role in the affairs of the company and therefore they have to act in the larger public interest and all other stakeholders including investors etc. Chapter X of the Act specifically for the "Audit and Auditors" looking to the importance of the auditors. Therefore, section 140(5) cannot be said to be discriminatory and/or violative of Article 14 of the Constitution of India.

REMOVAL OF AUDITOR [SECTION 140 (1)] AND RULE 7 OF THE COMPANIES (AUDIT AND AUDITORS RULES, 2014]

The auditor appointed under section 139 of the Act may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the prior approval of the Central Government in that behalf in the manner prescribed in Rule 7.

As per Rule 7, the auditor appointed under section 139 of the Act, may be removed from his office before the expiry of the term only by –

(i) Obtaining the prior approval of the Central Government by filling an application in **Form ADT-2** within 30 days of resolution passed by the Board.

(ii) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

(iii) The auditor concerned shall be given a reasonable opportunity of being heard.

CASE LAWS

1. It was held in case *of SPC & Associates (Chartered Accountants) vs. DVAK & Co. (2017) 138 CLA 188 (NCLT Hyd),* that where company appointed petitioner CA firm as its statutory auditor for the period of 5 years but did not ratify their appointment in its subsequent AGM and appointed another CA form as its statutory auditor, since company did not obtain prior approval of Central Government, the removal of petitioner was to be held illegal.
2. It was held in the case of *Pipara & Co, LLP vs. Gujarat State Police Housing Corporation Ltd, C/SCA/7342/ 2021 NCLT Ahmedabad,* that without giving opportunity of hearing CAG appointed statutory auditor cannot be terminated before the term.
3. *HGR Logistics Private Limited vs. Kishor Goyal & Co. Regional Director, North-Western Region, Ahmedabad. Application No. RD (NWR)/Sec.140/113/2020/33* removal of Statutory Auditor of Company by Regional Director upon complaint made by the company against Statutory Auditor for not conducting its audit in time.

Facts of the Case :

HGR Logistics Private Limited has filed an online application seeking approval for removal of its Statutory Auditors under Section 140 (1) of the Companies Act, 2013 by filing e-form no. ADT-2 on 20.02.2021. The company has stated in its application that it has faced heavy penalties because the auditor was not able to conduct the audit in timely manner. The company also stated that the auditor was unwilling to visit the company even after multiple request made by the company. This creates the deadlock for the company as the auditor was not completing the audit nor was resigning from the company.

On the other hand, the auditor of the company claimed that they were unable to complete the audit as the company had not provided them with the financial information necessary to conduct the audit.

In this regard, ROC, Ahmedabad has submitted its report in the aforesaid matter vide letter dated 30th March, 2021. ROC in its report stated that the company has filed its last Balance sheet for the year ended as on 31.03.2019 and has failed to file Balance sheet for the year ending as at 31.03.2020 and relevant annual returns as per the requirement of Section 137(1) and Section 92(4) of the Companies Act, 2013. As the company/officers have violated the aforesaid provisions the adjudication u/s 454 of the Act is under process.

Decision :

After careful examination of the application made under section 140(1) of the Companies Act and considering all the averments made by both the parties, the application filed by the company for removal of auditor deserves to be approved as the auditor could not establish or satisfy the authority as to why he should not be removed and why he should be continued as the auditor in the company even after complete loss of trust between both the parties. Thus, the matter has been decided on merits and in the interest of justice.

Hence, exercising powers vested with the Regional Director u/s 140 (1) of the Companies Act, 2013 as per the Notification No. S.O. 4090 (E) dated 19-12-2016, and having regards to all the facts & circumstances, the application for removal of statutory auditors, under Section 140 (1) is hereby approved. The application stands disposed of with these orders.

RESIGNATION OF AUDITOR [SECTION 140(2), 140 (3) AND RULE 8 OF THE COMPANIES (AUDIT AND AUDITORS) RULES, 2014]

The auditor who has resigned from the company shall file a statement in Form **ADT-3** indicating the reasons and other facts as may be relevant with regard to his resignation as follows:

(i) In case of other than Government Company, the auditor shall within 30 days from the date of resignation, file such statement to the company and the Registrar.

(ii) In case of Government Company or government controlled company, auditor shall within 30 days from the resignation, file such statement to the company and the Registrar and also file the statement with the Comptroller and Auditor General of India (CAG).

If the auditor does not comply with the provisions of section 140(2) of the Act, he or it shall be liable to a penalty of:

(i) fifty thousand rupees or

(ii) an amount equal to the remuneration of the auditor,

whichever is less.

In case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees.

REMUNERATION OF AUDITOR (SECTION 142)

Section 142 of the Act prescribed that the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. The Board may fix remuneration of the first auditor appointed by it. The remuneration will be in addition to the out of pocket expensed incurred by the auditor in connection with the audit of the company but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

AUDITOR NOT TO RENDER CERTAIN SERVICES (PROHIBITED SERVICES) [SECTION 144]

An auditor shall provide to the company only such other services as are approved by the Board of Directors/ the audit committee, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company, namely:-

(a) accounting and book keeping services;

(b) internal audit;

(c) design and implementation of any financial information system;

(d) actuarial services;

(e) investment advisory services;

(f) investment banking services;

(g) rendering of outsourced financial services;

(h) management services; and

(i) Any other kind of services as may be prescribed.

ELIGIBILITY & QUALIFICATIONS OF AUDITOR

Section 141 (1) & (2) of the Act prescribed the following eligibility and qualifications of auditor which are as under:-

(i) Only a Chartered Accountant (individual) or a firm where majority of partners practicing in India are Chartered Accountants can be appointed as auditor.

(ii) Where a firm including a Limited Liability Partnership (LLP) is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.

DISQUALIFICATIONS OF AUDITOR

Section 141 (3) of the Act read with Rule 10 prescribed the following persons shall not be eligible for appointment as an auditor of a company, namely:

- A body corporate, except LLP;
- An officer or employee of the company;
- A person who is a partner, or who is in the employment, of an officer or employee of the company;
- A person who himself or his relative/partner is holding any security or interest in the company, or its subsidiary, or of its holding or associate company or a subsidiary of such holding company ;
  - ➢ However, the relative may hold security or interest in the company of face value not exceeding rupees one lakh. This shall wherever relevant be also applicable in the case of a company not having share capital or other securities.
  - ➢ In the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within sixty days of such acquisition or interest.
  - ➢ A person who or whose relative or partner is indebted to the company or its subsidiary or its holding or associate company or a subsidiary of such holding company, in excess of rupees five lakh shall not be eligible for appointment.
  - ➢ A person who or whose relative or partner has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of one lakh rupees shall not be eligible for appointment.
- A person or a firm who, whether directly or indirectly, has “business relationship” with the company, or its subsidiary, or its holding or associate company;

> The term “business relationship” shall be construed as any transaction entered into for a commercial purpose, except –
>
> - commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
> - commercial transactions which are in the ordinary course of business of the company at arm’s length price-like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

- A person whose relative is a director or is in the employment of the company as a director or KMP;
- A person who is in full time employment elsewhere or a person or a partner of a firm holding appointment

as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies;

> In case of private company a person is ineligible to be appointed as an auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than one hundred crore rupee.

- A person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction;
- A person who, directly or indirectly, renders any service referred to in section 144 to the company or its holding company or its subsidiary company.

The term "directly or indirectly" shall include rendering of services by the auditor, -

(i) in case of auditor being an individual, either himself or through his relative or any other person connected or associated with such individual or through any other entity, whatsoever, in which such individual has significant influence or control, or whose name or trade mark or brand is used by such individual;

(ii) in case of auditor being a firm, either itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners.

Illustrations on disqualification of auditors:

A) A registered society cannot be appointed as Auditor of the company.

B) Mr. Arun who is employee of M/s ZXC Limited cannot be appointed as its auditor.

C) Mr. Sanjay is employee of M/s QWERTY Limited and Mr. Ashish is his partner. Mr. Ashish cannot be appointed as the auditor of M/s QWERTY Limited.

D) Mr. Sagar is holding an interest of more than Rs. 10,000 in M/s NHS Limited and Mr. Harshit is his partner. Neither Mr. Sagar nor Mr. Harshit can be appointed as the auditor of M/s NHS Limited.

E) M/s ASD Limited is a subsidiary of M/s EHG Limited. Mr. Abhay is holding interest in M/s ASD Limited and Mr. Tarun is his partner. Neither Mr. Abhay nor Mr. Tarun can be appointed as auditor of M/s ASD Limited or M/s EHG Limited.

F) Mr. Ratan is auditor of 20 companies and also appointed as auditor of M/s JKS Power Limited. This appointment is not valid and he should vacate the office.

G) Mr. Rahul was auditor of 2 companies and was convicted for fraud in January 2015. He is appointed as auditor of M/s QST Limited in January, 2021. The appointment is not valid as 10 years have not be lapsed after conviction.

According to section 141 (4) of the Act where a person appointed as an auditor of a company incurs any of the disqualifications mentioned as above after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

AUDITORS – RIGHTS, DUTIES AND LIABILITIES

AUDITOR'S RIGHT TO ATTEND GENERAL MEETING

According to section 146 of the Act, notice of all the general meetings shall also be forwarded to the auditor of the company and he must attend any general meeting either by himself or through his authorized representative (qualified to be an auditor) and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.

POWERS AND DUTIES OF AUDITORS

Section 143(1) of the Act provided that every auditor **can access at all times to the books of accounts, vouchers** and seek such information and explanation from the company and enquire such matters as he considers necessary, including the matters specified in sub-Clauses (a) to (f). It is the duty of every auditor to make proper enquiry regarding these matters, besides other matters and if he is satisfied, it is not necessary to disclose this fact in his report. However, on enquiry, if he finds some adverse features, it is his duty to report the same. Specific enquiries to be made by the auditor under this sub-Section are as under–

(a) Loans and Advances made by the Company

Auditor shall inquire into "whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interest of the company or its members." It is applicable to all loans and advances made on the basis of security. The auditor should verify that the security held against the loans and advances made by the company are legally enforceable and also ascertain the valuation of securities to see whether the loan is fully secured or partly secured.

(b) Transactions represented by book entries

Auditor is required to inquire "whether the transactions of the company which are represented merely by book entries are not prejudicial to the interests of the company". He should verify the all book entry transactions and determine whether such transactions have actually taken place and are not prejudicial to the interest of the company.

(c) Sale of investments

Auditor should inquire, "whether so much of the assets of the company (except an investment company or a banking company) as consists of shares, debentures and other securities, have been sold at a price less than that at which they were purchased by the company". Auditor must verify the cases where securities are sold at a price less than their cost of acquisition and if he finds that such sale is bona fide and the price realised is considered to be reasonable, having regards to the circumstances of each case, no further reporting is required.

(d) Loans and Advances shown as deposits

Auditor must verify "whether loans and advances made by the company have been shown as deposits". The auditor must inquire in respect of all the deposits shown by the company and satisfy himself that the loans and advances have not been shown as deposits.

(e) Charging of Personal expenses to revenue account

Auditor should inquire as to "whether personal expenses have been charged to revenue account". Auditor must ensure that no personal expenses of directors and officers of the company have been charged to revenue account.

(f) Allotment of shares for cash

Auditor should inquire as to "whether cash has actually been received in respect of shares stated to

have been allotted for cash and if no cash has actually been so received, whether the position as stated in the account books and balance sheet is correct, regular and not misleading". In this connection, auditor must ensure in respect of shares allotted in cash by the company that cash has actually been received in respect of such allotment by the company.

He should verify and report the cases where cash was not received and that the position, as stated in books of accounts and balance sheet, is correct, regular and not misleading.

Auditor will have access to books of accounts and vouchers, not only to those kept at registered office of the company but also to those kept at any other place. Such access shall be available at all times. Also, auditor of a holding company shall have access to the books of all of its subsidiary and associate companies for the purpose of consolidation of financial statements of holding company and its subsidiaries and associate companies.

CASE LAW

In Re *Ministry of Corporate Affairs Vs. Mukesh Maneklal Choksi (CP NO.4365/140(5)/MB/2019 NCLT-Mumbai,* it was held that in case where the family members of statutory auditor were shareholders of respondent company and the statutory auditor has issued audit certificate without examining the books of accounts of the company, provisions of section 143(3)(d) had been violated and statutory auditor would cease to function as statutory auditor of respondent company.

POWERS OF COMPTROLLER AND AUDITOR GENERAL OF INDIA IN CASE OF GOVERNMENT COMPANY [SECTION 143 (5) to 143 (7)]

In the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Government, or partly by the Central Government and partly by one or more State Government, the Comptroller and Auditor General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 of the Act, and direct such auditor the manner in which the accounts of the company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The CAG shall have a right to the conduct a supplementary audit of financial statement of the company and comment upon or supplement such audit report within 60 days from the date of receipt of the audit report u/s 143 (5).

Any comments given by the CAG upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements u/s 136 (1) and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

The CAG may, by an order, cause test audit to be conducted of the accounts of company covered u/s 139 (5) or 139 (7) and the provisions of section 19A of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

The National Company Law Appellate Tribunal (NCLAT) held that the auditor cannot be debarred for 5 years under the Companies Act, 2013 in the absence of evidence supporting fraudulent intentions, in the matter of *Mukesh Maneklal Choksi v. Union of India, Company Appeal (AT) No. 89 of 2019,* dated February 17, 2020.

AUDIT AND AUDITOR'S REPORT

Section 143 (2) of the Act provides that auditor shall make a report to the members of the company on the accounts examined by him and on every financial statement which is required to be laid in the general meeting of the company. The Audit report should take into consideration the provisions of this Act, the Accounting and Auditing standards and matters which are required under this Act or rules made thereunder or under any order made u/s 143(11) of the Act.

The Audit report should state that to the best of his information and knowledge, the said accounts and financial statements give a true and fair view of the state of the company's affair as at the end of the financial year and the profit or loss and the cash flow for the year and such other matters as may be prescribed.

Section 143 (3) of the Act, lay down that auditor's report shall also state other details which are as under:

(a) whether he has sought and obtained all the information and explanations which were necessary and if not, the details thereof and the effect of such information on the financial statements;

(b) whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books and proper returns adequate for the purposes of his audit have been received from branches not visited by him;

(c) whether the branch audit report prepared by a person other than the company's auditor has been sent to him;

(d) whether the company's balance sheet and profit and loss account dealt with in the report are in agreement with the books of account and returns;

(e) whether, in his opinion, the financial statements comply with the accounting standards;

(f) the observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company;

(g) whether any director is disqualified from being appointed as a director under section 164 (2);

(h) any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith;

(i) whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls;

Clause (i) of Sub-Section (3) of Section 143 related to internal financial controls shall not apply to a private company:-

- Which is an one person company or a small company; or
- Which has turnover of less than Rs. 50 crores as per the latest audited financial statement and which has aggregate borrowings of less than Rs. 25 crores, from banks, financial institutions, or any body corporate, at any point of time during the preceding financial year.

Further, Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribed that Auditor's Report shall also include the views and comments of the Auditors on the following matters, namely:-

(i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;

(ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;

(iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company;

(iv) (a) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;

(b) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and

(c) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.

(v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013;

(vi) Whether the company, in respect of financial years commencing on or after the 1st April, 2022, has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

The auditor is required to provide the reasons, where any of the matters required to be included in the Audit Report under this Clause is answered in negative or with a qualification. [Section 143 (4)]

COMPANIES (AUDITOR'S REPORT) ORDER, 2020

Ministry of Corporate Affairs 'MCA' notified Companies (Auditor's Report) Order, 2020 (CARO 2020) which is applicable for audit of financial statements of eligible companies for the financial years commencing on or after the 1st April, 2021.

CARO 2020 will be applicable to all the companies including foreign companies except banking company, insurance company, section 8 company, OPC [section 2(62)], small company [section 2(85)], certain private limited companies. This order stated that every report of the auditor under Section 143 of Companies Act, 2013 must contain the matters stated in 21 clauses as specified under paragraphs 3 and accord reasons for unfavorable or qualified answer as stated in paragraph 4 of CARO 2020.

CARO 2020 will not be applied with respect to auditor's report on Consolidated Financial Statements except clause (xxi) of paragraph 3 (Reporting requirements on qualifications or adverse remarks by the auditors in the CARO reports). The order 2020 elaborated on all the matters which are to be included in the auditor's report. Wherein, the following details of the subject-matter are described:

1. Whether the company is maintaining proper records showing full particulars such as:
    i. The quantitative detail and situation of property, plant, and equipment,
    ii. Physical verification of the property, plant, and equipment by the management at reasonable intervals,
    iii. The details of the title deeds of the immovable properties held in the name of company,

iv. Revaluation of the property, plant, and equipment or intangible assets or both and if there is more than 10% of the change in the property, plant, and equipment or intangible assets,

2. Details of proceedings against the company on the holding of any Benami property.
3. Physical verifications of inventory by the management at reasonable intervals and proper treatment of any discrepancies of 10% or more found.
4. Quarterly returns or statement filed by company having working capital limit more than 5 crore rupees with such banks or financial institution.
5. Details of the investments made by the company (except companies dealing in loans), security or guarantee given by the company.
6. Details of the payment pertaining to the undisputed statutory dues such as GST, provident Funds, Custom Duty, etc.
7. Details of any default done by the company in making the repayment of the loan.
8. Details of the funds raised by a company by the way of the Initial public offer.
9. Details of fraud done by the company, and many more.
10. The Auditor's Report Order 2020 of any company is supposed to state the reasons for unfavorable or qualified answers.

COST AUDIT [RULE 6 OF THE COMPANIES (COST RECORDS AND AUDIT) RULES, 2014]

A company engaged in production, processing, manufacturing or mining activity, is also required to maintain particulars relating to utilization of material, labour or other items of cost as the Central Government may prescribe for such class of companies. These are known as cost records. In a case the Central Government is of the opinion, that it is necessary to do so, it may, by order, direct that the audit of cost records of class of companies, which are covered under sub-section (1) of Section 148 of the Act and which have a net worth of such amount as prescribed or a turnover of such amount as prescribed, shall be conducted in the manner specified in the order.

Appointment of Cost Auditor

The category of companies specified in rule 3 and the thresholds limits laid down in rule 4, shall within 180 days of the commencement of every financial year, shall appoint a cost auditor.

Further, before such appointment is made, the written consent of the cost auditor to such appointment, and a Certificate from him or it is required to be obtained.

The cost auditor appointed shall submit a certificate that-

(a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;

(b) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Act, so far as may be applicable;

(c) the proposed appointment is within the limits laid down by or under the authority of the Act; and

(d) The list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Every company referred to in sub-rule (1) shall inform the cost auditor concerned of his or its appointment as such and file a notice of such appointment with the Central Government within a period of 30 days of the Board meeting in which such appointment is made or within a period of 180 days of the commencement of the financial year, whichever is earlier, through electronic mode, in Form CRA-2, along with the fee as specified in the Companies (Registration Offices and Fees) Rules, 2014.

Every cost auditor appointed as such shall continue in such capacity till the expiry of 180 days from the closure of the financial year or till he submits the cost audit report, for the financial year for which he has been appointed.

Every cost auditor, who conducts an audit of the cost records of a company, shall submit the cost audit report alongwith his or its reservations or qualifications or observations or suggestions, if any, in **Form CRA-3**.

(a) The cost auditor shall forward his duly signed report to the Board of Directors of the company within a period of 180 days from the closure of the financial year to which the report relates and the Board of Directors shall consider and examine such report particularly any reservation or qualification contained therein.

(b) Every company covered under these rules shall, within a period of 30 days from the date of receipt of a copy of the cost audit report, furnish the Central Government with such report along with full information and explanation on every reservation or qualification contained therein, in Form CRA-4 in Extensible Business Reporting Language format in the manner as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting language) Rules, 2015 along with fees specified in the Companies (Registration Offices and Fees) Rules, 2014.

(c) The Companies which have got extension of time of holding Annual General Meeting under section 96 of the Companies Act, 2013, may file Form CRA-4 within resultant extended period of filing financial statements under section 137 of the Companies Act, 2013.

Removal of Cost Auditor/Casual Vacancy

The cost auditor appointed under the Companies (Cost Records & Audit) Rules 2014, may be removed from his office before the expiry of his term, through a board resolution after giving a reasonable opportunity of being heard to the Cost Auditor and recording the reasons for such removal in writing.

Further **Form CRA-2** is required to be filed with the Central Government for intimating appointment of another cost auditor and the relevant Board Resolution to the effect shall be enclosed. However it shall not prejudice the right of the cost auditor to resign from such office of the company.

Any causal vacancy in the office of a cost auditor, whether due to resignation, death or removal, shall be filled by the Board of Directors within thirty days of occurrence of such vacancy and the company shall inform the Central Government in **Form CRA-2** within thirty days of such appointments of cost auditor.

Approval of Cost Audit Report

The cost statements, including other statements to be annexed to the cost audit report, shall be approved by the Board of Directors before they are signed on behalf of the Board by any of the director authorized by the Board, for submission to the cost auditor to report thereon.

Remuneration of the Cost Auditor (Rule 14 of Companies (Audit & Auditors), Rules, 2014)

(a) in the case of companies which are required to constitute an audit committee-

i. the Board shall appoint an individual, who is a cost accountant, or a firm of cost accountants in practice, as cost auditor on the recommendations of the Audit committee, which shall also recommend remuneration for such cost auditor;

ii. the remuneration recommended by the Audit Committee under clause (i) shall be considered and approved by the Board of Directors and ratified subsequently by the shareholders;

(b) In the case of other companies which are not required to constitute an audit committee, the Board shall appoint an individual who is a cost accountant or a firm of cost accountants in practice as cost auditor and the remuneration of such cost auditor shall be ratified by shareholders subsequently.

SECRETARIAL AUDIT

Secretarial Audit is a compliance audit and it is a part of total compliance management in an organization. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

Secretarial Audit is a process to check compliance with the provisions of various laws and rules/regulations/ procedures, maintenance of books, records etc., by an independent professional to ensure that the company has complied with the legal and procedural requirements and also followed the due process. It is essentially a mechanism to monitor compliance with the requirements of stated laws.

Considering the increasing importance of Corporate Governance, Section 204 of the Companies Act, 2013 mandates every listed company and such other class of prescribed companies to annex a Secretarial Audit Report, given by a company secretary in practice with its Board's report.

Secretarial Audit is an independent, objective assurance intended to add value and improve an organization's operations. It helps to accomplish the organization's objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes.

LEGAL FRAMEWORK GOVERNING SECRETARIAL AUDIT UNDER THE COMPANIES ACT, 2013

As per the provision of section 204(1) of the Companies Act, 2013 read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014:

1. Every listed company;
2. Every public company having a paid-up share capital of 50 crore rupees or more; or
3. Every public company having a turnover of 250 crore rupees or more; or
4. Every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more.

Require to annex with its Board's Report made in terms of Section 134(3) of the Companies Act, 2013, a Secretarial Audit Report, given by a Company Secretary in practice, in **Form MR- 3.**

MCA has clarified that the paid up share capital, turnover, or outstanding loans or borrowings as the case may be, existing on the last date of latest audited financial statement shall be taken into account.

APPLICABILITY OF SECRETARIAL AUDIT TO A PRIVATE COMPANY WHICH IS A SUBSIDIARY OF A PUBLIC COMPANY

According to the provisions of section 2(71) of the Companies Act, 2013 "public company" means a company which is not a private company and has a minimum paid-up share capital as may be prescribed.

However, the proviso to the aforesaid definition provides that, "a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of the Companies Act, 2013 even where such subsidiary company continues to be a private company in its articles".

Hence, it is clear from above proviso that Secretarial Audit is also applicable to a private company which is a subsidiary of a public company and which falls under the aforesaid prescribed class of companies.

Reserve Bank of India has come out with a discussion paper on Governance in Commercial Banks in India in the month of June, 2020 with the proposal to introduce Secretarial Audit in all commercial banks both listed and unlisted.

SECRETARIAL AUDIT UNDER SEBI REGULATIONS

The Committee on Corporate Governance, constituted under the Chairmanship of Shri Uday Kotak, in its report dated October 05, 2017, recommended the following in view of the criticality of secretarial functions to efficient board functioning:

a) Secretarial Audit to be made compulsory for all listed entities under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations"), in line with the provisions of the Companies Act, 2013.

b) Secretarial Audit to be extended to all material unlisted Indian subsidiaries. This is in line with the theme of strengthening group oversight and improving compliance at a group level for listed entities.

The aforesaid recommendations were accepted by SEBI and in order to implement the same, the SEBI (LODR) Regulations, 2015 have been amended vide Notification dated May 09, 2018 to include Regulation 24A.

Accordingly, as per Regulation 24A of the SEBI (LODR) Regulations, 2015, every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.

Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within sixty days from end of each financial year. *(Amended by the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2021 w.e.f. 5.5.2021).*

SEBI vide its Circular dated February 08, 2019 notified the formats for Annual Secretarial Audit Report and Annual Secretarial Compliance Report for listed entities and their material subsidiaries, effective from the financial year ended March 31, 2019.

Thus, vide above mentioned circular the following key points regarding the same has been clarified:

Annual Secretarial Audit Report: The listed entity and its unlisted material subsidiaries shall continue to use the same Form No. MR-3 for (secretarial audit report) as required under the Companies Act, 2013 and the rules made thereunder for the purpose of compliance with Regulation 24A of the SEBI (LODR) Regulations, 2015 as well.

Annual Secretarial Compliance Report: While the annual secretarial audit cover a broad check on compliance with all laws applicable to the entity, listed entities additionally, on an annual basis, require a check by the PCS on compliance of all applicable SEBI Regulations and circulars/ guidelines issued thereunder, consequent to which, the PCS need to submit annual secretarial compliance report to the listed entity in the format prescribed under said SEBI circular.

It shall be the duty of the company to give all assistance and facilities to the company secretary in practice, for auditing the secretarial and related records of the company.

The Board of Directors, in their report, shall explain in full any qualification or observation or other remarks made in the Secretarial Audit Report.The companies which are not covered under section 204 of the Act may obtain Secretarial Audit Report voluntarily as it provides an independent assurance of the compliances of applicable laws of the company.

THE OBJECTIVES OF SECRETARIAL AUDIT

The objectives of Secretarial Audit may be summarized as under:-

To check & report on compliances of applicable laws and Secretarial Standards;

To point out non-compliances and inadequate compliances;

To protect the interest of various stakeholders i.e. the customers, employees, society etc.;

To avoid any unwarranted legal actions/penalties by law enforcing agencies and other persons as well.

SCOPE OF SECRETARIAL AUDIT

The scope of Secretarial Audit comprises verification of the compliances under the following enactments, rules, regulations, notifications and guidelines:

(i) The Companies Act, 2013 (the Act) and the Rules made thereunder:

On various matters under Companies Act, 2013, Central Government has been empowered to make rules. A perusal of the scheme of the Act makes it clear that compliances under the Act may be divided into two categories. Compliances of the first type are annual and non-event based such as filing of the annual return, annual report including secretarial audit report, wherever applicable, etc. The compliances of second category are event based i.e. on happening of certain event.

These events require compliance of various provisions of the Act.

While secretarial audit envisages the verification of all secretarial records of a company. For ease of presentation, the following key areas have been highlighted for verification:

Under the Companies Act, 2013

1. Maintenance of registers and records
2. Filing of forms, returns and documents
3. Memorandum and/or Articles of Association
4. Meetings of directors/committees thereof, shareholders and other stakeholders
5. Secretarial Standards
6. Directors and Key Managerial Personnel (“KMP”)
7. Disclosures
8. Issue of shares and other securities
9. Transfer and transmission of shares and other securities and related matter
10. Dividend
11. Deposits
12. Borrowings
13. Loans, investments, guaranties and securities

14. Loans to directors etc. and Related party transactions
15. Charges
16. Corporate Social responsibility.

(ii) Other major Acts and Regulations:

(a) The Securities Contracts (Regulation) Act, 1956 and the Rules made under that Act; (where applicable): With special reference to listing, delisting and continuous listing of any of the securities

(b) The Depositories Act, 1996 and the Regulations and Bye-laws framed under that Act; (where applicable)

(c) The Foreign Exchange Management Act, 1999 and the Rules and Regulations made thereunder to the extent of Foreign Direct Investment, Overseas Direct Investment and External Commercial Borrowings; (where applicable)

(d) The regulations and guidelines made under the Securities and Exchange Board of India Act, 1992 (where applicable). The various laws/regulations/guidelines which could be considered under this are:

(i) The Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(ii) The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015;

(iii) The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(iv) The SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999/ SEBI (Share Based Employee Benefits) Regulations, 2014;

(v) The Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008;

(vi) The Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993 regarding the Companies Act and dealing with client;

(vii) The Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;

(viii) The Securities and Exchange Board of India (Buyback of Securities) Regulations, 2018;

(ix) SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015 (where applicable).

(iii) Other Applicable Laws include:

Reporting on compliance of 'Other laws as may be applicable specifically to the company' shall mean all the laws which are applicable to specific industry for example for Banks- all laws applicable to Banking Industry; for insurance company-all laws applicable to insurance industry; likewise for a company in petroleum sectoral laws applicable to petroleum industry; similarly for companies in pharmaceutical sector, cement industry etc.

The Secretarial Audit or should prepare a list of specific laws as applicable to the company whose secretarial audit is being conducted and verify compliance with the same. SS-1 requires every company to specify list of laws applicable specifically to the company at its Board Meeting.

Examining and reporting whether the adequate systems and processes are in place to monitor and ensure compliance with general laws like labour laws, competition law, and environmental laws.

The provisions relating to audit of accounts and financial statement of a company is dealt in the Statutory Audit, and that relating to taxation is dealt in Tax Audit, the Secretarial Auditor may rely on the reports given by statutory auditors or other designated professionals. However, Secretarial Auditor is expected to report on the Secretarial Compliance of these laws.

(iv) To examine and report on the compliance with Secretarial Standards issued by ICSI.

(v) Adherence to board process and compliance mechanism

The scope of Secretarial Audit should include the assessment of the adequacy and quality of board process and compliance mechanism. In preparing the Audit Report, the secretarial auditor shall consider the following matters (illustrative):

1. Instances of non-compliance during the defined audit period, in relation to the statutes, rules, regulations, etc. applicable to the company, continuing non-compliance, if any, and the reasons thereof;
2. Significant litigation(s) initiated by the company or filed against the company with brief details of the cases;
3. (a) Board structure –
   - (i) Composition of the Board
   - (ii) Is there a stated process to ascertain the suitability of directors?
   - (iii) Is there a stated process in place for succession planning?

   (b) Deficiencies in the Board systems and processes –
   - (i) In convening meetings.
   - (ii) In the circulation of agenda (whether the agenda is made available to the Board along with supporting papers/presentations sufficiently in advance of the meetings).
   - (iii) In conducting the meetings (frequency and length).
   - (iv) In the decision making process of the Board.
   - (v) Adequacy and integrity of minutes recorded.
   - (vi) In the functioning of Board constituted Committees.
4. The existence and adequacy of internal control systems, procedures and processes, commensurate with the size of the company and the nature of its business, for ensuring compliance with laws applicable to the company;
5. Any material event(s) that have happened, after the end of the financial year but before the date of the report, having a significant impact on any of the above reported items;
6. Whether any event occurred or action was taken in the audit company which may have bearing on the Compliances under various laws, regulations, guidelines and standards etc.

NEED FOR SECRETARIAL AUDIT

Secretarial Audit is the process of independent verification, examination of level of compliance of applicable Corporate Laws to a company. The audit process if properly devised ensures timely compliance and eliminates any un-intended non-compliance of various applicable rules and regulations. An action plan of the Corporate Secretarial Department is to be designed so as to ensure that all event based and time based compliances are

considered and acted upon. Secretarial Audit is to be on the principle of "Prevention is better than cure" rather than post mortem exercise and to find faults. Broadly, the need for Secretarial Audit is:

- Effective mechanism to ensure that the legal and procedural requirements are duly complied with.
- Provides a level of confidence to the directors & Key Managerial Personnel etc.
- Directors can concentrate on important business matters as Secretarial Audit ensures legal and procedural requirements.
- Strengthen the image and goodwill of a company in the minds of regulators and stakeholders.
- Secretarial Audit is an effective governance and compliance risk management tool.
- It helps the investor in analyzing the compliance level of companies, thereby increases the reputation.

APPOINTMENT OF SECRETARIAL AUDITOR

As per Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014, read with Section 179 of the Companies Act, 2013, secretarial auditor is required to be appointed by means of resolution at a duly convened board meeting.

ROLE OF COMPANY SECRETARY

Company secretary in practice has been exclusively recognized for conducting secretarial audit. The section 204 further provides that Secretarial Audit Report is to be submitted in a format prescribed under rules. As per sub-rule (2) of Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the format of the Secretarial Audit Report shall be in Form MR-3.

Section 134 and Sub-section (3) of Section 204 provides that the Board of Directors, in its report, shall explain in full any qualification or observation or other remarks made by the company secretary in practice in the secretarial audit report.

If a company or any officer of the company or the company secretary in practice, contravenes the provisions of section 204, the company, every officer of the company or the company secretary in practice, who is in default, shall be liable to a penalty of two lakh rupees.

INTERNAL AUDIT [SECTION 138]

Classes of companies requiring Internal Audit

The following class of companies shall be required to appoint an internal auditor which may be either an individual or a partnership firm or a body corporate namely:-:-

(a) Every listed company;

(b) Every unlisted public company having –

(i) Paid up share capital of fifty crore rupees or more during the preceding financial year; or

(ii) Turnover of two hundred crore rupees or more during the preceding financial year; or

(iii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or

(iv) Outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(c) Every private company having –

(i) Turnover of two hundred crore rupees or more during the preceding financial year; or

(ii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.

Exceptions:

In case of Specified IFSC Public Company / Specified IFSC Private Company - Section 138 shall apply if the articles of the company provides for the same. - Notification Dated 4th January 2017.

Who can be an Internal Auditor?

(a) A Chartered Accountant or;

(b) A Cost Accountant or;

(c) Such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the Company.

For this sub-section, Chartered Accountant means a Chartered Accountant, who is a member of the Institute of Chartered Accountants of India and Cost Accountant means a member of the Institute of Cost Accountants of India as the case may be, whether engaged in practice or not. Other professionals, as may be decided by the company's board, may also be appointed as an internal auditor.

Following classes of companies are required to appoint internal auditor –

Criterion	*Listed Companies*	*Unlisted Public Company*	*Every Private Company*
Paid-up Capital	Internal audit is mandatory for all listed companies, irrespective of any criterion	50 crore rupees or more*	Not Applicable
Turnover		200 crore rupees or more*	200 crore rupees or more*
Outstanding loans and borrowing from bank and PFI		exceeding 100 crore rupees or more**	exceeding 100 crore rupees or more**
Outstanding deposits		25 crore rupees or more**	Not Applicable

* during the preceding financial year.

** at any point of time during the preceding financial year.

Appointment of internal auditor is mandatory for every producer company irrespective of any criterion.

Further, the proviso provides that any existing company which is covered under any of the above criteria shall comply with the requirements of section 138 and rule 13 within six months of commencement of such section.

SPECIMEN RESOLUTION/FORMATS

Board Resolution for considering and approving place other than the registered office where books of account of the company may be kept

"RESOLVED THAT pursuant to the provisions of Section 128 of the Companies Act, 2013 read with Rules made thereunder (including any statutory modification or re-enactment thereof for the time being in force) consent of the Board of Directors of the Company be and is hereby accorded for keeping and maintaining Books of Accounts of the Company at _____ along with registered office of the company with effect from _____.

RESOLVED FURTHER THAT Mr. /Ms. _____, director/CS/CFO of the Company be and is hereby authorized to file the necessary documents/ form(s) with the ROC and to do all such acts, deeds, matters and things as may be necessary, desirable, proper or expedient for the purpose of giving effect to this resolution and for matters connected therewith or incidental thereto."

Board Resolution for Appointment of Auditors

"RESOLVED THAT pursuant to provision of section 139 of the Companies Act 2013 (as amended or reenacted from time to time) and other applicable provision of the companies Act 2013 and considering the recommendations made by the Audit Committee (mentioned only if applicable), the consent of the Board be and is hereby recommends M/s. _____ Chartered Accountants for appointment as the statutory auditor of the company for the financial year _____, from the conclusion of the forthcoming annual general meeting till the conclusion of sixth meeting , at a remuneration to be decided in consultation with it.

RESOLVED FURTHER THAT the Board of Directors of the Company be and are hereby authorized for and on behalf of the Company to take all necessary steps and to do all such acts, deeds, matter, filing and things which may deem necessary in this behalf.

Format of resolution for appointment of Statutory Auditors from the conclusion of this Annual General Meeting until the conclusion of the Sixth consecutive Annual General Meeting and to fixation of their remuneration

"RESOLVED THAT pursuant to Sections 139, 142 of the Companies Act, 2013 ("Act") and other applicable provisions, if any, of the said Act and Companies (Audit and Auditors) Rules, 2014 made thereunder and other applicable rules, if any, under the said Act (including any statutory modification(s) or re-enactment thereof for the time being in force) M/s. _____, Chartered Accountants (Registration No. _____), be and is hereby appointed as the Statutory Auditors of the Company commencing from the conclusion of this Annual General Meeting till the conclusion of Sixth consecutive Annual General Meeting at a remuneration to be fixed by the Audit Committee and/or Board of Directors of the Company, in addition to the re-imbursement of applicable taxes and actual out of pocket and travelling expenses incurred in connection with the audit and billed progressively.

RESOLVED FURTHER THAT the Board of Directors of the Company be and are hereby authorized for and on behalf of the Company to take all necessary steps and to do all such acts, deeds, matter, filing and things which may deem necessary in this behalf.

LESSON ROUND-UP

- As per the Companies Act, 2013, books of account and other books and papers should be available for inspection by any director on working days during business hours.
- The expression 'annual accounts' embraces both balance sheet and statement of profit and loss.
- The term 'Balance Sheet' means a statement prepared from the books of a concern showing the debit and credit balances after the trading and profit and loss accounts have been prepared – a statement drawn up at the end of each trading or financial period, setting forth the various assets, and liabilities of a concern at a particular date.
- Profit and loss account is a Statement by which the directors disclose to the shareholders of the company the result of the actual working of the company. It serves to give the shareholders an idea of the earning capacity of the company in relation to its capital, and enables them to judge about the administration and management of the affairs of the company.
- The Act provides that every profit and loss account and balance sheet of the company shall comply with the accounting standards.
- The balance sheet and profit and loss account must be approved by the Board of directors and signed by the directors before they are submitted to the auditors for their report. The Act gives other provisions also for authentication of annual accounts. The Act also requires the company to file such annual accounts with the Registrar of Companies.
- The main object of audit is to ensure that the statement of accounts of the relevant financial year truly and fairly reflect the state of affairs of the company. Audit also provides a moral check on those who are entrusted with the task of running business and of keeping and maintaining the books of account of the company. An audit of accounts is conducted with two-fold purpose:
    i. detection and prevention of errors;
    ii. detection and prevention of fraud.
- The Act provides that the auditor of a Government company shall be appointed or re-appointed by the Comptroller and Auditor General of India within the limits specified.
- The Act provides that the auditors' report shall be signed only by the person appointed as an auditor of the company.
- The Central Government has notified Cost Accounting Records Rules for a number of specified industries with a view to ensuring that the records so maintained highlight the area of inefficiencies or high costs.
- Secretarial Audit is a compliance audit and it is a part of total compliance management in an organization. The Secretarial Audit is an effective tool for corporate compliance management. It helps to detect non-compliance and to take corrective measures.

GLOSSARY

Accounts of Companies : As per section 2(12) of the Act, "book and paper" and "book or paper" include books of account, deeds, vouchers, writings, documents, minutes and registers maintained on paper or in electronic form.

National Financial Reporting Authority (NFRA) : Through Section 132 of the Companies Act, 2013, the Central Government has introduced a new regulatory authority named as National Authority for Financial Reporting known as National Financial Reporting Authority (NFRA) with wide powers to recommend, enforce and monitor the compliance of accounting and auditing standards.

Comptroller and Auditor General of India : The Comptroller and Auditor General (CAG) of India is an authority, established by the Constitution under Constitution of India/Part V - Chapter V/Sub-part 7B/ Article 148. The Comptroller and Auditor-General performs such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament and, until provision in that behalf is so made.

First Auditor : The first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days of the date of registration of the company, and the auditor so appointed shall hold office until the conclusion of the first AGM.

BoD : Board of Directors.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Section 128(1) requires every company to prepare and keep the books of accounts and other relevant books and papers and financial statements at its registered office. State the manner of maintenance of books of accounts in electronic form.
2. What is the procedure to report frauds?
3. ABC Ltd. wants to appoint FMC & Associates as its internal auditor. What are the conditions of such Appointment?
4. A is an auditor of OPR Ltd, a listed public company having paid-up share capital of Rs. 10 crore. Advise him as to whether he can render the following services, keeping in mind, the relevant provisions of the Companies Act, 2013.
    (i) A wishes to ''design and implement one financial system'' and offer management services to PQR Ltd, the holding company of OPR Ltd.
    (ii) A wants to conduct internal audit of OPR. He also wishes to provide actuarial services to XYZ Ltd.
    (iii) What will be your answer in the above two cases if services are provided to ABC Ltd, a subsidiary Company of OPR Ltd.?
5. Who can appoint Secretarial Auditor of the company: Board of Directors or Shareholders? What is the Duty of Board of Directors towards secretarial auditor and audit report?
6. ABC Ltd. had Rs.7 crore as securities premium in its reserves and surplus account in Balance Sheet as at 31st March, 2020. The Company has incurred significant losses in preceding years and as on 31st March, 2020 it has accumulated losses amounting to Rs. 8 crore in the Balance Sheet. In order to present a true and fair view of the financial results, the company wrote off the losses by reducing the amount standing to the credit of securities premium account. With reference to the provisions of the Companies Act, 2013, decide if the action of the Company is valid?

7. Which of the following statements is/are not correct with regards to the duties of auditor?
   (a) Physical verification of fixed assets is primarily the responsibility of the auditor.
   (b) Auditor should ascertain that the assets are in possession of the client company.
   (c) The auditor should satisfy himself that the assets have been valued in the financial statements according to the accounting principles
   (d) Ownership of fixed assets should be verified by examining the title deed by the auditor.
8. M/s RJM International Private Limited was incorporated on 15 January, 2022. It needs to appoint its first auditor. Its Board of Directors failed to appoint first auditors by 25 January, 2022.What recourse is available in this case as per Companies Act, 2013?
   (a) Board of director can appoint first auditors at any time after incorporation.
   (b) Where Board of directors fails to appoint within 30 days of incorporation, the shareholders will appoint within 90 days in EGM.
   (c) The auditor will be appointed by CAG in this case.
   (d) The first auditor needs to be appointed within 120 days.
9. M/s MFSL Limited is an unlisted public company with outstanding deposits of Rs. 35.00 crores. The management is of the view that since company is unlisted, there is no requirement to appoint internal auditor. Suggest:
   a) Internal auditor is required to be appointed.
   b) No requirement of internal auditor
   c) Statutory auditor appointment is sufficient.
   d) None of the above.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- Companies Act, 2013 and rules made thereunder
- ICSI Guidance note on Secretarial Audit

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==
- https://www.sebi.gov.in/legal/regulations/jul-2022/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-regulations-2015-last-amended-on-july-25-2022-_61405.html

Compromise, Arrangement and Amalgamation-Concepts

Lesson 10

KEY CONCEPTS

■ Merger ■ Amalgamation ■ Compromise ■ Arrangement ■ ~~Oppression~~ ■ ~~Mismanagement~~

Learning Objectives

To understand:

- The broad regulatory framework with respect to compromise/arrangement, mergers/amalgamation
- Preparation of scheme, filing of various documents including e-forms with ROC, filing of scheme of amalgamation with NCLT, etc.
- Purchase of minority shareholding
- ~~Oppression and Mismanagement in Companies & Power of Tribunal~~
- ~~Class Action Suit~~

Lesson Outline

- Provisions of the Companies Act, 2013
- Power to Compromise or make arrangements with members or creditors
- Merger and amalgamation of certain companies
- Merger and amalgamation of a company with a foreign company
- Power to acquire shares of shareholders dissenting from scheme or contract approved by majority
- Purchase of minority shareholding
- Power of Central Government to provide for amalgamation of companies
- ~~Oppression & Mismanagement~~
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Sections 230, 246 and 403-405)
- The Companies (Compromise, Arrangements and Amalgamations) Rules, 2016
- The Income Tax Act, 1961
- The SEBI (Listing Obligation & Disclosure Requirements) Regulations, 2015
- The Indian Stamp Act, 1899
- The SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011
- The Competition Act, 2002
- The Foreign Exchange Management Act, 1999

INTRODUCTION

Chapter XV (Section 230 to 240) of the Companies Act, 2013 (the Act) contains provisions on 'Compromise. Arrangements and Amalgamations', that covers compromise or arrangements, mergers and amalgamations, corporate debt restructuring, demergers, fast track merger for small companies, cross border mergers, takeovers, amalgamation of companies in public interest etc. The procedural aspects involved such as format of application to be made to the Tribunal, form of notice and the procedural aspects involved with respect to the substantive law are covered under the Rules made under Chapter XV of the Act.

Compromise and Arrangement are form of corporate restructuring which is an inorganic business strategy where one or more aspects of a business are redesigned to improve commercial efficiency, manage competition effectively, drive faster pace of growth, ensure effective utilization of resource, and fulfilment of stakeholders' expectations. It serves different purpose for different companies at different points of time and may take up various forms.

'Compromise' is an amicable agreement between the parties in which they make mutual concessions in order to solve the differences between them. Whereas, 'arrangement' is the process by which the share capital of the company is reorganized either by consolidating or division of the shares or doing both.

The word 'compromise' is nowhere defined in the Companies Act, 2013. It basically connotes the settlement of dispute by mutual consents/agreements or by way of scheme of compromise. Therefore, in case of compromise, there has to be some form of conflict. Following are the situations under which a company may call for a scheme of compromise:

- If a company faces challenge to pay all the creditors in full, in the normal course of business;
- Subsidiaries/units incurring losses etc.

On the other hand the word 'arrangement' has been defined under section 230(1) of the Companies Act, 2013. The arrangement has a wider connotation than compromise. The arrangement means reorganization of rights and liabilities of the shareholders without existence of dispute. A company may opt for scheme of compromise or arrangement to take itself out from the winding up proceedings. Following are the situations under which a company may call for a scheme of compromise:

- For any variation in property;
- Conversion of one class of share to another etc.

PROVISIONS OF THE COMPANIES ACT, 2013

Power to Compromise or make Arrangements with Members or Creditors

Section 230(1) states that when a compromise or arrangement is proposed –

(a) between a company and its creditors or any class of them; or

(b) between a company and its members or any class of them,

the Tribunal may, on the application of the (i) company, or (ii) any creditor or (iii) member of the company, or (iv) in the case of a company which is being wound up, of the liquidator, appointed under the Companies Act, 2013 or under Insolvency and Bankruptcy Code, 2016, as the case may be, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.

For the purposes of this sub-section, arrangement includes a reorganisation of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes, or by both these methods.

Affidavit by the applicant to disclose certain material facts

Section 230(2) states that the company or any other person, by whom an application is made under sub-section (1), shall disclose to the Tribunal by affidavit–

(a) all material facts relating to the company, such as the latest financial position of the company, the latest auditor's report on the accounts of the company and the pendency of any investigation or proceedings against the company;

In the matter of *Morepen Laboratories Ltd. vs. Regional Director Company Appeal (AT) No.136 of 2018, NCLT Chandigarh,* it was held that where petitioner company sought sanction of scheme of arrangement with fixed deposit holders, however the company did not disclosed investigation by SFIO or pendency of various criminal proceedings against it while bringing on record scheme under consideration, application of company has to be dismissed.

(b) reduction of share capital of the company, if any, included in the compromise or arrangement;

(c) any scheme of corporate debt restructuring consented to by not less than seventy-five per cent of the secured creditors in value, including—

(i) a creditors' responsibility statement in the prescribed form;

The Creditors' Responsibility Statement shall be in **Form CAA-1** and be included in the scheme of corporate debt restructuring. A scheme of corporate debt restructuring as referred to in clause (c) of sub-section (2) of section 230 of the Act shall mean a scheme that restructures or varies the debt obligations of a company towards its creditors.

(ii) safeguards for the protection of other secured and unsecured creditors;

(iii) report by the auditor that the fund requirements of the company after the corporate debt restructuring as approved shall conform to the liquidity test based upon the estimates provided to them by the Board;

(iv) where the company proposes to adopt the corporate debt restructuring guidelines specified by the Reserve Bank of India, a statement to that effect; and

(v) a valuation report in respect of the shares and the property and all assets, tangible and intangible, movable and immovable, of the company by a registered valuer.

Notice of the meeting

Section 230(3) states that when a meeting is proposed to be called in pursuance of an order of the Tribunal under sub-section (1), a notice of such meeting shall be sent to all the creditors or class of creditors and to all the members or class of members and the debenture-holders of the company, individually at the address registered with the company which shall be accompanied by:

- a statement disclosing the details of the compromise or arrangement,
- a copy of the valuation report, if any, and
- explaining their effect on creditors, key managerial personnel, promoters and non-promoter members, and the debenture-holders, and
- the effect of the compromise or arrangement on any material interests of the directors of the company or the debenture trustees, and
- such other matters as may be prescribed.

The notice of the meeting pursuant to the order of the Tribunal shall be in **Form No. CAA.2** and shall be sent individually to each of the creditors or members. The notice shall be sent by the chairperson appointed for the meeting, or, if the Tribunal so directs, by the company (or its liquidator), or any other person as the Tribunal may direct, by registered post or speed post or by courier or by e-mail or by hand delivery or any other mode as directed by the Tribunal to their last known address at least one month before the date fixed for the meeting. The notice of the meeting to the creditors and members shall be accompanied by a copy of the scheme of compromise or arrangement. [Rule 6 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

Such notice and other documents shall also be placed on the website of the company, if any, and in case of a listed company, these documents shall be sent to the Securities and Exchange Board and stock exchange where the securities of the companies are listed, for placing on their website and shall also be published in newspapers in such manner as may be prescribed.

When the notice for the meeting is also issued by way of an advertisement, it shall indicate the time within which copies of the compromise or arrangement shall be made available to the concerned persons free of charge from the registered office of the company.

The notice of the meeting shall be advertised in **Form No. CAA - 2** in at least one English newspaper and in at least one vernacular newspaper having wide circulation in the state in which the registered office of the company is situated, or such newspaper as may be directed by the Tribunal and shall also be placed, not less than thirty days before the date fixed for the meeting, on the website of the company, of the SEBI and the recognized stock exchange where the securities of the company are listed. Where separate meetings of classes of creditors or members are to be held, a joint advertisement for such meetings may be given. [Rule 7 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

Notice to provide for voting by themselves or through proxy or through postal ballot

Sub-section (4) of section 230 states that a notice under sub-section (3) shall provide that the persons to whom the notice is sent may vote in the meeting either themselves or through proxies or by postal ballot to the adoption of the compromise or arrangement within one month from the date of receipt of such notice.

Who can object to the scheme?

Any objection to the compromise or arrangement shall be made only by persons holding not less than ten per cent of the shareholding or having outstanding debt amounting to not less than five per cent of the total outstanding debt as per the latest audited financial statement.

Notice to be sent to the regulators seeking their representations

Section 230(5) states that a notice under sub-section (3) along with all the documents in **Form CAA- 3** as may be prescribed shall also be sent to-

- the Central Government, the Registrar of Companies, the Income-tax authorities, in all cases;
- the Reserve Bank of India, the Securities and Exchange Board, the respective stock exchanges, the Official Liquidator, the Competition Commission of India established under sub-section (1) of section 7 of the Competition Act, 2002, if necessary; and
- such other sectoral regulators or authorities which are likely to be affected by the compromise or arrangement; and

shall require that representations, if any, to be made by them shall be made within a period of thirty days from the date of receipt of such notice, failing which, it shall be presumed that they have no representations to make on the proposals.

Affidavit of Service

The chairperson appointed for the meeting of the company or other person directed to issue the advertisement and the notices of the meeting shall file an affidavit before the Tribunal not less than seven days before the date fixed for meeting or date of the first of the meetings, as the case may be, stating that the directions regarding the issue of notices and the advertisement have been duly complied with.

In case of default, the application along with copy of the last order issued shall be posted the Tribunal for such orders as it may think fit to make. [Rule 12 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

Voting

The person who receives the notice may within one month from date of receipt of the notice vote in the meeting either in person of through electronics means to the adoption of the scheme of compromise and arrangement.

Explanation. For the purpose of voting by persons who receive the notice as shareholder of creditor under this rule-

(a) "shareholding" shall mean the shareholding of the members of the class who are entitled to vote on the proposal; and

(b) "outstanding debt" shall mean all debt owed by the company to the respective class or classes of creditors that remains outstanding as per the latest audited financial statement, or if such statement is more than six months old, as per provisional financial statement not preceding the date of application by more than six months.

Rule 13 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

The voting at the meeting or meetings held in pursuance of the directions of the tribunal under Rule 5 on all resolutions shall take place by poll or by voting through electronics means.

The report of the result of the meeting under sub rule (1) shall be in **Form no CAA.4** and shall state accurately the number of creditors or class of creditors, as the case may be, who were present and who voted at the meeting either in person or by proxy, and where applicable, who voted through electronics means, their individual values and the way they voted.

Copy of compromise or arrangement to be furnished by the company :-

Every creditor or member entitled to attend the meeting shall be furnished by the company , free of charge , within one day on a requisition being made for the same, with a copy of the scheme of the proposed compromise or arrangement together with a copy of the statement required to be furnished under section 230 of the Act. [Rule 11 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016].

Approval and sanction of the scheme

Section 230(6) states that when at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be and the contributories of the company.

Order of the Tribunal sanctioning the scheme to provide for the following matters [Section 230(7)]

An order made by the Tribunal under sub-section (6) shall provide for all or any of the following matters, namely:—

(a) where the compromise or arrangement provides for conversion of preference shares into equity shares, such preference shareholders shall be given an option to either obtain arrears of dividend in cash or accept equity shares equal to the value of the dividend payable;

> **Illustration:**
>
> A compromise is permitted between ABC Limited and its shareholders which provide for conversion of preference shares into equity shares. Mr. V is a preferential shareholder and entitled to arrear of dividend (Rs. 20,000). The order of tribunal permitting compromise shall provide that either Mr. V will receive arrears of dividend or equity shares of value Rs. 20,000.

(b) the protection of any class of creditors;

(c) if the compromise or arrangement results in the variation of the shareholders' rights, it shall be given effect to under the provisions of section 48;

(d) if the compromise or arrangement is agreed to by the creditors under sub-section (6), any proceedings pending before the Board for Industrial and Financial Reconstruction established under section 4 of the Sick Industrial Companies (Special Provisions) Act, 1985 shall abate;

(e) such other matters including exit offer to dissenting shareholders, if any, as are in the opinion of the Tribunal necessary to effectively implement the terms of the compromise or arrangement.

Rule 17 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

Where the tribunal sanctions the compromise or arrangement, the order shall include such directions in regard to any matter or such modifications in the compromise or arrangement as the tribunal may think to fit to make for the proper working of the compromise or arrangement. The order shall direct that a certified copy of the same shall be filed with the registrar of companies within thirty days from the date of the receipt of copy of the order , or such other time as maybe fixed by the tribunal.

The order shall be in **Form No. CAA. 6**, with such variations as may be necessary.

Accounting treatment proposed in the scheme to be in conformity with accounting standards

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133. [Proviso to Section 230(7)].

In the matter of *SMS Iron Technology (P.) Ltd Company Petition NO. 937 of 2016 NCLT-New Delhi*, it was held that the petition filed by petitioner companies including demerged company seeking their amalgamation with transferee company could not be allowed where statutory auditor of demerged company certified in his report that accounting treatment of investments of company was not in consonance with prescribed Accounting Standards.

Order of Tribunal to be filed with the Registrar

Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.

Tribunal may dispense with calling of meeting of creditors

Section 230(9) states that the Tribunal may dispense with calling of a meeting of creditors or class of creditors where such creditors or class of creditors, having at least ninety per cent value, agree and confirm, by way of affidavit, to the scheme of compromise or arrangement.

In the matter of *In Re Visa Bao Ltd. Co. Application No. 106 of 2017, NCLT Kolkata*, it was held that where in process of implementing scheme of amalgamation, majority secured creditors of amalgamating companies gave their consent to dispensed with meeting of secured creditors, said meetings were to be dispensed, while shareholders'/unsecured creditors meetings were to be convened.

NCLT is not empowered to dispense with holding of shareholders' meetings under section 230 in case of compromise or arrangements. *In Re Quickcalls (P.) Ltd. CA (CAA) - 75 (ND) OF 2020, NCLT-New Delhi*

Compromise in respect of buy back is to be in compliance with section 68

As per Section 230(10), no compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68.

Compromise includes takeover

Section 230(11) states that any compromise or arrangement may include takeover offer made in such manner as may be prescribed. In case of listed companies, takeover offer shall be as per the regulations framed by the Securities and Exchange Board.

Application to the Tribunal by an aggrieved party

Section 230(12) states that an aggrieved party may make an application to the Tribunal in the event of any grievances with respect to the takeover offer of companies other than listed companies in such manner as may be prescribed and the Tribunal may, on application, pass such order as it may deem fit.

Do provisions of section 66 apply with respect to reduction of capital effected in pursuance of order of Tribunal under section 230?

Provisions of section 66 shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section.

An application may be made in **Form NCLT-1** and shall be accompanied with prescribed documents.

Certain statutory enactments to be considered at the time of Compromise, Arrangement & Amalgamations :

1. INCOME TAX ACT 1961

The Income Tax Act, 1961 covers aspects such as tax reliefs to amalgamating/amalgamated companies, carry forward of losses, exemptions from capital gains tax, etc. For example, when a scheme of merger or demerger involves the merger of a loss-making company or a hiving off of a loss-making division, it is necessary to check the relevant provisions of the Income Tax Act and the Rules for the purpose of ensuring, *inter alia*, the availability of the benefit of carrying forward the accumulated losses and setting of such losses against the profits of the Transferee Company. Taxation aspects of the Merger and Amalgamation have more elaborately given under the relevant module.

2. SEBI (LISTING OBLIGATIONS & DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

Regulation 37 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, provides that the listed entity shall not file any scheme of arrangement under sections 391-394 and 101 of the erstwhile Companies Act, 1956 or under Sections 230-234 and Section 66 of Companies Act, 2013, whichever applicable, with any Court or Tribunal unless it has obtained the No-objection letter from the stock exchange(s).

Generally, stock exchanges raise several queries and on being satisfied that the scheme does not violate any laws concerning securities such as the Takeover Code or the SEBI (ICDR) Regulations, Stock Exchanges accord their approval.

The listed entity shall place the No-objection letter of the stock exchange(s) before the Court or Tribunal at the time of seeking approval of the scheme of arrangement. The validity of the No-objection letter of stock exchanges shall be six months from the date of issuance, within which the draft scheme of arrangement shall be submitted to the Court or Tribunal.

In addition to the above, Securities and Exchange Board of India has also provided some compliances with regard to the merger and amalgamation.

Rule 19 of the Securities Contracts (Regulation) Rules, 1957 provides basic compliance requirement for listing of securities on stock exchanges and SEBI has the power to relax listed companies from such compliances.

SEBI has issued Circular No. CFD/DIL3/CIR/2017/21 dated March 10, 2017 which *inter-alia* regulate the scheme of arrangement/ amalgamation/ merger/ etc. as filed with Stock Exchange (STX) for their NOC/ observation letter and also the provides for certain requirements to be complied with for being eligible to get relaxation under Rule 19 of Securities Contracts (Regulation) Rules, 1957 and get the specified securities, issued by the transferee company, pursuant to a Scheme, listed on the stock exchange. Circular provides for the format of Detailed Compliance Report (DCR) to be filed with STX at the time obtaining their NOC/ Observation letter duly certified by the Company Secretary, Chief Financial Officer and the Managing Director, confirming compliance with various regulatory requirements specified for schemes of arrangement and all accounting standards.

Upon sanction of the Scheme by the Court or Tribunal, the listed entity shall submit the documents, to the stock exchange(s), as prescribed by the Board and/or stock exchange(s) from time to time.

However, draft schemes which solely provide for merger of a wholly owned subsidiary with its holding company the requirement of No Objection Certification will not be apply. Provided that such draft schemes shall be filed with the stock exchanges for the purpose of disclosures.

Further, the requirements as specified in regulation 37 and under regulation 94 shall not apply to a restructuring proposal approved as part of a resolution plan by the Tribunal under section 31 of the Insolvency Code, subject

to the details being disclosed to the recognized stock exchanges within one day of the resolution plan being approved.

3. THE INDIAN STAMP ACT 1899

It is necessary to refer to the Stamp Act to check the stamp duty payable on transfer of undertaking through a merger or demerger.

The Constitution of India confers the power on the state legislature to make the laws in regard to the matters of stamp duty other than the documents specified in schedule I. The State in exercise of its legislative powers under Article 246 of the Constitution read with Entry 63 of List II (Seventh Schedule) of the Constitution levy the Stamp Duty.

Stamp duty is levied on the instrument evidencing a transfer *inter-vivos*, i.e., a conveyance. As per Section 2(10) of the Indian Stamp Act, 1899, "***Conveyance***" includes a conveyance on sale and ***every instrument*** by which property whether movable or immovable, is transferred *inter vivos* and which is not otherwise specifically provided for by Schedule I.

As per Section 2(14) of the Indian Stamp Act, 1899, "***Instrument***" includes every ***document*** by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or record.

The term Section 3(18) of the General Clauses Act, 1897, "***Document***" ***shall include any matter written***, expressed or described upon any substance by means of letters, figures or marks, or by more than one of those means ***which is intended to be used***, or which may be used, ***for the purpose or recording that matter***.

The definition(s) as reproduced above are inclusive in nature and are not self-explanatory. Hence, to avoid any ambiguity and confusion in this regard, with time, certain States has amended their Stamp Act and included Order of Court approving scheme of arrangement within the meaning of 'conveyance'. Maharashtra, Gujarat, Karnataka, Rajasthan, Chhattisgarh, Madhya Pradesh and Andhra Pradesh are the States which have specifically included an amalgamation order of a High Court as "Conveyance".

In *Re. Sahayanidhi (Virudhunagar) Ltd. vs. AR.S Subramanya Nadar,* (1950) *20 Com Cases 214 (Mad)* Hon'ble Madras High Court held that, "the documents (scheme of amalgamation or reconstruction) purport to transfer movable property in the shape of book debts and promissory notes and the consideration for such transfer is partly in the shape of a cash payment and partly in the shape of covenants entered into by the transferee. We are therefore of the opinion that these two documents fall within Article 23 of Schedule I and are to be stamped as such."

Payment of Stamp Duty in Various States

Some of the States like Maharashtra, Gujarat, Karnataka, Rajasthan etc. which have enacted their own Stamp Acts have made specific provisions with respect to payment of Stamp Duty on Order of the High Court under the Companies Acts/Schedules, while some other states like Madhya Pradesh, Andhra Pradesh etc. which have adopted the Indian Stamp Act, 1899 have made state amendments to levy Stamp duty on the High Court Order. The remaining states which neither have their own Stamp Act nor have they made any State Amendment in the adopted Indian Stamp Act, 1899, levy Stamp duty as per the decision of High Court, if any, covering their states, or follow the decision of Supreme Court as laid down in the case of Hindustan Lever.

The law relating to payment of Stamp Duty on the Order of High Court in case of Merger lacks uniformity in India and levy of Stamp Duty will depend upon the Stamp Duty Law of the Concerned State. Also, in cases where the Transferor Company has its assets in different states things may get more complicated. The method of arriving at the figure of Stamp Duty also varies from State to State. Non -payment of Stamp Duty can cause legal hurdles at the time of registration of properties in the name of Transferee Company. Payment of Stamp

Duty is an important aspect to be considered before going in for a merger especially in those cases where the asset of the Transferor Company poses a significant value.

4. SEBI (SUBSTANTIAL ACQUISITION OF SHARES AND TAKEOVER) REGULATIONS, 2011

If an acquisition is contemplated by way of issue of new shares, or the acquisition of existing shares or voting rights, of a listed company, to or by an acquirer, the provisions of the Takeover Code are applicable. The Takeover Code regulates both direct and indirect acquisitions of shares or voting rights in, and control over a target company. The key objectives of the Takeover Code are to provide the shareholders of a listed company with adequate information about an impending change in control of the company or substantial acquisition by an acquirer, and provide them with an exit option in case they do not wish to retain their shareholding in the company.

5. THE COMPETITION ACT, 2002

The provisions of Competition Act and the Competition Commission of India (Procedure in regard to the Transaction of Business relating to Combinations) Regulations, 2011 are to be complied with.

6. THE FOREIGN EXCHANGE MANAGEMENT (CROSS BORDER MERGER) REGULATIONS, 2018

The Foreign Exchange Management (Cross Border Merger) Regulations, 2018 have been notified vide notification no. FEMA 389/ 2018-RB dated 20th March, 2018 and are effective from the date of notification. As per the Regulations, merger transactions in compliance with these regulations shall be deemed to have been approved by RBI, and hence, no separate approval should be required. In other cases, merger transactions require prior RBI approval.

Corporate Restructuring process in India is governed by the Companies Act, 2013, the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 and various other regulatory laws such as the Income Tax Act, 1961, the Competition Act, 2002, the Foreign Exchange Management Act, 1999, the Indian and State Stamp Acts and Insolvency and Bankruptcy Code, 2016. Chapter XV of the Companies Act, 2013 (comprising sections 230 to 240) regulates compromises, arrangement and amalgamations.

POWER OF THE TRIBUNAL TO ENFORCE COMPROMISE OR ARRANGEMENT

As per section 231(1), when the Tribunal makes an order under section 230 sanctioning a compromise or an arrangement in respect of a company, it—

(a) shall have power to supervise the implementation of the compromise or arrangement; and

(b) may, at the time of making such order or at any time thereafter, give such directions in regard to any matter or make such modifications in the compromise or arrangement as it may consider necessary for the proper implementation of the compromise or arrangement.

Sub-section (2) states that if the Tribunal is satisfied that the compromise or arrangement sanctioned under section 230 cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the scheme, it may make an order for winding-up the company and such an order shall be deemed to be an order made under section 273.

In case of Government Company - In Section 231 for the word “Tribunal” the words “Central Government” shall be substituted.

In the matter of *Joint Commissioner of Income Tax (OSD), Circle (3)(3)-1 & Ors. (Appellants) vs. Reliance Jio Infocomm Ltd. & Ors. (Respondents)*

Mere fact that a Scheme of Arrangement may result in reduction of tax liability does not furnish a basis for challenging the validity of the same.

The National Company Law Appellate Tribunal (NCLAT), held that without going to the record and without placing any evidence or substantiating the allegation of avoidance of tax by appearing before the Tribunal, it was not open to the income tax department to hold that the composite scheme of arrangement amongst the petitioner companies and their respective shareholders and creditors is giving undue favour to the shareholders of the company and also the overall scheme of arrangement results into tax avoidance.

The NCLAT observed that mere fact that a scheme may result in reduction of tax liability does not furnish a basis for challenging the validity of the same. The Income Tax Department, which sought for liberty, while accepted by the Petitioner Companies (Respondents herein) and the NCLT, Ahmedabad bench while approving the Composite Scheme of Arrangement has granted liberty. Such liberty to the Income Tax Department to enquire into the matter, if any part of the Composite Scheme of Arrangement amounts to tax avoidance or is against the provisions of the Income Tax and is to let it take appropriate steps if so required. Thus, NCLAT upheld the decision of NCLT, Ahmedabad bench and in view of the liberty given to the Income Tax Department decided not to interfere with the Scheme of Arrangement as approved by the Tribunal and dismissed the appeals filed.

MERGER AND AMALGAMATION OF COMPANIES

Merger

The term merger and amalgamation has not been defined under the Companies Act, 2013. Merger & Amalgamation is often known to be a single terminology. However, there is a thin difference between the two. 'Merger' is the fusion of two or more companies, whereby the identity of one or more is lost resulting in a single company whereas 'Amalgamation' signifies the blending of two or more undertaking into one undertaking, blending enterprises loses their identity forming themselves into a separate legal identity.

There may be amalgamation by the transfer of two or more undertakings to a new or existing company. 'Transferor company' means the company which is merging also known as amalgamating company in case of amalgamation and 'transferee company' is the company which is formed after merger or amalgamation also known as amalgamated company in case of amalgamation.

A merger is a legal consolidation of two entities into one entity which can be merged together either by way of amalgamation or absorption or by formation of a new company. The Board of Directors of two companies approve the combination and seek shareholders' approval. After the merger, the acquired company ceases to exist and becomes part of the acquiring company.

Amalgamation

Amalgamation is a legal process by which two or more companies are joined together to form a new entity or one or more companies are to be absorbed or blended with another as a consequence the amalgamating company loses its existence and its shareholders become the shareholders of new company or amalgamated company. In other words, property, assets, liabilities of one or more companies, is taken over by another or are absorbed by and transferred to an existing company or a new company. Therefore, the essence of amalgamation is to make an arrangement thereby uniting the undertakings of two or more companies so that they become vested

in, or under the control of one company which may or may not be the original of the two or more of such uniting companies. The word "amalgamation" is not defined under the Companies Act 2013 whereas section 2(1B) of Income Tax Act, 1961 defines Amalgamation as:

"Amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that –

(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company.

Tribunal's power to call meeting of creditors or members, with respect to merger or amalgamation of companies

Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal –

(a) that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and

(b) that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies,

the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply *mutatis mutandis*.

As per Rule 18 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, where the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies, and the matters involved cannot be dealt with or dealt with adequately on the petition for sanction of the compromise or arrangement, an application shall be made to the tribunal under section 232 of the Act, by a notice of admission supported by an affidavit for directions of the Tribunal as to the proceedings to be taken.

Notice of admission in such cases shall be given in such manner and to such persons as the tribunal may direct.

Circulation of documents for members'/creditors' meeting

Section 232(2) states that when an order has been made by the Tribunal under sub-section (1), merging companies or the companies in respect of which a division is proposed, shall also be required to circulate the following for the meeting so ordered by the Tribunal, namely:—

(a) the draft of the proposed terms of the scheme drawn up and adopted by the directors of the merging company;

(b) confirmation that a copy of the draft scheme has been filed with the Registrar;

(c) a report adopted by the directors of the merging companies explaining effect of compromise on each class of shareholders, key managerial personnel, promoters and non-promoter shareholders laying out in particular the share exchange ratio, specifying any special valuation difficulties;

(d) the report of the expert with regard to valuation, if any;

(e) a supplementary accounting statement if the last annual accounts of any of the merging company relate to a financial year ending more than six months before the first meeting of the company summoned for the purposes of approving the scheme.

Sanctioning of scheme by Tribunal

Section 232(3) states that the Tribunal, after satisfying itself that the procedure specified in sub-sections (1) and has been complied with, may, by order, sanction the compromise or arrangement or by a subsequent order, make provision for the following matters, namely:—

(a) the transfer to the transferee company of the whole or any part of the undertaking, property or liabilities of the transferor company from a date to be determined by the parties unless the Tribunal, for reasons to be recorded by it in writing, decides otherwise;

(b) the allotment or appropriation by the transferee company of any shares, debentures, policies or other like instruments in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person:

A transferee company shall not, as a result of the compromise or arrangement, hold any shares in its own name or in the name of any trust whether on its behalf or on behalf of any of its subsidiary or associate companies and any such shares shall be cancelled or extinguished;

No transferee company can hold shares in its own name or under any trust;

(c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company on the date of transfer;

(d) dissolution, without winding-up, of any transferor company;

(e) the provision to be made for any persons who, within such time and in such manner as the Tribunal directs, dissent from the compromise or arrangement;

(f) where share capital is held by any non-resident shareholder under the foreign direct investment norms or guidelines specified by the Central Government or in accordance with any law for the time being in force, the allotment of shares of the transferee company to such shareholder shall be in the manner specified in the order;

(g) the transfer of the employees of the transferor company to the transferee company;

(h) when the transferor company is a listed company and the transferee company is an unlisted company,—

(i) the transferee company shall remain an unlisted company until it becomes a listed company;

(ii) if shareholders of the transferor company decide to opt out of the transferee company, provision shall be made for payment of the value of shares held by them and other benefits in accordance with a pre- determined price formula or after a valuation is made, and the arrangements under this provision may be made by the Tribunal.

The amount of payment or valuation under this clause for any share shall not be less than what has been specified by the Securities and Exchange Board under any regulations framed by it;

(i) where the transferor company is dissolved, the fee, if any, paid by the transferor company on its authorised capital shall be set-off against any fees payable by the transferee company on its authorised capital subsequent to the amalgamation; and

(j) such incidental, consequential and supplemental matters as are deemed necessary to secure that the merger or amalgamation is fully and effectively carried out.

Auditor's certificate as to conformity with accounting standards

No compromise or arrangement shall be sanctioned by the Tribunal unless a certificate by the company's auditor has been filed with the Tribunal to the effect that the accounting treatment, if any, proposed in the scheme of compromise or arrangement is in conformity with the accounting standards prescribed under section 133.

In the matter of *Real Image LLP Vs. Qube Cinema Technologies (P.) Ltd. CP NO. 123/CAA/2018 NCLT-Chennai,* It was held that where both transferor LLP and transferee company were regularly filing its statutory return and all proposed accounting treatment was in conformity with accounting standards prescribed under section 133 and all statutory compliances had been made under section 232, amalgamation of transferor LLP with transferee company was to be allowed.

Transfer of property or liabilities

Sub-section (4) of Section 232 states that where an order under this section provides for the transfer of any property or liabilities, then, by virtue of the order, that property shall be transferred to the transferee company and the liabilities shall be transferred to and become the liabilities of the transferee company and any property may, if the order so directs, be freed from any charge which shall by virtue of the compromise or arrangement, cease to have effect.

Certified copy of the order to be filed with the Registrar

An order made under section 232 read with section 230 of the act shall be in **Form No CAA.7** with such variation as the circumstances may require. [Rule 20 of the Companies (Compromise, Arrangements and Amalgamation) Rules, 2016]

Section 232(5) states that every company in relation to which the order is made shall cause a certified copy of the order to be filed with the Registrar for registration within thirty days of the receipt of certified copy of the order.

Effective date of the scheme

Section 232(6) states that the scheme under this section shall clearly indicate an appointed date from which it shall be effective and the scheme shall be deemed to be effective from such date and not at a date subsequent to the appointed date.

Annual statement certified by CA/CS/CWA to be filed with Registrar every year until the completion of the scheme

For the purpose of section 232(7) of Act , every company in relation to which an order is made under sub section (3) of section 232 of the act shall until the scheme is fully implemented, file with the registrar of companies, the statement in **Form No.CAA.8** along with such fee as specified in the companies (Registration offices and Fees) Rules, 2014 within two hundred and ten days from the end of each financial year.

Punishment

Section 232(8) states that if a company fails to comply with provisions of section 232 (5) i.e.failure to file Certified copy of the order with the Registrar, the company and every officer of the company who is in default shall be liable to a penalty of twenty thousand rupees, and where the failure is a continuing one, with a further penalty of one thousand rupees for each day after the first during which such failure continues, subject to a maximum of three lakh rupees.

Explanation under Section 232

For the purpose of the Section, —

(i) in a scheme involving a merger, where under the scheme the undertaking, property and liabilities of one or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to another existing company, it is a merger by absorption, or

where the undertaking, property and liabilities of two or more companies, including the company in respect of which the compromise or arrangement is proposed, are to be transferred to a new company, whether or not a public company, it is a merger by formation of a new company;

(ii) references to merging companies are in relation to a merger by absorption, to the transferor and transferee companies, and, in relation to a merger by formation of a new company, to the transferor companies;

(iii) a scheme involves a division, where under the scheme the undertaking, property and liabilities of the company in respect of which the compromise or arrangement is proposed are to be divided among and transferred to two or more companies each of which is either an existing company or a new company; and

(iv) property includes assets, rights and interests of every description and liabilities include debts and obligations of every description.

In case of Government Company - In Section 232 for the word “Tribunal” the words “Central Government” shall be substituted.- Notification Dated 13th June, 2017.

In the matter of *Mohit Agro Commodities & Ors. NCLAT, dated June 28, 2021*

When the ‘Transferor and Transferee Company’ involve a Parent Company and a Wholly Owned Subsidiary the meeting of Equity Shareholders, Secured and Unsecured Creditors can be dispensed with as the rights of the Equity Shareholders of the ‘Transferee Company’ are not being affected

Fact of the Case

The Appellant Company (‘Transferor Company’ and ‘Transferee Company’) filed Applications under Sections 230 to 232 and other relevant provisions of the Companies Act, 2013 seeking dispensation of the meeting of the Equity Shareholders, Secured Creditors and Unsecured Creditors in respect of the

scheme of Amalgamation of the 'Transferor Company' with the 'Transferee Company' with effect from the appointed date on the aggrieved terms and conditions has set out in the scheme in accordance with Sections 230 to 232 of the Companies Act, 2013 and other applicable provisions of the Act. It is contented that there is no change in the capital structure of the 'Transferor Company' till the date of approval of the schemes by the Board of Directors.

It is further stated that the 'Transferor Company' is a Wholly Owned Subsidiary of the 'Transferee Company' and that both the Companies are incorporated in similar type of nature of activities and that the 'Transferee Company' had acquired the 'Transferor Company' as a business supportive mechanism for ease of operations.

Judgment

The NCLAT has observed that Section 232(1) of the Companies Act, 2013 uses the word 'may' which introduces an element of discretion to the Tribunal to be exercised in the interest of justice in appropriate situations. Section 232 is a specific provision carved out by the Legislature when both conditions maintained in clauses (a) and (b) of sub-Section (1) of Section 232 are met.

In the instant case the amalgamation sought for is between a Wholly Owned Subsidiary and the Holding Company. The point which needs to be noted is:

- whether such an arrangement alters the rights of the Stakeholders of the Company?
- whether such an amalgamation has any bearing internally on Creditors/Members of both the Companies?
- whether not holding the subject meeting would amount to violation of any of the provisions of the Companies Act, 2013?
- whether the Tribunal can exercise their discretion when the 'Transferor Company' is a Wholly Owned Subsidiary of the 'Transferee Company' and financial position of the 'Transferee Company' is positive and the merger is not affecting the rights of the Shareholders or the Creditors?

Therefore, it is held that the rights and liabilities of Secured and Unsecured Creditors were not getting affected in any manner by way of the proposed scheme as no new shares are being issued by the 'Transferor Company' and no compromise is offered to any Secured and Unsecured Creditors of the 'Transferee Company'. Hence, when the 'Transferor and Transferee Company' involve a Parent Company and a Wholly Owned Subsidiary the meeting of Equity Shareholders, Secured Creditors and Unsecured Creditors can be dispensed with as the rights of the Equity Shareholders of the 'Transferee Company' are not being affected.

MERGER AND AMALGAMATION OF CERTAIN COMPANIES

Section 233 prescribes simplified procedure for Merger or amalgamation of –

- two or more small companies; or
- between a holding company and its wholly-owned subsidiary company; or
- such other class or classes of companies as may be prescribed.

Merger of small companies/holding and subsidiary companies

Section 233(1) states that notwithstanding the provisions of section 230 and section 232, a scheme of merger or amalgamation may be entered into between two or more small companies or between a holding company and its wholly-owned subsidiary company or such other class or classes of companies as may be prescribed, subject to the following, namely:–

(a) a notice of the proposed scheme inviting objections or suggestions, if any, from the Registrar and Official Liquidators where registered office of the respective companies are situated or persons affected by

the scheme within thirty days is issued by the transferor company or companies and the transferee company; Such objections or suggestions from the Registrar and official liquidator or persons affected by the scheme shall be in **Form CAA-9**;

(b) the objections and suggestions received are considered by the companies in their respective general meetings and the scheme is approved by the respective members or class of members at a general meeting holding at least ninety per cent of the total number of shares;

(c) each of the companies involved in the merger files a declaration of solvency, in **Form No.CAA-10**, with the Registrar of the place where the registered office of the company is situated; and

(d) the scheme is approved by majority representing nine-tenths in value of the creditors or class of creditors of respective companies indicated in a meeting convened by the company by giving a notice of twenty-one days along with the scheme to its creditors for the purpose or otherwise approved in writing.

According to Rule 25, of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 for the purpose of clause (b) and (d) of sub-section (1) of section 233 of the Act, the notice of the meeting to the members and creditors shall be accompanied by-

(a) a statement, as far as applicable, referred to in sub section (3) of section 230 of the act read with sub rule (3) of rule 6 hereof;

(b) The declaration of solvency made in pursuance of clause (c) of sub-section (1) of section 233 of the Act in **Form No. CAA.10**; and

(c) A copy of the scheme.

The declaration of solvency shall be filed by each of the companies involved in the scheme of merger or amalgamation, before convening the meeting of members and creditors for approval of the scheme.

The Central Government has prescribed class of Companies between which a scheme of merger or amalgamation under section 233 of the Act may be entered into, namely:-

(i) two or more start-up companies; or

(ii) one or more start-up company with one or more small company.

Explanation.- For the purposes of this sub-rule, "start-up company" means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with notification number G.S.R. 127 (E), dated the 19th February, 2019 issued by the Department for Promotion of Industry and Internal Trade.

Transferee company to file a copy of scheme approved

Section 233(2) states that the transferee company shall file a copy of the scheme so approved in the manner as may be prescribed, with the Central Government, Registrar and the Official Liquidator where the registered office of the company is situated.

According to Rule 25(4)(a) of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, the transferee company shall, within seven days after the conclusion of the meeting of members or class of members or creditors, file a copy of the scheme as agreed to by the members and creditors, along with a report of the result of each of the meetings in **Form No. CAA.11** with the central government, along with the fees as provided under the Companies (Registration Offices and Fees) Rules, 2014.

Further, as per Rule 25(4)(b) Copy of the scheme shall also be filed, along with **Form No. CAA.11** with –

(i) the registrar of companies in **Form No. GNL-1** along with fees provided under the Companies (Registration Offices and Fees) Rules, 2014; and

(ii) the official liquidator through hand delivery or by registered post or speed post.

Central Government to issue confirmation order, where there are no objections or suggestions from Registrar or Official Liquidator

Section 233(3) states that on the receipt of the scheme, if the Registrar or the official liquidator has no objections or suggestions to the scheme, the Central Government shall register the same and issue a confirmation thereof to the companies.

Where no objection or suggestion is received within a period of thirty days of receipt of copy of scheme under sub-section (2) of section 233, from the Registrar of Companies and Official Liquidator by the Central Government and the Central Government is of the opinion that the scheme is in the public interest or in the interest of creditors, it may, within a period of fifteen days after the expiry of said thirty days, issue a confirmation order of such scheme of merger or amalgamation in Form No. CAA.12.

Provided that if the Central Government does not issue the confirmation order within a period of sixty days of the receipt of the scheme under sub-section (2) of section 233, it shall be deemed that it has no objection to the scheme and a confirmation order shall be issued accordingly.[Rule 25(5)]

Objections if any by the Registrar or Official Liquidator to be communicated to the Central Government

Section 233(4) provides that if the Registrar or Official Liquidator has any objections or suggestions, he may communicate the same in writing to the Central Government within a period of thirty days. If no such communication is made, it shall be presumed that he has no objection to the scheme.

Application by Central Government to the Tribunal

Section 233(5) states that if the Central Government after receiving the objections or suggestions or for any reason is of the opinion that such a scheme is not in public interest or in the interest of the creditors, it may file an application before the Tribunal within a period of sixty days of the receipt of the scheme under sub-section stating its objections and requesting that the Tribunal may consider the scheme under section 232.

Rule 25(6) of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 mandate where objections or suggestions are received within a period of thirty days of receipt of copy of scheme under sub-section (2) of section 233 from the Registrar of Companies or Official Liquidator or both by the Central Government and –

(a) such objections or suggestions of Registrar of Companies or Official Liquidator, are not sustainable and the Central Government is of the opinion that the scheme is in the public interest or in the interest of creditors, it may within a period of thirty days after expiry of thirty days referred to above, issue a confirmation order of such scheme of merger or amalgamation in Form No. CAA.12;

(b) the Central Government is of the opinion, whether on the basis of such objections or otherwise, that the scheme is not in the public interest or in the interest of creditors, it may within sixty days of the receipt of the scheme file an application before the Tribunal in Form No. CAA.13 stating the objections or opinion and requesting that Tribunal may consider the scheme under section 232 of the Act:

Provided that if the Central Government does not issue a confirmation order under clause (a) or does not file any application under clause (b) within a period of sixty days of the receipt of the scheme under subsection (2) of section 233 of the Act, it shall be deemed that it has no objection to the scheme and a confirmation order shall be issued accordingly.

Tribunal's Action to Central Government's application

Section 233(6) states that on receipt of an application from the Central Government or from any person, if the Tribunal, for reasons to be recorded in writing, is of the opinion that the scheme should be considered as per

the procedure laid down in section 232, the Tribunal may direct accordingly or it may confirm the scheme by passing such order as it deems fit:

If the Central Government does not have any objection to the scheme or it does not file any application under this section before the Tribunal, it shall be deemed that it has no objection to the scheme.

Registrar having jurisdiction over transferee company has to be communicated

Section 233(7) states that a copy of the order under sub-section (6) confirming the scheme shall be communicated to the Registrar having jurisdiction over the transferee company and the persons concerned and the Registrar shall register the scheme and issue a confirmation thereof to the companies and such confirmation shall be communicated to the Registrars where transferor company or companies were situated.

Rule 25(7) of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 states that the confirmation order of the scheme issued by the Central Government or tribunal under sub section (7) of section 233 of the Act, shall be filed, within thirty days of the receipt of the order of confirmation, in **Form INC-28** along with the fees as provided under Companies (Registration Offices and Fees) Rules 2014 with the Registrar of companies respectively.

Effect of registration of the scheme

Section 233(8) states that registration of the scheme under sub-section (3) or sub-section (7) shall be deemed to have the effect of dissolution of the transferor company without process of winding-up.

Section 233(9) states that the registration of the scheme shall have the following effects, namely:—

(a) transfer of property or liabilities of the transferor company to the transferee company so that the property becomes the property of the transferee company and the liabilities become the liabilities of the transferee company;

(b) the charges, if any, on the property of the transferor company shall be applicable and enforceable as if the charges were on the property of the transferee company;

(c) legal proceedings by or against the transferor company pending before any court of law shall be continued by or against the transferee company; and

(d) where the scheme provides for purchase of shares held by the dissenting shareholders or settlement of debt due to dissenting creditors, such amount, to the extent it is unpaid, shall become the liability of the transferee company.

Transferee Company not to hold any share in its own name or trust and all such shares are to be cancelled or extinguished

Section 233(10) states that a transferee company shall not on merger or amalgamation, hold any shares in its own name or in the name of any trust either on its behalf or on behalf of any of its subsidiary or associate company and all such shares shall be cancelled or extinguished on the merger or amalgamation.

Transferee Company to file an application with Registrar along with the scheme registered

Section 233(11) provides that the transferee company shall file an application with the Registrar along with the scheme registered, indicating the revised authorised capital and pay the prescribed fees due on revised capital. The fee, if any, paid by the transferor company on its authorised capital prior to its merger or amalgamation with the transferee company shall be set-off against the fees payable by the transferee company on its authorised capital enhanced by the merger or amalgamation.

Section 233(12) provides that the provisions of Section 233 shall *mutatis mutandis* apply to a company or companies specified in sub-section (1) in respect of a scheme of compromise or arrangement referred to in section 230 or division or transfer of a company referred to clause (b) of subsection (1) of section 232.

The Central Government may provide for the merger or amalgamation of companies in such manner as may be prescribed.

It is clarified that with respect to schemes of arrangement or compromise falling within the purview of section 233 of the Act, the concerned companies may , at their discretion, opt to undertake such schemes under sections 230 to 232 of the Act, including where the condition prescribed in clause (d) of sub-section (1) of section 233 of the Act has not been met.

A company covered under this section may use the provisions of section 232 for the approval of any scheme for merger or amalgamation.

MERGER OR AMALGAMATION OF A COMPANY WITH A FOREIGN COMPANY

Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or *vice versa* and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

The expression "foreign company" means any company or body corporate incorporated outside India whether having a place of business in India or not.

Section 234(1) states that the provisions of this Chapter unless otherwise provided under any other law for the time being in force, shall apply *mutatis mutandis* to schemes of mergers and amalgamations between companies registered under this Act and companies incorporated in the jurisdictions of such countries as may be notified from time to time by the Central Government. The Central Government may make rules, in consultation with the Reserve Bank of India, in connection with mergers and amalgamations provided under this section.

Rule 25A of the of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016

(1) A foreign company incorporated outside India may merge with an Indian company after obtaining prior approval of Reserve Bank of India and after complying with the provisions of sections 230 to 232 of the Act and these rules.

(2) (a) A company may merge with a foreign company incorporated in any of the jurisdictions specified in Annexure B after obtaining prior approval of the Reserve Bank of India and after complying with provisions of sections 230 to 232 of the Act and these rules.

(b) The transferee company shall ensure that valuation is conducted by valuers who are members of a recognised professional body in the jurisdiction of the transferee company and further that such valuation is in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect shall be attached with the application made to Reserve Bank of India for obtaining its approval under clause (a) of this sub-rule.

(3) The concerned company shall file an application before the Tribunal as per provisions of section 230 to section 232 of the Act and these rules after obtaining approvals specified in sub-rule (1) and sub-rule (2), as the case may be.

(4) Notwithstanding anything contained in sub-rule (3), in case of a compromise or an arrangement or

merger or demerger between an Indian company and a company or body corporate which has been incorporated in a country which shares land border with India, a declaration in Form No. CAA-16 shall be required at the stage of submission of application under section 230 of the Act.

Explanation 1. For the purposes of this rule the term "company" means a company as defined in clause (20) of section 2 of the Act and the term "foreign company" means a company or body corporate incorporated outside India whether having a place of business in India or not.

Explanation 2. For the purposes of this rule, it is clarified that no amendment shall be made in this rule without consultation of the Reserve Bank of India.

In exercise of the powers conferred by sub-sections (1) and (2) of section 469 read with sections 233 and 234 of the Companies Act, 2013, the Central Government has notified the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2024 which came into effect from 17th day of September, 2024.

In rule 25A, new sub rule (5) is inserted, namely:

Where the transferor foreign company incorporated outside India being a holding company and the transferee Indian company being a wholly owned subsidiary company incorporated in India, enter into merger or amalgamation, –

(i) both the companies shall obtain the prior approval of the Reserve Bank of India;

(ii) the transferee Indian company shall comply with the provisions of section 233;

(iii) the application shall be made by the transferee Indian company to the Central Government under section 233 of the Act and provisions of rule 25 shall apply to such application; and

(iv) the declaration referred to in sub-rule (4) shall be made at the stage of making application under section 233 of the Act."

POWER TO ACQUIRE SHARES OF SHAREHOLDERS DISSENTING FROM SCHEME OR CONTRACT APPROVED BY MAJORITY [Section 235(1)]

Offer to dissenting shareholders

Where a scheme or contract involving the transfer of shares or any class of shares in a company (the transferor company) to another company (the transferee company) has, within four months after making of an offer in that behalf by the transferee company, been approved by the holders of not less than nine-tenths in value of the shares whose transfer is involved, other than shares already held at the date of the offer by, or by a nominee of the transferee company or its subsidiary companies, the transferee company may, at any time within two months after the expiry of the said four months, give notice in the prescribed manner to any dissenting shareholder that it desires to acquire his shares.

For the purposes of sub-section (1) of section 235 of the Act, the transferee company shall send a notice to the dissenting shareholder(s) of the transferor company, in **Form No. CAA.14** at the last intimated address of such shareholder for acquiring the shares of such dissenting shareholders.

Meaning of dissenting shareholders [Explanation to Section 235]

As per the explanation to Section 235, dissenting shareholder includes a shareholder who has not assented to the scheme or contract and any shareholder who has failed or refused to transfer his shares to the transferee company in accordance with the scheme or contract.

Acquisition of shares of dissenting shareholders [Section 235(2)]

After the notice under section 235(1) of the Act, the transferee company shall, unless on an application made by the dissenting shareholder to the Tribunal, within one month from the date on which the notice was given and the Tribunal thinks fit to order otherwise, be entitled to and bound to acquire those shares on the terms on which, under the scheme or contract, the shares of the approving shareholders are to be transferred to the transferee company.

Process of acquisition of shares from dissenting shareholders [Section 235(3)]

Where a notice has been given by the transferee company under Section 235(1) and the tribunal has not, on an application made by the dissenting shareholder, made an order to the contrary, the transferee company shall, on the expiry of one month from the date on which the notice has been given, or, if an application to the Tribunal by the dissenting shareholder is then pending, after that application has been disposed of, send a copy of the notice to the transferor company together with an instrument of transfer, to be executed on behalf of the shareholder by any person appointed by the transferor company and on its own behalf by the transferee company, and pay or transfer to the transferor company the amount or other consideration representing the price payable by the transferee company for the shares which, by virtue of this section, that company is entitled to acquire, and the transferor company shall—

(a) thereupon register the transferee company as the holder of those shares; and

(b) within one month of the date of such registration, inform the dissenting shareholders of the fact of such registration and of the receipt of the amount or other consideration representing the price payable to them by the transferee company.

Utilization of funds [Section 235(4)]

Any sum received by the transferor company under this section shall be paid into a separate bank account, and any such sum and any other consideration so received shall be held by that company in trust for the several persons entitled to the shares in respect of which the said sum or other consideration were respectively received and shall be disbursed to the entitled shareholders within sixty days.

Illustration:

ABC Ltd, made an offer to acquire share of EFG Ltd on 01.01.2021. 90% shareholders of EFG Ltd agreed but one shareholder has not assented to the scheme or contract. By 01.02.2021 ABC Ltd is entitled to acquire shares. For this ABC Ltd shall send notice along with instrument of transfer and pay for share. EFG Ltd shall keep the consideration received in a separate bank and hall distribute that money within 60 days to the concerned shareholders.

PURCHASE OF MINORITY SHAREHOLDING – SECTION 236

Definition of Acquirer and Person acting in concert

The expressions “acquirer” and “person acting in concert” shall have the meanings respectively assigned to them in clause (a) and clause (q) of sub regulation (1) of regulation 2 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.

According to Regulation 2(1)(a) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 “acquirer” means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company;

According to Regulation 2(1)(q) of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 "persons acting in concert" means,–

(1) persons who, with a common objective or purpose of acquisition of shares or voting rights in, or exercising control over a target company, pursuant to an agreement or understanding, formal or informal, directly or indirectly co-operate for acquisition of shares or voting rights in, or exercise of control over the target company.

(2) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be persons acting in concert with other persons within the same category, unless the contrary is established,–

(i) a company, its holding company, subsidiary company and any company under the same management or control;

(ii) a company, its directors, and any person entrusted with the management of the company;

(iii) directors of companies referred to in item (i) and (ii) of this sub-clause and associates of such directors;

(iv) promoters and members of the promoter group;

(v) immediate relatives;

(vi) a mutual fund, its sponsor, trustees, trustee company, and asset management company;

(vii) a collective investment scheme and its collective investment management company, trustees and trustee company;

(viii) a venture capital fund and its sponsor, trustees, trustee company and asset management company;

(viiia) an alternative investment fund and its sponsor, trustees, trustee company and manager;

(ix) a merchant banker and its client, who is an acquirer;

(x) a portfolio manager and its client, who is an acquirer;

(xi) banks, financial advisors and stock brokers of the acquirer, or of any company which is a holding company or subsidiary of the acquirer, and where the acquirer is an individual, of the immediate relative of such individual:

Provided that this sub-clause shall not apply to a bank whose sole role is that of providing normal commercial banking services or activities in relation to an open offer under these regulations;

(xii) an investment company or fund and any person who has an interest in such investment company or fund as a shareholder or unitholder having not less than 10 per cent of the paid-up capital of the investment company or unit capital of the fund, and any other investment company or fund in which such person or his associate holds not less than 10 per cent of the paid-up capital of that investment company or unit capital of that fund:

Provided that nothing contained in this sub-clause shall apply to holding of units of mutual funds registered with the Board;

Explanation. – For the purposes of this clause "associate" of a person means,–

(a) any immediate relative of such person;

(b) trusts of which such person or his immediate relative is a trustee;

(c) partnership firm in which such person or his immediate relative is a partner; and

(d) members of Hindu undivided families of which such person is a coparcener.

As per Section 236(1) of the Act, in the event of an acquirer, or a person acting in concert with such acquirer, becoming registered holder of ninety per cent or more of the issued equity share capital of a company, or in the event of any person or group of persons becoming ninety per cent majority or holding ninety per cent. of the issued equity share capital of a company, by virtue of an amalgamation, share exchange, conversion of securities or for any other reason, such acquirer, person or group of persons, as the case may be, shall notify the company of their intention to buy the remaining equity shares.

As per Section 236(2) of the Act, the acquirer, person or group of persons under sub-section (1) shall offer to the minority shareholders of the company for buying the equity shares held by such shareholders at a price determined on the basis of valuation by a registered valuer in accordance with such rules as may be prescribed.

For the purposes of sub-section (2) of section 236 of the Act, the registered valuer shall determine the price (hereinafter called as offer price) to be paid by acquirer, person or group of persons referred to in sub-section of section 236 of the Act for purchase of equity shares of the minority shareholders of the company.

Without prejudice to the provisions of sub-sections (1) and (2), the minority shareholders of the company may offer to the majority shareholders to purchase the minority equity shareholding of the company at the price determined as in accordance with Rule 27 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016, which is as under:

Determination of price for purchase of minority shareholding:-

The registered valuer shall determine the price (hereinafter called as offer price) to be paid by acquirer, person or group of persons referred to in sub-section (1) of section 236 of the Act for purchase of equity shares of the minority shareholders of the company, in accordance with the following:

In case of a listed company;

(i) The offer price shall be determined in the manner as may be specified by the Securities and Exchange Board of India under the relevant regulations framed by it, as may be applicable; and

(ii) The registered valuer shall also provide a valuation report on the basis of valuation addressed to the Board of directors of the company giving justification for such valuation.

In the case of an unlisted company and a private company,

(i) the offer price shall be determined after taking into account the following factors:-

  (a) the highest price paid by the acquirer, person or group of persons for acquisition during last twelve months;

  (b) the fair price of shares of the company to be determined by the registered valuer after taking into account valuation parameters including return on net worth, book value of shares, earning per share, price earning multiple vis-à-vis the industry average, and such other parameters as are customary for valuation of shares of such companies; and

(ii) the registered valuer shall also provide a valuation report on the basis of valuation addressed to the Board of directors of the company giving justification for such valuation.

The majority shareholders shall deposit an amount equal to the value of shares to be acquired by them under sub- section (2) or sub-section (3), as the case may be, in a separate bank account to be operated by company whose shares are being transferred for at least one year for payment to the minority shareholders and such amount shall be disbursed to the entitled shareholders within sixty days.

Such disbursement shall continue to be made to the entitled shareholders for a period of one year, who for any reason had not been made disbursement within the said period of sixty days or if the disbursement has been

made within the aforesaid period of sixty days, fail to receive or claim payment arising out of such disbursement [Section 236(4)].

In the event of a purchase under this section, company whose shares are being transferred shall act as a transfer agent for receiving and paying the price to the minority shareholders and for taking delivery of the shares and delivering such shares to the majority, as the case may be [Section 236(5)].

In the absence of a physical delivery of shares by the shareholders within the time specified by the company, the share certificates shall be deemed to be cancelled, and company whose shares are being transferred shall be authorised to issue shares in lieu of the cancelled shares and complete the transfer in accordance with law and make payment of the price out of deposit made under sub-section (4) by the majority in advance to the minority by dispatch of such payment [Section 236(6)].

In the event of a majority shareholder or shareholders requiring a full purchase and making payment of price by deposit with the company for any shareholder or shareholders who have died or ceased to exist, or whose heirs, successors, administrators or assignees have not been brought on record by transmission, the right of such shareholders to make an offer for sale of minority equity shareholding shall continue and be available for a period of three years from the date of majority acquisition or majority shareholding [Section 236(7)].

Where the shares of minority shareholders have been acquired in pursuance of this section and as on or prior to the date of transfer following such acquisition, the shareholders holding seventy-five per cent. or more minority equity shareholding negotiates or reach an understanding on a higher price for any transfer, proposed or agreed upon, of the shares held by them without disclosing the fact or likelihood of transfer taking place on the basis of such negotiation, understanding or agreement, the majority shareholders shall share the additional compensation so received by them with such minority shareholders on a pro rata basis [Section 236(8)].

When a shareholder or the majority equity shareholder fails to acquire full purchase of the shares of the minority equity shareholders, then, the provisions of this section shall continue to apply to the residual minority equity shareholders, even though,—

(a) the shares of the company of the residual minority equity shareholder had been delisted; and

(b) the period of one year or the period specified in the regulations made by the Securities and Exchange Board under the Securities and Exchange Board of India Act, 1992, had elapsed [Section 236(9)].

Power of Central Government to provide for Amalgamation of Companies in public interest [Section 237]

- If the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

  In Re *Cello Pens (P.) Ltd, CSP. NO. 818/2016 NCLT-Ahmedabad,* it was held that where petition seeking sanction of scheme of amalgamation was found to be genuine, bona fide and in interest of shareholders and creditors as well as in public interest and questions raised by Regional Director was satisfied, same was to be sanctioned.

- The order under sub-section (1) may also provide for the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company and such consequential,

incidental and supplemental provisions as may, in the opinion of the Central Government, be necessary to give effect to the amalgamation.

- Every member or creditor, including a debenture holder, of each of the transferor companies before the amalgamation shall have, as nearly as may be, the same interest in or rights against the transferee company as he had in the company of which he was originally a member or creditor, and in case the interest or rights of such member or creditor in or against the transferee company are less than his interest in or rights against the original company, he shall be entitled to compensation to that extent, which shall be assessed by such authority as may be prescribed and every such assessment shall be published in the Official Gazette, and the compensation so assessed shall be paid to the member or creditor concerned by the transferee company.
- Any person aggrieved by any assessment of compensation made by the prescribed authority under sub- section (3) may, within a period of thirty days from the date of publication of such assessment in the Official Gazette, prefer an appeal to the Tribunal and thereupon the assessment of the compensation shall be made by the Tribunal.
- No order shall be made under this section unless—
  - (a) a copy of the proposed order has been sent in draft to each of the companies concerned;
  - (b) the time for preferring an appeal under sub-section (4) has expired, or where any such appeal has been preferred, the appeal has been finally disposed off; and
  - (c) the Central Government has considered, and made such modifications, if any, in the draft order as it may deem fit in the light of suggestions and objections which may be received by it from any such company within such period as the Central Government may fix in that behalf, not being less than two months from the date on which the copy aforesaid is received by that company, or from any class of shareholders therein, or from any creditors or any class of creditors thereof.

The copies of every order made under this section shall, as soon as may be after it has been made, be laid before each House of Parliament.

Registration of offer of schemes involving transfer of shares [Section 238]

In relation to every offer of a scheme or contract involving the transfer of shares or any class of shares in the transferor company to the transferee company under section 235,—

(a) every circular containing such offer and recommendation to the members of the transferor company by its directors to accept such offer shall be accompanied by such information and in the manner as prescribed under Rule 28 of the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 which states that every circular containing the offer of scheme or contract involving transfer of shares or any class of shares and recommendation to the members of the transferor company by its directors to accept such offer, shall be accompanied by such information as set out in **Form No. CAA.15**. The circular shall be presented to the Registrar for registration.

(b) every such offer shall contain a statement by or on behalf of the transferee company, disclosing the steps it has taken to ensure that necessary cash will be available; and

(c) every such circular shall be presented to the Registrar for registration and no such circular shall be issued until it is so registered:

Provided that the Registrar may refuse, for reasons to be recorded in writing, to register any such circular which does not contain the information required to be given under clause (a) or which sets out such information in a

manner likely to give a false impression, and communicate such refusal to the parties within thirty days of the application.

An appeal shall lie to the Tribunal against an order of the Registrar refusing to register any circular under sub-section (1).

Any aggrieved party may file an appeal against the order of the Registrar of Companies refusing to register any circular under sub-section (2) of section 238 of the Act and the said appeal shall be in the **Form No. NCLT.9** (appended in the National Company Law Tribunal Rules, 2016) supported with an affidavit in the **Form No. NCLT.6** (appended in the National Company Law Tribunal Rules, 2016).

The director who issues a circular which has not been presented for registration and registered under clause (c) of sub-section (1), shall be liable to a penalty of one lakh rupees.

Preservation of books and papers of Amalgamated Companies [Section 239]

The books and papers of a company which has been amalgamated with, or whose shares have been acquired by, another company under this Chapter shall not be disposed of without the prior permission of the Central Government and before granting such permission, that Government may appoint a person to examine the books and papers or any of them for the purpose of ascertaining whether they contain any evidence of the commission of an offence in connection with the promotion or formation, or the management of the affairs, of the transferor company or its amalgamation or the acquisition of its shares.

Liability of Officers in Respect of Offences Committed Prior to Merger, Amalgamation, etc. [Section 240]

Notwithstanding anything in any other law for the time being in force, the liability in respect of offences committed under this Act by the officers in default, of the transferor company prior to its merger, amalgamation or acquisition shall continue after such merger, amalgamation or acquisition.

"MAJORITY RULE AND MINORITY RIGHTS"

The Principle of Non-interference (Rule in *Foss v. Harbottle*)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority. Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority. But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company. The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company. In other words, the articles are the protective shield for the majority of shareholders who compose the Board of directors for carrying out their object at the cost of minority of shareholders. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of *Foss v. Harbottle 67 E.R. 189; (1843) 2 Hare 461* that no action can be brought by a member against the directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

CASE LAWS

In *Foss v. Harbottle*, two shareholders, Foss and Turton brought an action on behalf of themselves and all other shareholders against the directors and solicitor of the company alleging that by their concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board. Foss and Turton claimed damages to be paid by the defendants to the company. It was held by the court that the action could not be brought by the minority shareholders although there was nothing to prevent the company itself, acting through the majority of its shareholders, bringing action. The wrong done to the company was not which could be ratified by the majority of members. The company (i.e., the majority) is the proper plaintiff for wrong done to the company, so the majority of members are competent to decide whether to commence proceedings against the directors. The reasons for rule were nicely stated by Melish L.J. in *MacDougall v. Gardiner, (1875) 1 Ch. D. 13 (C.A.) at p. 25* in the following words:

"If the thing complained of is a thing which in substance the majority of company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes."

In *Rajahmundry Electric Supply Co. v. Nageshwara Rao AIR 1956 SC 213*, the Supreme Court observed that:

"The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it."

From the above it follows then that a company being a separate legal person from the members who compose it, the company is the proper person to bring an action.

CASE LAWS

In *Pavlides v. Jensen (*1956) Ch. 565, a minority shareholder brought an action for damages against three directors and against the company itself on the ground that they have been negligent in selling a mine owned by the company for £ 82,000, whereas its real value was about £ 10,00,000. It was held that the action was not maintainable. The judge observed, "It was open to the company, on the resolution of a majority of the shareholders to sell the mine at a price decided by the company in that manner, and it was open to the company by a vote of majority to decide that if the directors by their negligence or error of judgement has sold the company's mine at an undervalue, proceedings should not be taken against the directors".

In *Edwards v. Halliwell* (1950) 2 All. E.R. 1064, Jenkins, L.J. restated the rule in the following terms: "The rule in *Foss v. Harbottle* comes to no more than this. First, the proper plaintiff in respect of wrong alleged to be done to company is prima facie the company itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company by a simple majority of members, no individual member is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company is in favour of what has been done, then *cadit quaestio...* (cannot be questioned). If on the other hand, a simple majority of members of the company or association is against what has been done, then there is no valid reason why the company itself should not sue".

Justification and Advantages of the Rule in Foss *v.* Harbottle

The justification for the rule laid down in *Foss* v. *Harbottle* is that the will of the majority prevails. On becoming a member of a company, a shareholder agrees to submit to the will of the majority. The rule really preserves the right of the majority to decide how the company's affairs shall be conducted. If any wrong is done to the company, it is only the company itself, acting, as it must always act, through its majority, that can seek to redress and not an individual shareholder.

Moreover, a company is a person at law, the action is vested in it and cannot be brought by a single shareholder. Where there is a corporate body capable of filing a suit for itself to recover property either from its directors or officers or from any other person then that corporate body is the proper plaintiff and the only proper plaintiff [*Gray* v. *Lewis,* (1873) 8 Ch. Appl. 1035].

The main advantages that flow from the Rule in *Foss* v. *Harbottle* are of a purely practical nature and are as follows:

1. ***Recognition of the separate legal personality of company:*** If a company has suffered some injury, and not the individual members, it is the company itself that should seek to redress.
2. ***Need to preserve right of majority to decide:*** The principle in *Foss* v. *Harbottle* preserves the right of majority to decide how the affairs of the company shall be conducted. It is fair that the wishes of the majority should prevail.
3. ***Multiplicity of futile suits avoided:*** Clearly, if every individual member were permitted to sue anyone who had injured the company through a breach of duty, there could be as many suits as there are shareholders. Legal proceedings would never cease, and there would be enormous wastage of time and money.
4. ***Litigation at suit of a minority futile if majority does not wish it:*** If the irregularity complained of is one which can be subsequently ratified by the majority it is futile to have litigation about it except with the consent of the majority in a general meeting. In *Mac Dougall* v. *Gardiner,* (1875) 1 Ch. 13 (C.A.), the articles empowered the chairman, with the consent of the meeting, to adjourn a meeting and also provided for taking a poll if demanded by the shareholders. The adjournment was moved, and declared by the chairman to be carried; a poll was then demanded and refused by the chairman. A shareholder brought an action for a declaration that the chairman's conduct was illegal. Held, the action could not be brought by the shareholder; if the chairman was wrong, the company alone could sue.

Application of *Foss* v. *Harbottle* Rule in Indian context — The Delhi High Court in *ICICI* v. *Parasrampuria Synthetic Ltd.* SSL, July 5, 1998 has held that an automatic application of *Foss v. Harbottle* Rule to the Indian corporate realities would be improper. Here the Indian corporate sector does not involve a large number of small individual investors but predominantly financial institutions funding atleast 80% of the finance. It is these financial institutions which provide entire funds for the continuous existence and corporate activities. Though they hold only a small percentage of shares, it is these financial institutions which have really provided the finance for the company's existence and, therefore, to exclude them or to render them voiceless on an application of the principles of *Foss* v. *Harbottle* Rule would be unjust and unfair.

Exception to the Rule in *Foss v. Harbottle*

The rule in *Foss* v. *Harbottle* is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

(a) the common law; and

(b) the provisions of the Companies Act.

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in *Foss* v. *Harbottle* and are available to the minority. In all these cases an individual member may sue for declaration that the resolution complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following case:

The minority shareholders are empowered to bring action with a view to preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study.

In *Bennet Coleman & Co. and Ors.* v. *Union of India & Ors.,* (1977) 47 Com Cases 92 (Bom), the Division Bench of the Bombay High Court held that Sections 397 and 398 of the Companies Act, 1956 are intended to avoid winding up of the company if possible and keep it going while at the same time relieving the minority shareholders from acts of oppression and mismanagement or preventing its affairs from being conducted in a manner prejudicial to public interest. Thus, the Court has wide powers to supplant the entire corporate management by resorting to non- corporate management which may take the form of appointing an administrator or a special officer or a committee of advisers etc., who will be in charge of the affairs of the company.

The exceptions to the rule in *Foss* v. *Harbottle* are not limited to those covered above. Further exceptions may be admitted where the rules of justice require that an exception to the rule should be made.

It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up [*Panipat Woollen & General Mills Co.Ltd.* v. *R.L. Kaushik,* (1969) 39 Com Cases 249 (Punj & Har)].

"MAJORITY RULE AND MINORITY RIGHTS" UNDER THE COMPANIES ACT, 2013

In India, the Companies Act attempts to maintain a balance between the rights of majority and minority shareholders by admitting in the rule of the majority but limiting it at the same time by a number of well-defined minority rights, and thus protecting the minority shareholders.

Chapter XVI of the Companies Act, 2013 deals with the provisions relating to prevention of oppression and mismanagement of a company. Oppression and mismanagement of a company mean that the affairs of the company are being conducted in a manner that is oppressive and biased against the minority shareholders or any member or members of the company. To prevent the same, there are provisions for the prevention and mismanagement of a company.

The Ministry of Corporate Affairs *vide* its Notification S.O.1934 (E) dated 1st June 2016 notified section 241 to 245 of the Companies Act, 2013. Section 246 was notified *vide* Notification S.O.2912 (E) dated 9th September, 2016. These provisions are discussed in detail hereunder.

PREVENTION OF OPPRESSION AND MISMANAGEMENT

Meaning of Oppression

The words "oppression" and "mismanagement" are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

The meaning of the term "oppression" as explained by Lord Cooper in the Scottish case of *Elder* v. *Elder & Western Ltd.,* (1952) Scottish Cases 49, which has been cited with approval by Wanchoo, J (afterwards C.J.) of the Supreme Court in *Shanti Prasad* v. *Kalinga Tubes,* (1965) 1 Comp. L.J. 193 at 204 is as under :

"The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholder who entrusts his money to the company is entitled to rely."

CASE LAWS

An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This was held in *Re. Hindustan Co-operative Insurance Society Ltd., AIR. 1961 Cal. 443* wherein the life insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among shareholders, rather they passed a special resolution changing the objects of the company to utilise the compensation money for the new objects. This was held to be an "Oppression". The court observed: "The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in different kind of business against their will. The minority had invested their money in a life insurance business with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards".

A similar relief was allowed by the House of Lord in *Scottish Co-operative Wholesale Society* v. *Mayer* (1959) AC 324. In this case, the society created a subsidiary company to enable it to enter in the rayon industry. Subsequently when the need for the subsidiary ceased to exist, the society adopted a policy of running down its business which depressed the value of its shares. The two petitioners who were managing directors and minority shareholders in the company successfully pleaded "oppression". The court ordered the society to purchase the minority shares at the value at which they stood before the oppressive policy started [This decision has also been followed in Re. *H.R. Harmer Ltd.*, (1959) 1 WLR 62].

Minor acts of mismanagement, however, are not to be regarded as oppression. As far as possible, shareholders should try to resolve their differences by mutual readjustment. Moreover, the courts will not allow these special remedies to become a vexatious source of litigation. For example, in *Lalita Rajya Lakshmi* v. *Indian Motor Co.* A.I.R. 1962 Cal 127, the petitioner alleged that the Board of directors were guilty of certain acts detrimental to the minority of the shareholders. The allegations were that the income of the company was deliberately shown less by excessive expenditure; that passengers travelling without ticket on the company's buses were not checked; that petrol consumption was not properly checked; that second hand buses of the company had been disposed of at low price, that dividends were being declared at too low a figure. It was held that even if each of these allegations were proved to the satisfaction of the court, there would have been no oppression.

A member can complain of oppression only in his capacity as a member and not in his capacity as director or creditor [In Re. *Bellador Silk Ltd*., (1965) 1 All ER 667].

The legal representatives of a deceased member whose name is still on the register of members are entitled to file a petition under Sections 397 and 398 of the Companies Act, 1956, for relief against oppression or mismanagement, *Worldwide Agencies Pvt. Ltd. and Another* v. *Mrs. Margaret T. Desor and Others,* Com Cases Vol. 67 (1990), 807 (S.C.).

A shareholder dies and his heirs apply for transmission of shares while their application for succession certificate was pending before the Civil Court. The legal heirs alleged illegal allotment of shares by respondent to themselves, reducing the legal heirs to minority. It has held that the legal heirs are entitled to file a petition alleging oppression and mismanagement. [*Rajkumar Devraj & Aur.* v. *Jai Mahal Hotels Pvt. Ltd. & Others* (CLB) CA. No. 133 of 2006 in C.P. No. 30 of 2006.

It should not, however, be supposed that these special remedies against oppression or mismanagement are available only to minorities. "In an appropriate case, if the court is satisfied about the act of oppression or mismanagement, relief can be granted even if the application is made by a majority, who have been rendered completely ineffective by the wrongful acts of a minority group. "Accordingly, a relief under the section was allowed to a majority group by Mitra, J., of the Calcutta High Court in In *Re. Sindhri Iron Foundry (P) Ltd. (1963) 68 CWN 118*. His Lordship observed that "if the court finds that the company's interest is being seriously prejudiced

by the activities of one or the other group of shareholders, that two different registered offices at two different addresses have been set up, that two rival Boards are holding meetings, that the company's business, property and assets have passed to the hands of unauthorised persons who have taken wrongful possession and who claim to be the shareholders and directors there is no reason why the court should not make appropriate order to put an end to such matters.

Referring to the argument that the majority could always call a meeting and put things in order by passing resolutions, his Lordship said:

"The facts in this case show very clearly, that there is no chance of redress in the domestic forum of the company. If a Board meeting was to be called, one group would contend that there were five directors, whereas the other group would urge that there were seven. If a meeting of the shareholders was to be convened, according to one group there would be only sixteen shareholders, while according to the other the number would exceed twenty- five ... There would be complete chaos and confusion ... "(Ibid., p. 335).

"This ingenious remedy has not only permitted redressal of many abuses, but its mere availability has had a deterrent effect upon management." [George H. Hornstein: The Future of Corporate Control, (1950) 63 HLR 476].

It was held in the case of *Ajit Singh Ahuja* v. *Saphire (India) (P) Ltd.* [(2009) 1 Comp LJ 313 (CLB)] that in a case of oppression, a member has to specifically plead on five facts — (a) what is the alleged act of oppression; (b) who committed the act of oppression; (c) how it is oppressive; (d) whether it is in the affairs of the company; and whether the company is party to the commission of the act of oppression.

Oppression must be a continuous process. This is suggested by the words, 'are being conducted in a manner...' used in Section 397. Hence isolated acts of oppression or mismanagement will not give rise to an action under Section 397 of the Act. In *Shanti Pd. Jain's* case, the court said:... "events have to be considered not in isolation but as a part of a consecutive story. There must be continuous acts on the part of the majority shareholders, continuing up-to- date of petition".

However in *Tea Brokers P. Ltd.* v. *Hemendra Prosad Barooah* (1998) 5 Comp LJ 963 (Cal.) the Division Bench of Calcutta High Court observed that:

'This is undoubtedly, a right and privilege which a member enjoys in his capacity as a member of the company... such an act may be even a single act done on one particular occasion if the effect of such an act will be of a continuing nature and the member concerned is deprived of his rights and privilege for all time to come in future'.

In *Ramshankar Prasad* v. *Sindu Iron Foundry (P) Ltd.,* AIR 1966 Cal 512, it was held that a petition under Section 397, would be maintainable even if the oppression was of a short duration and of a singular conduct if its effects persisted indefinitely [followed in *Maharashtra Power Development Corporation. Ltd.* v. *Dabhol Power Co. Ltd.* (2003) 56 CLA 263 (Bom.)].

In *Bhagirath Agarwala* v. *Tara Properties P. Ltd.* (2003) 51 CLA 57 (Cal.), also the removal of a director and allotment of shares were set aside as they were done at a meeting which was covered without complying with the requirements of Section 286 and also reflected an oppressive policy. The allotment was made only to one member without simultaneous offer to others on pro rata basis. A single act of issue of additional shares can have a continuous effect. It can constitute oppression. A relief can be had against it. There is no bar of limitation in such a case. [*Ashok Kumar Oswal* v. *Panchsher Textile Mfg. & Trading Co. Ltd.* (2002) 110 Com Cases 800 (CLB-PB)].

Past acts of oppression will not entitle a plaintiff to seek the remedy under Section 397. The purpose of this section is not so much to take up the past as to redeem the future. A catalogue of charges of the past alleged misdeeds will not attract the section [*Thakur Prem Singh* v. *Thakur Hotel (Simla) Co. (P) Ltd.,* AIR 1963 Punj. 63; *Raghunath Swarup Mathur* v. *Har Swarup Mathur,* (1970) 40 Com Cases 282 (All)].

PROVISIONS UNDER THE COMPANIES ACT, 2013

APPLICATION TO TRIBUNAL FOR RELIEF IN CASE OF OPPRESSION & MISMANAGEMENT (SECTION 241)

A. BY ANY MEMBER OF A COMPANY

Section 241 of the Companies Act, 2013 states that any member of a company, who has right to apply under section 244, may apply to the Tribunal in **Form NCLT-1** for complains that –

(a) The affairs of the company have been or are being conducted -

- in a manner prejudicial to public interest, or
- in a manner prejudicial or oppressive to him or any other member or members, or
- in a manner prejudicial to the interests of the company, or

(b) The material change, has taken place in the management or control of the company, whether by -

- an alteration in the Board of Directors, or manager, or
- in the ownership of the company's shares, or
- if it has no share capital, in its membership, or
- in any other manner whatsoever,

And that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to its interests or its members or any class of members.

However, such material change shall not be a change brought about by, or in the interests of, any creditors, including debenture holders or any class of shareholders of the company.

B. BY CENTRAL GOVERNMENT

The Central Government, if it is of the opinion that the affairs of the company are being conducted in a manner prejudicial to public interest, it may itself apply to the Tribunal for an order [Sec 241(2)].

As per Section 241(3), where in the opinion of the Central Government there exist circumstances suggesting that –

(a) any person concerned in the conduct and management of the affairs of a company is or has been in connection therewith guilty of fraud, misfeasance, persistent negligence or default in carrying out his obligations and functions under the law or of breach of trust;

(b) the business of a company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices;

(c) a company is or has been conducted and managed by such person in a manner which is likely to cause, or has caused, serious injury or damage to the interest of the trade, industry or business to which such company pertains; or

(d) the business of a company is or has been conducted and managed by such person with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

The Central Government may initiate a case against such person and refer the same to the Tribunal with a request that the Tribunal may inquire into the case and record a decision as to whether or not such person

is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

The person against whom a case is referred to the Tribunal under Section 241(3), shall be joined as a respondent to the application. [Section 241(4)]

Illustration:

Mr. A is a director of ABC Ltd. The Central Government is of opinion that Mr. A is guilty of fraud, misfeasance, persistent negligence, or default in carrying out his obligations and functions under the law or of breach of trust and hence cannot continue as director. The Government applied to Tribunal to decide whether or not Mr. A can continue as director. Here Mr. A will be the respondent.

As per Section 241(5), every application under Section 241(3) –

(a) shall contain a concise statement of such circumstances and materials as the Central Government may consider necessary for the purposes of the inquiry; and

(b) shall be signed and verified in the manner laid down in the Code of Civil Procedure, 1908, for the signature and verification of a plaint in a suit by the Central Government.

RIGHT TO APPLY UNDER SECTION 241 (SECTION 244)

Sub-section (1) of Section 244 states that following members of a company shall have the right to apply under section 241, namely: –

(a) In the case of a company having a share capital –

(i) not less than one hundred members of the company; or

(ii) not less than one-tenth of the total number of its members, whichever is less; or

(iii) any member or members holding not less than one tenth of the issued share capital of the company, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares.

(b) In the case of a company not having a share capital –

(i) not less than one-fifth of the total number of its members shall have the right to apply under section 241.

For the purposes of this sub-section, where any share or shares are held by two or more persons jointly, they shall be counted only as one member.

Where any members of a company are entitled to make an application under sub-section (1), any one or more of them having obtained the consent in writing of the rest, may make the application on behalf and for the benefit of all of them.

In Re Tata Consultancy Services Limited vs. Cyrus Investments Pvt Ltd civil appeal No.440441 of 2020 Supreme Court, in this case Mr. Cyrus Mistry was removed from his position as Executive Chairman of Tata Sons Limited on October 24, 2016, because the company's Majority Shareholders and Board of Directors lost faith in him as Chairman. Cyrus Mistry was terminated from the board of directors of Tata Sons and by vote of the shareholders at a general meeting. Following that, Cyrus Mistry approached the National Company Law Tribunal (NCLT) Mumbai, alleging persecution of minority shareholder rights and operational mismanagement by Tata Sons under Sections 241, 242 and 244 of the Companies Act, 2013.

The Supreme Court observed that unless the removal of a person as a chairman of a company is oppressive or mismanaged or done in a prejudicial manner damaging the interests of the company, its members or the public at large, the Company Law Tribunal cannot interfere with the removal of a person as a Chairman of a Company in a petition under Section 241 of the Companies Act, 2013.

Power of Tribunal

Power of Tribunal to waive requirements to apply specified under Section 244

Proviso to section 244(1) states that the Tribunal may, on an application made to it in this behalf in **Form No: NCLT- 9**, may waive all or any of the requirements specified in clause (a) or clause (b) of sub – section (1) of Section 244 so as to enable the members to apply under Section 241.

POWER OF TRIBUNAL TO ISSUE ORDERS [SECTION 242(1)]

On any application made under section 241, the Tribunal is of the opinion—

(a) that the company's affairs have been or are being conducted in a manner prejudicial or oppressive to any member or members or prejudicial to public interest or in a manner prejudicial to the interests of the company; and

(b) that to wind up the company would unfairly prejudice such member or members, but that otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up, the Tribunal may, with a view to bringing to an end the matters complained of, make such order as it thinks fit.

In Re *Union of India Vs. Infrastructure Leasing and Financial Services Ltd C.P. No. 3638 of 2018, NCLT-Mumbai,* Union of India filed petition under section 242 alleging that managerial persons of IL & FS were responsible for negligence and incompetence and affairs of company were conducted in manner prejudicial to public interest, Board of Directors of IL & FS were suspended and Government Directors were directed to take over IL& FS with immediate effect.

Filing of copy of Order of Tribunal [Section 242(3)]

Section 242(3) provides that a certified copy of the order of the Tribunal under section 242(1) shall be filed by the company with the Registrar within 30 days of the order of the Tribunal.

Details in Order passed by Tribunal [Section 242(2)]

An order made by the Tribunal under sub – section (1) shall provide for—

(a) the regulation of conduct of affairs of the company in future;

(b) the purchase of shares or interests of any members of the company by other members thereof or by the company;

(c) in the case of a purchase of its shares by the company as aforesaid, the consequent reduction of its share capital;

(d) restrictions on the transfer or allotment of the shares of the company;

(e) the termination, setting aside or modification, of any agreement, howsoever arrived at, between the company and the managing director, any other director or manager, upon such terms and conditions as may, in the opinion of the Tribunal, be just and equitable in the circumstances of the case;

(f) the termination, setting aside or modification of any agreement between the company and any person other than those referred to in clause (e):

Provided that no such agreement shall be terminated, set aside or modified except after due notice and after obtaining the consent of the party concerned;

(g) the setting aside of any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within three months before the date of the application under this section, which would, if made or done by or against an individual, be deemed in his insolvency to be a fraudulent preference;

(h) removal of the managing director, manager or any of the directors of the company;

(i) recovery of undue gains made by any managing director, manager or director during the period of his appointment as such and the manner of utilisation of the recovery including transfer to Investor Education and Protection Fund or repayment to identifiable victims;

(j) the manner in which the managing director or manager of the company may be appointed subsequent to an order removing the existing managing director or manager of the company made under clause (h);

(k) appointment of such number of persons as directors, who may be required by the Tribunal to report to the Tribunal on such matters as the Tribunal may direct;

(l) imposition of costs as may be deemed fit by the Tribunal;

(m) any other matter for which, in the opinion of the Tribunal, it is just and equitable that provision should be made.

Illustration:

Mr. A is a director of ABC Ltd. The Central Government is of opinion that Mr. A is guilty of fraud, and hence cannot continue as director. The Government applied to Tribunal to decide whether or not Mr. A can continue as director. The Tribunal may pass any order to terminate or modify the agreement or transaction entered into by Mr. A in a fraudulent manner.

Interim Order [Section 242(4)]

The Tribunal may, on the application of any party to the proceeding, make any interim order which it thinks fit for regulating the conduct of the company's affairs upon such terms and conditions as appear to it to be just and equitable.

At the conclusion of the hearing of the case in respect of sub-section (3) of section 241, the Tribunal shall record its decision stating therein specifically as to whether or not the respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

In *Smruti Shreyans Shah vs. Lok Prakashan Ltd & Ors, C.P. No. 16/241/NCLT/AHM/2017*

The court held that the Tribunal can issue interim orders under section 242 if a prima facie case is made out. It observed that the making of an interim order by the Tribunal across the ambit of section 242 (4) postulates a situation where the affairs of the company have not been or are not being conducted in accordance with the provision of law and the Article of Association. For carving out a prima facie case, the member alleging oppression and mismanagement has to demonstrate that he has raised fair questions in the company petition and which require a probe.

Alteration in Memorandum or Articles

Where an order of the Tribunal makes any alteration in the memorandum or articles of a company, then, the company shall not have power, except to the extent, if any, permitted in the order, to make, without the leave of the Tribunal, any alteration whatsoever which is inconsistent with the order, either in the memorandum or in the articles *[Section 242(5)]*.

The alterations made by the order in the memorandum or articles of a company shall, in all respects, have the same effect as if they had been duly made by the company in accordance with the provisions of this Act and the said provisions shall apply accordingly to the memorandum or articles so altered *[Section 242(6)]*.

A certified copy of every order altering, or giving leave to alter, a company's memorandum or articles, shall within thirty days after the making thereof, be filed by the company with the Registrar who shall register the same *[Section 242(7)]*.

However, if a company contravenes the provisions of sub-section (5) of Section 242, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

CONSEQUENCE OF TERMINATION OR MODIFICATION OF AGREEMENTS (SECTION 243)

1. Where an order made under Section 242 terminates, sets aside or modifies an agreement –

   (a) such order shall not give rise to any claims whatever against the company by any person for damages or for compensation for loss of office or in any other respect either in pursuance of the agreement or otherwise;

   (b) no managing director or other director or manager whose agreement is so terminated or set aside shall, for a period of five years from the date of the order terminating or setting aside the agreement, without the leave of the Tribunal, be appointed, or act, as the managing director or other director or manager of the company.

(1A) The person who is not a fit and proper person pursuant to sub-section (4A) of section 242 shall not hold the office of a director or any other office connected with the conduct and management of the affairs of any company for a period of five years from the date of the said decision:

Provided that the Central Government may, with the leave of the Tribunal, permit such person to hold any such office before the expiry of the said period of five years.

(1B) Notwithstanding anything contained in any other provision of this Act, or any other law for the time being in force, or any contract, memorandum or articles, on the removal of a person from the office of a director or any other office connected with the conduct and management of the affairs of the company, that person shall not be entitled to, or be paid, any compensation for the loss or termination of office.

Provided that the Tribunal shall not grant leave under this clause unless notice of the intention to apply for leave has been served on the Central Government and that Government has been given a reasonable opportunity of being heard in the matter.

Any person who knowingly acts as a managing director or other director or manager of a company in contravention of clause (b) of sub-section (1) or sub-section (1A) of Section 243, and every other director of the company who is knowingly a party to such contravention, shall be punishable with fine which may extend to five lakh rupees.

In the matter of *Aruna Oswal (Appellant) vs. Pankaj Oswal & Ors. (Respondents) (Supreme Court) (July 06, 2020)*

Dispute of Inheritance of Shares is a civil dispute, it cannot be decided under section 241/242 of the Companies Act, 2013

Fact of the case:

The brief facts of the case are that Late Mr. Abhey Kumar Oswal, during his lifetime, held as many as 5,35,3,960 shares in M/s. Oswal Agro Mills Ltd., a listed company. He died on 29.3.2016. Mr. Abhey Kumar Oswal filed a nomination according to section 72 of the Companies Act, 2013 in favour of Mrs. Aruna Oswal, his wife. Two witnesses duly attested the nomination in the prescribed manner. The name of Mrs. Aruna Oswal, the appellant, was registered as a holder on 16.4.2016 as against the shares held by her deceased husband.

Pankaj Oswal (respondent no. 1), son of late Abhay Oswal filed a partition suit in High Court claiming entitlement to 1/4th of the estate of his father including the deceased's shareholdings. The High Court passed an interim order to maintain status quo concerning shares and other immoveable property.

While the suit was pending, respondent no. 1 also moved the NCLT, Chandigarh, alleging 'oppression and mis- management' under Section 241/242 of the Companies Act, 2013 in the affairs of respondent no. 2 company. The appellant challenged the maintainability of the petition. The NCLT directed filing of reply to the petition, without deciding the question of maintainability.

This was challenged before NCLAT, which in turn directed the NCLT to decide the question of maintainability of the petition. The NCLT thereafter dismissed the challenge to maintainability and held that the respondent no. 1, being a legal heir, was entitled to one-fourth of the property/shares. Therefore, the matter eventually reached the Supreme Court of India.

Judgment

Supreme Court observed that the basis of the petition is the claim by way of inheritance of 1/4th shareholding so as to constitute 10% of the holding. This is the right, which cannot be decided in proceedings under Section 241/242 of the Companies Act, 2013. Thus, filing of the petition under sections 241 and 242 seeking waiver is a misconceived exercise as the, respondent no. 1 has to firmly establish his right of inheritance before a civil court to the extent of the shares he is claiming; more so, in view of the nomination made as per the provisions contained in Section 71 of the Companies Act, 2013. In order to maintain the proceedings, the respondent should have waited for the decision of the right title and interest, in the civil suit concerning shares in question. The orders passed by the NCLT as well as NCLAT are set aside, and the appeals are allowed.

In the matter of *Mrs. Arti Meenakshi Muthiah (Appellant) vs. MCTM Global Investments Pvt. Ltd. & Ors. (Respondents) (NCLAT) (June 11, 2020)*

Merely adding an additional signatory to a bank account cannot be claimed to be an act of Oppression

Fact of the case

The brief facts of the case are that the 1st respondent company is a closely held family company. The company was incorporated by Mr. M.Ct. Muthiah in 1988 and the shareholding was equally held by the Mr. M. Ct Muthiah and his wife, 2nd respondent. Mr. M. Ct Muthiah died in September, 2006 and his shareholding in 1st respondent was equally divided into his legal heirs.

The appellant (original petitioner) had filed a Company Petition before the Company Law Board, Chennai against the respondents under Section 397 and 398 read with Section 402 of the Companies Act 1956/2013 alleging oppression and mismanagement by the respondents and after establishment of NCLT the petition was transferred to NCLT, Chennai Bench.

After hearing the parties, the NCLT Chennai dismissed the petition. Being aggrieved by the impugned order the appellant has filed the present appeal.

Judgment:

NCLAT held that every shareholder have a right to transfer his right after completing all the formalities, if otherwise the same are in order. NCLAT further observed that shares relating to the appellant are untouched and she continues to be 17% shareholder of 1st respondent. Further the shares have not been transferred to an outsider. Appellant failed to show any illegality in such transfer. Further, purchase of the property is a commercial decision which cannot be question as the same may either result in profit or loss and the commercial decision does not require any judicial interference.

Furthermore, NCLAT opined that merely adding an additional signatory to a bank account cannot be claimed to be an act of oppression especially when the Appellant continues to be one of the signatories. Thus, no prima facie case is made out to interfere in the impugned order of NCLT, Chennai Bench and the appeal is dismissed.

CLASS ACTION SUITS (SECTION 245)

The initiation of class action suits is one of the major changes introduced by the Companies Act, 2013. The major objective behind the provision of class action suits is to safeguard the interests of the minority shareholders. So, class action suits are expected to play an important role to address numerous prejudicial and abusive acts committed by the Board of Directors and other managerial personnel as it has been statutorily recognized under the Companies Act, 2013.

What is a class action suit?

A class action suit is a lawsuit where a group of people representing a common interest may approach the Tribunal to sue or be sued. It is a procedural instrument that enables one or more plaintiffs to file and prosecute litigation on behalf of a larger group or class having common rights and grievances.

Application of Class Action and Reliefs [Section 245(1)]

Sub-section (1) of section 245 states that such number of members, depositor or any class of them, as the case may be, may, file an application in **Form NCLT-9** before the Tribunal for seeking all or any of the following orders, namely:—

(a) to restrain the company from committing an act which is *ultra vires* the articles or memorandum of the company;

(b) to restrain the company from committing breach of any provision of the company's memorandum or articles;

(c) to declare a resolution altering the memorandum or articles of the company as void if the resolution was passed by suppression of material facts or obtained by mis-statement to the members or depositors;

(d) to restrain the company and its directors from acting on such resolution;

(e) to restrain the company from doing an act which is contrary to the provisions of this Act or any other law for the time being in force;

(f) to restrain the company from taking action contrary to any resolution passed by the members;

(g) to claim damages or compensation or demand any other suitable action from or against—

(i) the company or its directors for any fraudulent, unlawful or wrongful act or omission or conduct or any likely act or omission or conduct on its or their part;

(ii) the auditor including audit firm of the company for any improper or misleading statement of particulars made in his audit report or for any fraudulent, unlawful or wrongful act or conduct; or

(iii) any expert or advisor or consultant or any other person for any incorrect or misleading statement made to the company or for any fraudulent, unlawful or wrongful act or conduct or any likely act or conduct on his part;

(h) to seek any other remedy as the Tribunal may deem fit.

Such application may be filed by the members, depositor or any class of them, as the case may be, if they are of the opinion that the management or conduct of the affairs of the company are being conducted in a manner prejudicial to the interests of the company or its members or depositors.

Sub-section (10) of Section 245 states that subject to the compliance of this section, an application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

Liability of Audit Firm and its Partners [Section 245(2)]

Where the members or depositors seek any damages or compensation or demand any other suitable action from or against an audit firm, the liability shall be of the firm as well as of each partner who was involved in making any improper or misleading statement of particulars in the audit report or who acted in a fraudulent, unlawful or wrongful manner.

Required Number of Applicants [Section 245(3)]

The requisite number of members provided in sub-section (1) of Section 245, shall be as under:—

A. In case, application by Members:

(a) In the case of a company having a share capital -

(i) not less than one hundred members of the company; or

(ii) not less than such percentage of the total number of its members as may be prescribed, whichever is less; or

(iii) any member or members holding not less than such percentage of the issued share capital of the company as may be prescribed, subject to the condition that the applicant or applicants has or have paid all calls and other sums due on his or their shares.

(b) In the case of a company not having a share capital -

not less than one-fifth of the total number of its members.

B. In case, application by Depositors:

(i) Not less than one hundred depositors of the company, or

(ii) Not less than such percentage of the total number of depositors as may be prescribed, whichever is less shall have right to apply.

(iii) Any depositor or depositors to whom the company owes such percentage of total deposits of the company as may be prescribed shall also have right to apply.

An application may be filed or any other action may be taken under this section by any person, group of persons or any association of persons representing the persons affected by any act or omission, specified in sub-section (1).

As per Rule 84 of the NCLT Rules, in case of a company having a share capital, the requisite prescribed number of member or members to file an application under sub-section (1) of section 245 shall be –

(i) (a) at least five per cent. of the total number of members of the company; or

(b) one hundred members of the company, whichever is less; or

(ii) (a) member or members holding not less than five per cent. of the issued share capital of the company, in case of an unlisted company;

(b) member or members holding not less than two per cent. of the issued share capital of the company, in case of a listed company.

As per sub-rule (4) The requisite prescribed number of depositor or depositors to file an application under sub-section (1) of section 245 shall be –

(i) (a) at least five per cent. of the total number of depositors of the company; or

(b) one hundred depositors of the company, whichever is less; or;

(ii) depositor or depositors to whom the company owes five per cent. of total deposits of the company.

Requirement for Consideration of Application [Section 245(4)]

In considering an application for class action, the Tribunal shall take into account, in particular—

(a) whether the member or depositor is acting in good faith in making the application for seeking an order;

(b) any evidence before it as to the involvement of any person other than directors or officers of the company on any of the matters provided in clauses (a)to (f) of Sub-section (1) of Section 245;

(c) whether the cause of action is one which the member or depositor could pursue in his own right rather than through an order under this section;

(d) any evidence before it as to the views of the members or depositors of the company who have no personal interest, direct or indirect, in the matter being proceeded under this section;

(e) where the cause of action is an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—

(i) authorised by the company before it occurs; or

(ii) ratified by the company after it occurs;

(f) where the cause of action is an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company.

In case of admission of application

Section 245(5) provides that if an application filed for class action is admitted, then the Tribunal shall have regard to the following, namely:—

(a) public notice shall be served on admission of the application to all the members or depositors of the class in such manner as may be prescribed;

(b) all similar applications prevalent in any jurisdiction should be consolidated into a single application and the class members or depositors should be allowed to choose the lead applicant and in the event the members or depositors of the class are unable to come to a consensus, the Tribunal shall have the power to appoint a lead applicant, who shall be in charge of the proceedings from the applicant's side;

(c) two class action applications for the same cause of action shall not be allowed;

(d) the cost or expenses connected with the application for class action shall be defrayed by the company or any other person responsible for any oppressive act.

Effects of Order

Order shall be binding: Any order passed by the Tribunal shall be binding on the company and all its members, depositors and auditor including audit firm or expert or consultant or advisor or any other person associated with the company. *[Section 245(6)]*

Punishment for non-compliance: Any company which fails to comply with an order passed by the Tribunal under this section shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees. *[Section 245(7)]*

Frivolous or vexatious Application [Section 245(8)]

Where any application filed before the Tribunal is found to be frivolous or vexatious, it shall, for reasons to be recorded in writing, reject the application and make an order that the applicant shall pay to the opposite party such cost, not exceeding one lakh rupees, as may be specified in the order.

Exemption to Banking Company [Section 245(9)]

This Section is not applicable to Banking Company. Nothing contained in under section 245 of the companies Act, 2013 shall apply to a banking company.

APPLICATION OF CERTAIN PROVISIONS TO PROCEEDINGS UNDER SECTION 241 OR SECTION 245 (SECTION 246)

According to Section 246, the provisions of sections 337 to 341 (both inclusive) shall apply mutatis mutandis, in relation to an application made to the Tribunal under section 241 or section 245.

- Penalty for fraud by officers (Section 337):
- Liability for proper account not kept (Section 338):
- Liability for fraudulent conduct of business (Section 339):
- Power of Tribunal to assess damages against delinquent directors, etc. (Section 340):
- Liability under Sections 339 and 340 to extend to partners or directors in Firms or Companies (Section 341).

REGISTRATION OFFICES AND FEES

Registration of Documents

Section 403 states that any document, required to be submitted, filed, registered or recorded, or any fact or information required or authorised to be registered under the Companies Act, 2013, shall be submitted, filed, registered or recorded within the time specified in the relevant provision on payment of such fee as may be prescribed. The fees is prescribed under the Companies (Registration Offices and fees) Rules, 2014.

However, in case of failure to submit, file or register or record the above stated documents, within the period provided in the relevant section, it may, without prejudice to any other legal action or liability under the Companies Act, 2013, be submitted, filed, registered or recorded as the case may be :-

(a) In case of documents provided under Section 92 or 137 [First proviso to Section 403]

- after expiry of the period so provided *under Section 92 or 137*,
- on payment of such additional fee as may be prescribed –
  - (i) which shall not be less than one hundred rupees per day, and
  - (ii) different amounts may be prescribed for different classes of companies.

(b) In case of any other documents [Second proviso to Section 403]:-

- after expiry of the period so provided under relevant Section,
- on payment of such additional fee as may be prescribed and different fees may be prescribed for different classes of companies.

Continuous Default

Third proviso to Section 403(1) states that where there is default on two or more occasions in submitting, filing, registering or recording of the document, fact or information, it may, without prejudice to any other legal action or liability under the Companies Act, 2013, be submitted, filed, registered or recorded, as the case may be, on payment of a higher additional fee, as may be prescribed.

Punishment on Failure

Further, sub- section (2) of Section 403 states that where a company fails or commits any default to submit, file, register or record any document, fact or information under Section 403(1) before the expiry of the period specified in the relevant section, the company and the officers of the company who are in default, shall, without prejudice to the liability for the payment of fee and additional fee, be liable for the penalty or punishment provided under this Act for such failure or default.

COMPANIES TO FURNISH INFORMATION OR STATISTICS

Power of Central Government to Direct Companies to Furnish Information or Statistics

Section 405(1) of the Companies, Act, 2013 states that the Central Government may, by order, require companies or any class of companies, to furnish such information or statistics with regard to their or its constitution or working, and within such time, as may be specified in the order.

Every such order shall be published in the Official Gazette and may be addressed to companies or to any class of companies, in such manner, as the Central Government may think fit and the date of such publication shall be deemed to be the date on which requirement for information or statistics is made on such companies or class of companies, as the case may be.

For the purpose of satisfying itself that any information or statistics furnished by a company or companies in pursuance of any order stated above is correct and complete, the Central Government may by order require such company or companies to produce such records or documents in its possession or allow inspection thereof by such officer or furnish such further information as that Government may consider necessary [Sec 405(3)].

Failure to furnish information or statistics by the companies required by the Central Government

As per Section 405(4), if any company fails to comply with an order specified above, or furnishes any information or statistics which is incorrect or incomplete in any material respect, the company and every officer of the company who is in default shall be liable to a penalty of twenty thousand rupees and in case of continuing failure, with a further penalty of one thousand rupees for each day after the first during which such failure continues, subject to a maximum of three lakh rupees.

In case of Foreign Companies

Where a foreign company carries on business in India, all references to a company in Section 405 this section shall be deemed to include references to the foreign company in relation, and only in relation, to such business.

The Specified Companies (Furnishing of information about Payment to Micro and Small Enterprise Suppliers) Order, 2019

The Central Government vide notification number S.O. 5622(E), dated the 2nd November, 2018 has directed that all companies, who get supplies of goods or services from micro and small enterprises and whose payments to micro and small enterprise suppliers exceed forty five days from the date of acceptance or the date of deemed acceptance of the goods or services as per the provisions of section 9 of the Micro, Small and Medium Enterprises Development Act, 2006 referred to as "Specified Companies", shall submit a half yearly return to the Ministry of Corporate Affairs stating the following:

(a) the amount of payment due; and

(b) the reasons of the delay.

In exercise of the powers conferred by section 405 of the Companies Act, 2013, the Central Government hereby vide MCA Notification No. S.O. 368 (E), dated 22nd January, 2019 has notified the Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Order, 2019.

Under this order:

(i) Every specified Company had to file initial return in **MSME Form I** regarding details of all outstanding dues to Micro or small enterprises suppliers existing on the date of notification of this order (22nd January, 2019) within the prescribed period.

(ii) Every specified company have to file a half-yearly return as per **MSME Form I** by 31st October for the period from April to September and by 30th April for the period from October to March.

Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Amendment Order, 2024 (July 15, 2024)

In exercise of the powers conferred by section 405 of the Companies Act, 2013 the Central Government issued Specified Companies (Furnishing of information about payment to micro and small enterprise suppliers) Order, 2024. In paragraph 3, the following proviso is inserted.

Provided that only those specified companies which are having payments pending to any micro or small enterprises for more than 45 days from the date of acceptance or the date of deemed acceptance of the goods or services under section 9 of the Micro, Small and Medium Enterprises Development Act, 2006 shall furnish the information in MSME Form-1.

MSME Form-1 form has been substituted.

LESSON ROUND-UP

- Section 230(1) states that when a compromise or arrangement is proposed–
  - between a company and its creditors or any class of them; or
  - between a company and its members or any class of them.
- the Tribunal may, on the application of the (i) company, or (ii) of any creditor or (iii) member of the company, or (iv) in the case of a company which is being wound up, of the liquidator appointed under this Act or under the Insolvency and Bankruptcy Code, 2016, as the case may be, order a meeting of the creditors or class of creditors, or of the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal directs.
- Section 230(6) states that where at a meeting held in pursuance of sub-section (1), majority of persons representing three-fourths in value of the creditors, or class of creditors or members or class of members, as the case may be, voting in person or by proxy or by postal ballot, agree to any compromise or arrangement and if such compromise or arrangement is sanctioned by the Tribunal by an order, the same shall be binding on the company, all the creditors, or class of creditors or members or class of members, as the case may be, or, in case of a company being wound up, on the liquidator appointed under the Companies Act, 2013 or under the Insolvency and Bankruptcy Code, 2016, as the case may be and the contributories of the company.
- Section 230(8) states that the order of the Tribunal shall be filed with the Registrar by the company within a period of thirty days of the receipt of the order.
- Section 232(1) states that when an application is made to the Tribunal under section 230 for the sanctioning of a compromise or an arrangement proposed between a company and any such persons as are mentioned in that section, and it is shown to the Tribunal that the compromise or arrangement has been proposed for the purposes of, or in connection with, a scheme for the reconstruction of the company or companies involving merger or the amalgamation of any two or more companies; and that under the scheme, the whole or any part of the undertaking, property or liabilities of any company (hereinafter referred to as the transferor company) is required to be transferred to another company (hereinafter referred to as the transferee company), or is proposed to be divided among and transferred to two or more companies, the Tribunal may on such application, order a meeting of the creditors or class of creditors or the members or class of members, as the case may be, to be called, held and conducted in such manner as the Tribunal may direct and the provisions of sub-sections (3) to (6) of section 230 shall apply *mutatis mutandis*.
- Section 233 prescribes simplified procedure for Merger or amalgamation of two or more small companies or between a holding company and its wholly-owned subsidiary company, or such other class or classes of companies as may be prescribed
- Section 234(2) states that subject to the provisions of any other law for the time being in force, a foreign company, may with the prior approval of the Reserve Bank of India, merge into a company registered under this Act or vice versa and the terms and conditions of the scheme of merger may provide, among other things, for the payment of consideration to the shareholders of the merging company in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as the case may be, as per the scheme to be drawn up for the purpose.

- Section 237(1) states that when the Central Government is satisfied that it is essential in the public interest that two or more companies should amalgamate, the Central Government may, by order notified in the Official Gazette, provide for the amalgamation of those companies into a single company with such constitution, with such property, powers, rights, interests, authorities and privileges, and with such liabilities, duties and obligations, as may be specified in the order.

GLOSSARY

Merger: A 'merger' is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but organization of such entity into one business. The possible objectives of mergers are manifold - economies of scale, acquisition of technologies, access to sectors / markets etc. Generally, in a merger, the merging entities would cease to be in existence and would merge into a single surviving entity.

Tribunal: Tribunal refers to National Company Law Tribunal

Banking Company "banking company" means any company which transacts the business of banking in India. Explanation.—Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking. [Sec 5(c) of banking Regulation Act 1949]

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not required to be submitted for evaluation).

1. What are the requirements relating to notice required under Section 230 of the Companies Act, 2013?
2. Describe the powers of Central Government to provide for amalgamation of companies in public interest.
3. "Power to compromise or make arrangements with creditors and members is conferred on the company". Comment.
4. Explain law relating to power to acquire shares of shareholders dissenting from scheme or contract approved by a majority.
5. Write a comprehensive note on the prevention of oppression and mismanagement.
6. Write short notes on:
   (a) Purchase of minority shareholding
   (b) Preservation of books and papers of amalgamated companies
   (c) Liability of officers in respect of offences committed prior to corporate restructuring by way of merger or amalgamation etc.
   (d) Right to apply under section 241

7. M/s ABC Ltd is amalgamated with M/s XYZ Ltd. now the amalgamated company is of the opinion to dispose off the books and papers of M/s ABC Ltd. after 8 years of amalgamation. Whether it is of correct opinion, choose the correct option:

   (a) The books and papers can be disposed of after completion of 8 years by passing special resolution

   (b) The books and papers cannot be disposed of without the order of Tribunal

   (c) The books and papers can be disposed of after completion of 8 years

   (d) The books and papers cannot be disposed of without the prior permission of the Central Government

8. Globe Limited, a BSE listed company filed a petition to the NCLT for the scheme of Compromise and Arrangement under Section 230. The petition included a takeover offer. The NCLT approved the scheme of scheme of Compromise and Arrangement but the company not followed compliance as per the SEBI (SAST) Regulations, 2011. Choose on the correct option:

   (a) The NCLT has sanctioned the scheme and hence binding on company, members, creditors or class thereof and no further compliance is necessary

   (b) Compromise or Arrangement may include takeover offer but for listed companies, takeover offer shall be according to SEBI (SAST) Regulations, 2011 and compliance needs to be done according to

   (c) The Company require approval in Annual General Meeting

   (d) None of the above.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- Companies Act, 2013 and Rules made thereunder

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

Dormant Company

Lesson 11

KEY CONCEPTS

■ Dormant Company ■ Inactive Company ■ Significant Accounting Transaction ■ Active Company

Learning Objectives

To understand:

- The Concepts of Dormant and Active Company
- Legal Procedure Involved in Obtaining the Status of Dormant Company
- Compliances for Dormant Company
- Procedure to make a Dormant Company to Active Company
- Advantage of Dormant Company

Lesson Outline

- Legal framework for Dormant Companies
- Procedure to obtain the status of a Dormant Company
- Perquisite for obtaining the status of Dormant Company
- Benefits/exemptions provided to a Dormant Company
- Compliance requirements by Dormant Company
- Procedure to obtain the status of an active company from dormant company
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 455)
- The Companies (Miscellaneous) Rule, 2014

INTRODUCTION

A dormant company means a company which is inactive or inoperative i.e., not carrying out any business activity and has applied to the Registrar of Companies ("ROC") to change its status in the Register of Companies maintained by the said Registrar of Companies from "Active Company "to "Dormant Company". A company may become dormant immediately after its registration or after a few years of its incorporation. There are many reasons as to why a company may change its status from "active "to "dormant". The major reason for such a change is that it gives the company the liberty to start its business activities after a few years rather than incorporating a new company at that time, thus providing cost and time advantage to the company. A company may also choose to temporarily shut down its operations due to adverse market conditions and decide to commence its operations at a future date. In all such cases, a company may make an application to the ROC to change its status from "active" to "dormant".

Dormant companies are also known as inactive companies.

CASE LAW

In Re: AVS Enterprises Pvt. Ltd. v. Registrar of Companies, Delhi and Ors. Company Appeal (AT) No. 47 of 2021

It was pertinently pointed out that Section 455 of the Companies Act, 2013 mentions 'Dormant Company'. The word 'Dormant' in 'Business Per longs' means an entity's identity being unknown to others, inactive and a passive one. No wonder, in law, a 'Company' can apply for securing the nomenclature of a 'Dormant Company' by passing a 'Special Resolution' at the General Meeting of the Company or by getting shareholders' consent holding at least '3/4th of the Shares in Value'.

Section 455 of the Companies Act, 2013 read with Companies (Miscellaneous) Rules, 2014 stipulates the provisions pertaining to "Dormant Company". Where a company is formed and registered under this Act for a future project or to hold an asset or intellectual property without having any significant accounting transaction, such a company or an inactive company may make an application to the ROC in such a manner as may be prescribed for obtaining the status of a dormant company. A dormant company may either be a public company or a private company or a one person company (OPC).

For the above purposes, 'inactive company' means a company which:

(a) has not been carrying on any business or operation; or

(b) has not made any significant accounting transaction during last two financial years; or

(c) has not filed financial statements and annual returns during the last two financial years.

'Significant Accounting Transaction' means any transaction made by the company except transactions mentioned below:

(a) payment of fees by a company to the Registrar;

(b) payments made by the company to fulfil the requirements of this Act or any other law;

(c) allotment of shares to fulfil the requirements of this Act; and

(d) Payments for maintenance of its office and records.

All the transactions, apart from the above mentioned transactions, will be considered as significant accounting transactions. If a company has made only the above mentioned transactions in the last two financial years, then that company will fall under the definition of 'Inactive Company'.

The Registrar on consideration of the application shall allow the status of a dormant company to the applicant and issue a certificate allowing the status of a Dormant Company to the applicant and the Registrar shall also maintain a register of dormant companies.

A dormant company shall have a minimum number of three directors in case of a public company, two directors in case of a private company and one director in case of a One Person Company. Further, it shall file required documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the register. The dormant company may become an active company on an application made in this behalf accompanied by required documents and fees.

A company may retain its status of Dormant Company for five (5) years once it has obtained the dormant company status, after it Registrar may strike off the name of the company from the register of companies, if such company failed to comply with the requirements of section 455.

ADVANTAGES OF DORMANT COMPANIES UNDER COMPANIES ACT, 2013

Dormant Companies offers number of advantages to its promoters. Some of the main advantages are listed below:

(a) It helps in preserving the domain name and hence a company may be founded to prepare for a future undertaking.

(b) A Dormant Company offers excellent advantage to the promoters who want to hold an asset or intellectual property under the corporate shield for its usage at a later stage. A Trademark of a Company Name is among the intellectual property owned by a dormant company. Others are not authorized to trade using the name of the dormant company since it is protected.

For instance: if a promoter wants to buy land now for its future project at a comparatively lesser price, he may do the same through dormant company so that he can use the land for its future project.

(c) It assists the company in projecting a more positive image to potential consumers and/or lenders.

(d) Once a company is registered as a dormant company, the annual return for the company can be filed using a simplified Form MSC-3. Also, the number of Board Meetings to be conducted by the Company is reduced. The compliance burden of the company is also reduced.

(e) Dormant Company is not liable to pay any taxes until it is reactive.

(f) Dormant Company is not required to include the statement of cash flow in its financial statement.

(g) The provision of rotation of auditors is not applicable in case of a dormant company.

(h) Dormant companies enjoy the advantages of lower statutory compliance cost as there are few statutory compliances applicable to dormant company as compared to active company, for example, a dormant company need not hold Annual General Meeting every year and no need to hold and convene four (4) Board Meetings in a year, etc.

(i) It is easier for dormant companies to reacquire its active status and it also reduces the cost of incorporation of a new company.

COMPLIANCES FOR DORMANT COMPANY

There are certain compliances which needs to be fulfilled by the dormant company. These are mentioned below:

1) Company needs to have minimum number director as required by Companies Act, 2013 i.e. at least 3 Directors in case of a Public Company, 2 for Private Company and 1 for OPC.

2) The company shall continue to file the returns of allotment and change in directors, whenever the company allots any security to any person or there is any change in the directors of the company.

3) The Dormant Company is required to hold at least one meeting of the Board of Directors in every half year. The gap between two meetings shall not be more than 90 days.

4) The maximum tenure for which a company can remain dormant is 5 consecutive financial years. If a company remains dormant for more than 5 years, the Registrar commences the process of striking off the name of the company from the Records, i.e. the company will be removed.

5) A dormant company is required to file a "Return of Dormant Company" in Form MSC-3 annually, *inter-alia*, indicating financial position duly audited by a Chartered Accountant in Practice along with such annual fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 within a period of thirty days from the end of each financial year.

6) No need not enclose cash flow statements in its annual accounts.

7) The provisions of the Act in relation to the rotation of auditors are not applicable to dormant companies.

Test Yourself:

State the privileges and exemptions available to the dormant companies under the provisions of the Companies Act, 2013.

Illustration:

A Limited Company wants to start its operations after three years. For the business purpose, the company needs to acquire land. The land prices will be very high after the period of three years.

Hence, in this case, the company will acquire the land at current price which is much cheaper as compared to land prices after three years by incorporating the company and applying the dormant status afterwards.

PROCEDURE TO OBTAIN THE STATUS OF A DORMANT COMPANY

A Company can obtain its status as Dormant Company suo-moto or the ROC may declare a company as Dormant:

***Suo-Moto* application :** A company which meets the above criteria can apply suo-moto to ROC for the status of a "Dormant company" in Form MSC-1 along with such fee as provided in the Companies (Registration Offices and Fees) Rules, 2014 after complying with the provision of Rule 3 of the Companies (Miscellaneous) Rules, 2014.

Dormant by ROC : In case of a company which has not filed financial statements or annual returns for two financial years consecutively, the ROC shall issue a notice to the company and enter the name of such company in the register maintained for dormant companies.

Hence, it is not always the company which applies for the status of the dormant company; even the ROC is empowered *suo moto* to change the status of a company into a dormant company.

The Registrar shall initiate the process of striking off the name of the company, if the company remains as a dormant company for a period of five consecutive years.

Maximum period for which the company can be in the dormant status is **five consecutive years**. Before completion of five years as dormant company, such a company may apply for activation or strike off.

Where a company fails to comply with the requirements of Section 455 of the Companies Act, 2013 read with the Companies (Miscellaneous) Rules, 2014, the Registrar can strike off the name of a dormant company from the Register of dormant companies.

PRE-REQUISITES FOR OBTAINING THE STATUS OF DORMANT COMPANY

As per rule 3 of the Companies (Miscellaneous) Rules, 2014, the Registrar **shall not grant** the status of a dormant company if:

i. Any inspection, inquiry or investigation has been ordered or taken up or carried out against the company.

ii. Any prosecution has been initiated and pending against the company under any law.

iii. There are public deposits which are outstanding or the company is in default in payment thereof or interest thereon.

iv. There is any outstanding loan, whether secured or unsecured. In case the company has any outstanding unsecured loan, the company may apply for the status of a dormant company after obtaining the concurrence of the lender.

v. There is no dispute in the management or ownership of the company.

vi. There are outstanding statutory taxes, dues, duties, etc., payable to the Central Government or any State Government or local authorities etc.

vii. There is default in payment of its workmen's dues.

viii. The Company is a listed company within or outside India.

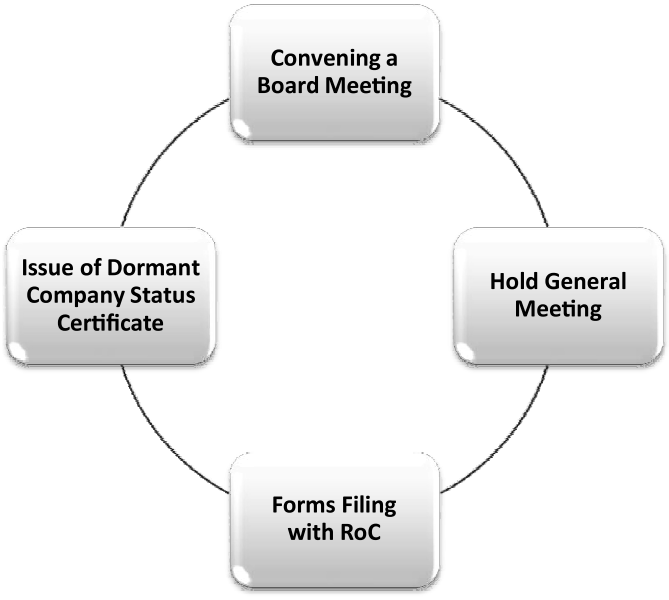
Approvals/documents required for obtaining the status of Dormant Company:

- Board Resolution.
- Special Resolution or consent of 3/4th shareholders of the company.
- Copy of Memorandum and Articles of Association.
- Consent of lender, if any loan is subsisting.
- Statement of affairs duly certified by a Chartered Accountant or Auditor.
- Latest financial statement and annual return of the company.
- No objection certificate from regulatory authority, if company, is regulated by any such authority.

- Certificate that company has not defaulted in the payment of workmen's dues.
- Certificate that company does not have any outstanding taxes, dues, duties, etc payable to Central or State Government or local authority.
- Certificate regarding no inspection, inquiry or investigation has been ordered or taken up or carried out against the company.
- Certificate regarding no prosecution has been initiated and pending against the company under any law.

Step by step procedure for obtaining the status of Dormant Company:

The Act read with the Rules stipulates the following procedure to be followed by a company for obtaining status as a 'dormant company':



1. **Holding a Board Meeting**: The Company shall prepare notice of board meeting alongwith draft resolutions to be passed in the board meeting. Send the notice of board meeting to all the directors at least 7 days before the date of board meeting as per section 173 of Companies Act, 2013 and SS-1.

   Prepare a draft notice that may be sent to the shareholders for holding General Meeting for obtaining the status of the company as Dormant Company. Hold a board meeting to fix day, date, time and venue for General Meeting of the members of the company to pass a special resolution for making application to the ROC to obtain status of a dormant company.

   The company shall obtain Statement of affairs from the Auditor of the company. The statement of affairs shall give the financial position of the company at the time of passing said resolution in the shareholders meeting.

2. **Hold General Meeting:** The Company shall hold the General Meeting at the appointed time, place and date as per the notice calling the said meeting. The notice shall propose the resolution as a special resolution. The company shall pass a special resolution for obtaining the status of a dormant company and authorize the director(s) to make application to ROC after issuing a notice to all the shareholders of the company for this purpose and obtaining consent of at least 3/4th shareholders (in value).

3. **Filing of Form MGT-14:** After passing the special resolution, the company shall file Form MGT-14 with ROC for filing special resolution and notice alongwith explanatory statement within 30 days from the date of passing of the said special resolution.

4. **Filing of Form MSC-1:** After filing of Form MGT-14, the company shall file an application in Form MSC-1 with the ROC within 30 days of passing special resolution for change of status of the company as dormant company along with the copy of the special resolution, copy of statement of affairs, declarations by the directors and other necessary documents.

   Attachments to be filed with Form MSC-1: Following attachments needs to be filed alongwith e-form MSC-1:

   - Certified true copy of board resolution authorizing making application.
   - Certified true copy of special resolution authorizing for obtaining dormant status.
   - Statement of affairs duly certified by the Chartered Accountant or auditor of company.
   - Concurrence of lender if the company is having any outstanding loans, whether secured or unsecured.
   - Latest financial statement and annual return of the company.
   - Copy of approval or no objection certificate from the regulatory authority in case company is regulated by such authority.

5. **Issue of Dormant Company Status Certificate:** On being satisfied with the merits of the application, the ROC shall issue a certificate in **Form MSC -2** for confirming the application and allowing the status of a dormant company to the applicant.

PROCEDURE TO OBTAIN THE STATUS OF ACTIVE COMPANY FROM DORMANT COMPANY

Section 455 of the Companies Act, 2013 read with Rule 8 of the Companies (Miscellaneous) Rule, 2014 lays down the provisions for seeking the status of active company from dormant company. An application shall be made in Form MSC-4 for obtaining the status of an active company from dormant company before the end of five consecutive years from the date of becoming a dormant company. In case the said application is not made before the said period of five consecutive years, the name of the company may be removed from the Register of Companies maintained by the ROC.

Moreover, if any company has contravened any of the conditions mentioned in the grounds of application for obtaining the status of dormant company, the directors should, within seven days of such contravention, file an application for obtaining the status of an active company. The Registrar can take action to remove the company from the list of dormant companies, if it is observed that the company has contravened the conditions for granting the dormant company status, after carrying out an enquiry and after giving a notice and a reasonable opportunity of being heard.

The dormant company shall follow the below procedure for obtaining status of an active company on its own:

Where a dormant company does or omits to do any act which is mentioned in the grounds of application in Form MSC-1 submitted to Registrar for obtaining the status of dormant company, affecting its status of dormant company, the directors shall within 7 days from the date of event file an application for obtaining the status of active company.

1. **Hold board meeting:** The Company shall prepare notice of board meeting alongwith draft resolutions to be passed in the board meeting. Send the notice of board meeting to all the directors at least 7 days

before the date of board meeting as per section 173 of Companies Act, 2013 and SS-1. The following resolutions needs to be passed at the board meeting:

- To make an application with the Registrar of Companies for obtaining status of dormant company as an active company.
- To authorize a director to make an application and sign the documents or forms and to complete all the formalities relating to the application.

2. **Prepare return in Form MSC-3:** The return in form MSC-3 shall be prepared in respect of the financial year in which the application for obtaining the status of an active company is being filed.
3. **File e-Form MSC-4:** An application for obtaining the status of an active company is required to be made in Form MSC-4 along with fees as provided in the Companies (Registration Offices and Fees) Rules, 2014 which should be accompanied by a return in Form MSC-3 in respect of the financial year in which the application for obtaining the status of an active company is being filed**.**
4. **Certificate for active company:** The ROC after considering the application filed for obtaining the status of the active company from dormant company shall issue a certificate in Form MSC-5 allowing the status of an active company to the applicant.

When ROC shall change the status of the dormant company to active company?

(a) Where a dormant company does or omits to do any act mentioned in the grounds in the application made for obtaining status of a dormant company and such act or omission affects its status of dormant company, the directors of such a company are required to file an application within seven days from such event for obtaining the status of an active company.

(b) Where the ROC has reasonable cause to believe that any company registered as 'dormant company' under his jurisdiction has been functioning in any manner, directly or indirectly affecting the status of dormant company, the ROC can initiate the proceedings for enquiry under section 206 of the Companies Act, 2013 and if, after giving a reasonable opportunity of being heard to the company in this regard, it is found that the company has actually been active, the ROC can remove the name of such company from Register of dormant companies and treat it as an active company.

SPECIMEN RESOLUTIONS

A. Draft Board Resolution for obtaining status of Dormant Company:

"RESOLVED THAT consent of Board of directors of the company be and is hereby accorded to make an application to the Registrar of Companies, _____ (ROC), for obtaining the status of "dormant company" for the company, in pursuance of the provisions of section 455 of the Companies Act, 2013 and rules made thereunder, including any amendments thereto from time to time, and subject to the approval of the members of the company.

RESOLVED FURTHER THAT Mr./Ms. _____ (Designation), be and is hereby authorized to sign and file Form MSC-1 to the ROC alongwith all the necessary documents as may be required with regard to the application for obtaining the status of dormant company.

RESOLVED FURTHER THAT Mr./Ms. _____ (Designation), be and is hereby authorized to file such documents and ensure payment of such annual fees as may be prescribed to the ROC to retain the dormant status of the company."

B. Draft Special Resolution for obtaining status of Dormant Company:

"RESOLVED THAT pursuant to provisions of Section 455 of the Companies Act, 2013 ('the Act") and the Companies (Miscellaneous) Rules, 2014 and other applicable provisions, if any, of the Companies Act, 2013 and the rules made thereunder, (including any statutory modifications or re-enactments thereof) and subject to such other approvals and permissions as may be required, the consent of the Members be and is hereby accorded to the Company to make an application to the Registrar of Companies, _____ _____ _____ _____ in Form MSC-1 for obtaining the status of a dormant company.

RESOLVED FURTHER THAT Mr./Mrs. _____, Director and/or Mr./Mrs. _____, Director be and are hereby jointly and severally authorized to submit necessary e-forms to ROC for obtaining the status of a dormant company and to do all such acts, deeds, matters and things as may be deemed necessary, desirable, proper or expedient for the purpose of giving effect to this Resolution and for matters connected therewith or incidental thereto."

C. Draft Board Resolution for Dormant to Active Company:

"**RESOLVED THAT** consent of Board be and is hereby accorded to make an application to the Registrar of Companies, _____ (ROC), for seeking the status of an "active company" for the company, in pursuance of the provisions of section 455 (5) of the Companies Act, 2013 and rule 8 of the Companies (Miscellaneous) Rules, 2014 and any other applicable provisions thereof, including any amendments thereto for the time being in force.

RESOLVED FURTHER THAT Mr./Ms. _____ (Designation) and Mr./Ms. _____ (Designation) be and is hereby severally authorized to sign and file Form MSC-4 to the ROC alongwith all the necessary documents as may be required with regard to the application for seeking the status of an active company and further authorized to all such acts, deeds and things as may be necessary in this regard."

LESSON ROUND-UP

- 'Dormant company' means a company which is an inactive company in the records of the Registrar of Companies and which is not carrying out any business activity and has applied to the Registrar of Companies to change its status in the Register of Companies.
- 'Inactive company' means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years.
- Section 455 of the Companies Act, 2013 read with Companies (Miscellaneous) Rules, 2014 stipulate the provisions pertaining to "Dormant Company".
- A company can either on an application to Registrar change the status of the company from active to dormant company or the Registrar can suo moto after issuing the notice to the concerned company change the status of the company from active to dormant company in the Register of Companies and enter the name of such a dormant company in the Register of Dormant Companies maintained by the Registrar.

- A dormant company enjoys the status of the dormant company for a maximum period of five consecutive years. Before the end of the five consecutive years, an application is required to be made for changing the status of the company from dormant to active company or such a company's name is struck off from the Register of Companies. However, if the company breaches any of the grounds of being a dormant company, then such a company's status is automatically changed from dormant to active company in the Register maintained by the Registrar.
- The Act provides certain benefits / exemptions to a dormant company apart from lesser compliance requirements.

GLOSSARY

Inactive Company: Means a company which has not:

(a) carried on any business or operations

(b) not made any significant accounting transaction during last two financial years

(c) not filed financial statements and annual returns during the last two financial years

Significant Accounting Transaction: It means any transaction made by the company except below transaction:

(a) payment of fees by a company to the Registrar;

(b) payments made by company to fulfil the requirements of this Act or any other law;

(c) allotment of shares to fulfil the requirements of this Act; and

(d) Payments for maintenance of its office and records.

Listed company: It means a Company whose shares are traded on an official stock exchange.

TEST YOURSELF

(*These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Hans Plastic Ltd., not carrying out any business activity, wants to apply to ROC to change its status from Active Company to Dormant Company. Board of directors seeks your advice about the procedure to obtain the status of Dormant Company.
2. Discuss in brief the law relating to Active Company.
3. State the circumstances under which the status of the Dormant Company is restored to active company.
4. Summarize the provisions of the Companies Act, 2013 relating to prerequisite for an active company to change its status to dormant company.
5. State the circumstances under which a dormant company is struck off from the Register of Companies.
6. Can a Dormant company make allotment of shares? Also, can there be a change in Directors of such Company?

7. A Company is not carrying on any business for last two years, the Management of the Company decided to make an application for obtaining the status of Dormant Company. One of the Director stated that since, the Company is having unsecured loans from Shareholders and relatives of Directors, the Company cannot obtain the dormant status. Citing relevant provisions of the Companies Act, 2013 and Rules made thereunder, explain whether the statement of the Director of the Company is correct? Will your answer differ, if the Company have also obtained Loans from Shareholders and relatives of Directors in the form of secured Debentures?

8. Alishaan Ltd., has recently obtained the status of dormant company. The Board of Directors seeks your advice about the required compliances in respect of the following :

   i. Minimum number of Directors.

   ii. Requirement of Return filing.

   iii. Meeting of Board of Directors.

9. ABC Pvt Ltd is not carrying on any business for last two years, the Management of the Company decided to make an application for obtaining the status of Dormant Company. One of the Director stated that since, the Company is having unsecured loans from Shareholders and relatives of Directors, the Company cannot obtain the Dormant status. Choose whether the statement of the Director of the Company is correct ?

   (a) No, Registrar shall not grant the status of a dormant company, if there is any outstanding loan, whether secured or unsecured and until the concurrence or approval of the lender is received.

   (b) Yes, Registrar shall grant the status of a dormant company, even if there is any outstanding loan, whether secured or unsecured and concurrence or approval of the lender is not required.

   (c) No, Registrar shall not grant the status of a dormant company, if there is any outstanding loan, whether secured or unsecured and until the concurrence or approval of the lender is not required.

   (d) None of the above

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- Bare Act- The Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks.html

Inspection, Inquiry and Investigation

Lesson 12

KEY CONCEPTS

■ Inspection ■ Inspection Report ■ Information ■ Inquiry ■ Investigation ■ Fraud ■ Search and seizure ■ Adjudication ■ Summon ■ Confiscation ■ Scrutiny

Learning Objectives

To understand:

- Meaning of inspection, inquiry and investigation
- Purpose and powers for conducting Inspection
- Kinds of Investigation
- Protection of employees during Investigation
- Search and Seizure
- Freezing of Assets

Lesson Outline

- Introduction
- Purpose of conducting inspection
- Circumstances when the inspection may be ordered
- Circumstances when Registrar may initiate inquiry
- Conduct of Inspection and Inquiry
- Seizing after obtaining permission of Special Court
- Investigation of the affairs of company and its kinds
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 206-229)
- The Companies (Inspection, Investigation and Inquiry) Rules, 2014

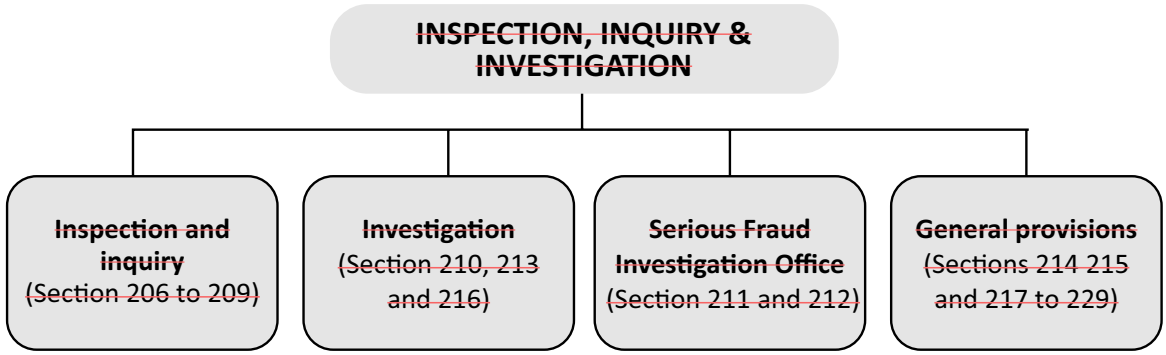
INTRODUCTION

To prevent from any fraudulent activity, the regulations are needed. The person committing the fraud is punished by the authority. For frauds committed by individuals in their own capacity are punished by the law, depends on the nature of fraud or offence.

This takes a lot of efforts in drafting and making a law. In addition to that, the task of enforcing a law is the real challenge for any law-making authority. Without enforcement of a law, there will be lesser compliance of the law. A law without regulatory or penal powers is a toothless tiger. Regulatory actions ensure proper compliance of the law.

A check on the performance and compliance of various applicable laws are generally exercised by the scrutiny of any document filed by a company with the Registrar of Companies or any other regulatory authority, which is empowered to call for information and explanation with respect to any matter to which such documents or any information purports to relate. The object of inspection is not only to keep a watch on the performance of companies but also to evaluate the level of efficiency in the conduct of the companies.

Likewise, Chapter XIV of the Companies Act, 2013 ("the Act") contains Sections 206 to 229, stipulates the provisions relating to inspection, inquiry and investigation into the affairs of the Company.



The Act empowers the Registrar of Companies (RoC) to carry out the inquiry to call for information, to order an enquiry, to enter and search the place or places where the books are kept. The Act empowers the Central Government to appoint an inspector to carry out the inquiry and to order an investigation into the affairs of the company. The Act also mandates constitution of Serious Fraud Investigation Office (SFIO) and assigns certain offences to be investigated by SFIO, which has power to arrest in respect of certain offences.

For example, Form AOC-4 for filing of Financials and Form MGT-7 for filing the annual return are basic annual compliance which must be followed by every Company. Failure to file such forms whether intentional or not, encourages the regulatory actions. In such situation, the regulatory actions become the tool to enforce regulatory compliances.

These regulatory actions may be any of the following:

- Call for information;
- Inspection;
- Investigation;

- Inquiry;
- Search and seizure;
- Litigation;
- Arrest;
- Penalty and Punishment.

The agencies responsible for enforcement of Laws and Regulations applicable to businesses are : RoC, RD, SFIO, SEBI, Stock Exchange, RBI, CCI, Labour Law Authorities, Income Tax Authorities, Enforcement Directorate, CBI, Economic Offence Wing, etc.

Meaning of Inquiry, Inspection and Investigation

Inquiry and Inspection is a process, through which one can collect the required information. Investigation is a process of unearthing the concealed and hidden facts and the truth about a matter.

Inquiry:

The word 'inquiry' is not defined under the Act. The word 'inquiry' is derived from the French word "enquerre" which means "to ask".

As per Black Law Dictionary, the word 'inquiry' is defined as *"A request for information, whether procedural or substantive."*

As per Collins Dictionary *"Inquiry"* is defined as *"the act of inquiring; a seeking for information by asking questions; interrogation; a question or questioning."*

Inquiry is a process questioning and interrogation by way of researching and probing in order to find a solution to the problem. This is the process to bring clarity or clear any doubt on any subject matter. This is basically searching for and acquiring knowledge and information about something.

Inspection:

The word 'inspection' is not defined under the Act. The word 'inspection' is derived from the Latin word "inspectus" means to look into, inspect.

As per Black Law dictionary, the word 'inspection' is defined as "A careful examination of something such as goods (to determine their fitness for purchase) or items produced in response to a discovery request to determine their relevance to a lawsuit."

Investigation:

The word 'investigation' is not defined under the Act. The word 'investigation' is derived from the lating word "Investigatus" which is the past participate of 'investigare" meaning "to track or investigation.'

As per Black Law dictionary, the word 'investigation' is defined as to inquire into (a matter) systematically; to make (a suspect) the subject of a criminal inquiry.

Investigation within the meaning of Companies Act is a form of probe; a deeper probe; into the affairs of the company. It is a fact finding exercise. The main object of investigation is to collect evidence and to see if any illegal acts or offences are disclosed and then decide the action to be taken up. The said expression also includes investigation of all business affairs-profits and losses, assets including goodwill, contracts and transactions, investments and other property interests and control of subsidiary companies too.

Inspection vs. Inquiry vs. Investigation

Inspection, inquiry and investigation are three connected but different regulatory actions. These regulatory actions start with some information. Inspection and Inquiry are the preliminary stage while investigation is a later stage.

To understand this with the purview of Companies Act, 2013, the registrar got some information about a Company in which fraud is going on. The registrar issues an order to ***inspect*** the books & accounts and other statutory records of the Company. The registrar may carry out the ***inquiry*** if circumstance so warrant. Further, if registrar is not satisfied with the inspection and inquiry, the registrar will file its report to Central Government and the Central Government may issue the order to conduct ***investigation***. Inspects and issued an inquiry into the affairs of the Company. Here, it is important to note that it doesn't matter from where the registrar gets information. Anyone can provide information be it stakeholder, director, shareholder, employee and they may play the role of whistle blower.

Therefore, Inspection is intended to be a routine and not ad hoc or special affair. However, if sufficient evidence suggests that of the company's affairs are being mismanaged and/or managed in fraudulent way, then inspection can lead to orders for investigation into the affairs of the company.

Powers alloted under the Companies Act, 2013

AUTHORITIES	***SECTIONS***	***POWERS***
Registrar of Companies	206, 207, 208 & 209	• Call for Information, Inspect Books and Conduct Inquiries • Conduct of Inspection and enquiry • Report on Inspection Made • Search and Seizure
Inspector	206, 207, 208 & 209, 216, 218 and 219	• Call for Information, Inspect Books and Conduct Inquiries • Conduct of Inspection and enquiry • Report on Inspection Made • Search and Seizure • To investigate on matters relating to the company, and its membership for determining ownership of the company • Power of Inspector to Conduct Investigation into Affairs of Related Companies
Central Government	206, 210, 211, 212, 216 and 224	• Authorise any statutory authority to carry out the inspection of books of account of a company or class of companies • Direct any statutory authority appointed by it for the purpose to carry out the inquiry • Investigate into Affairs of Company • Establishment of Serious Fraud Investigation Office

AUTHORITIES	SECTIONS	POWERS
		• Assign the investigation into the affairs of the company to the Serious Fraud Investigation Office • Appointment of inspector, to investigate on matters relating to the company, and its membership for determining ownership of the company • Actions to be Taken in Pursuance of Inspector's Report
Regional Director	206	• Central government delegates power to appoint inspector for inspection of books and papers of a company
Tribunal	213, 221, 222	• Freezing of Assets of Company on Inquiry and Investigation • Imposition of Restrictions Upon Securities

PURPOSE OF CONDUCTING INSPECTION

Some of the objectives of conducting such inspections may be thus:

1. To detect concealment of income by falsification of accounts.
2. To secure knowledge about the mismanagement of the business of a company and transactions entered into with an intent to defraud creditors, shareholders or otherwise for fraudulent or unlawful purposes.
3. To ascertain whether the statutory auditors have discharged their functions and duties in certifying the true and fair view of a company's accounts and their proper maintenance.
4. To enable the Government to ascertain the quantum of profits accrued but not adequately accounted for.
5. To detect misapplication of funds leading a company to a state of perpetual financial crisis.
6. To keep a watch on performance of a company.
7. To detect misuse of fiduciary responsibilities by the company's management for personal aggrandizement.

Inspection is intended to be a routine and not *ad hoc* or special affair. However, if sufficient evidence suggests that the company's affairs are being mismanaged and/or managed in fraudulent way, then inspection can lead to orders for investigation into the affairs of the company.

POWER TO CALL FOR INFORMATION, INSPECT BOOK AND CONDUCT INQUIRIES – SECTION 206(1) AND (2)

Issuance of notice by registrar – Section 206(1)

The Registrar by a written notice issued under sub-section (1) of section 206 may require a company to:

(a) furnish in writing information or explanation; or

(b) to produce documents, within a given reasonable specified time.

The Registrar may ask such information after framing his opinion:

(a) on scrutiny of any document filed by the company; or

(b) on any information received by him.

The registrar shall frame its opinion and record it while issuing the notice. His opinion shall be a reasoned opinion framed on the basis of the scrutiny of documents and information received by him.

The notice issued by the Registrar and the information or explanation submitted by the company shall be in writing.

Duty of the company to furnish information – Section 206(2)

On receipt of the notice issued by the Registrar under sub-section (1), it shall be a duty of the company and of its officers concerned:

(a) to furnish the information or explanation to the best of their knowledge and power; and

(b) to produce the documents within the specified or extended time.

Past employees to furnish information- Proviso to sub-section (2) of Section 206

Where such information or explanation relates to any past period, the Registrar through a notice in writing may require the officers who were employees during that past period to furnish such information or explanation to the best of their knowledge.

Both Past as well Present employees need to furnish such information or explanation to the best of their knowledge.

INSPECTION- SECTION 206(3), 206(5) AND 206(6)

There are three authorities which may order inspection under Section 206:

- By Registrar under sub-section (3) of section 206;
- By Regional Director under power delegated to it by Central Government under sub-section (5) of Section 206; and
- By Central Government by a general or special order under sub-section (6) of section 206.

Inspection ordered by the Registrar by Another Notice – Section 206(3)

According to Section 206(3), Inspection may be ordered by the Registrar, where –

- If no information or explanation is furnished to the Registrar within the time specified under sub-section (1) ; or
- if the Registrar on an examination of the documents furnished is of the opinion that the information or explanation furnished is inadequate; or
- if the Registrar is satisfied on a scrutiny of the documents furnished that an unsatisfactory state of affairs exists in the company and does not disclose a full and fair statement of the information required.

Then the Registrar may by another written notice, call on the company to produce for his inspection such further books of accounts, books, papers and explanations as he may require at such place and at such time as specified in the notice.

In this written notice, the Registrar shall record his reason in writing for issuing the notice for inspection.

Inspection ordered by the Regional Director – Section 206(5)

The Central Government may, on satisfaction that circumstance so warrant, direct inspection of books and papers of a company by an inspector appointed for the purpose. This power given under sub – section (5) to the Central Government has been delegated to jurisdictional Regional Directors by virtue of notification dated 29th April, 2016.

Inspection ordered by the Central Government – Section 206(6)

The Central Government may by general or special order authorize any statutory authority to carry out the inspection of books of account of a company or class of companies. While issuing such general or special order, the Central Government will consider the circumstances.

This sub-section gives wide powers to the central government. Such inspection may be carried out by any statutory authority including SFIO, ICSI, ICAI, SEBI, IRDA, CCI, TRAI, etc. depending upon the circumstances of the case.

Meaning of General or Special Order

When there is need to investigate any specific industry for their wrongful practice the Ministry may issue general order of inspection and when such order is issued against any specific company is called special order.

INQUIRY- SECTION 206(4)

If the Registrar is satisfied that the business of the company is being carried on –

- for a fraudulent purpose;
- unlawful purpose; or
- not in compliance with the provision of this Act; or
- investors grievances not being addressed.

Then, the Registrar may initiate inquiry under sub-section (4) of section 206,

The Registrar shall satisfy itself before order of such inquiry on the basis of –

- information available with him; or
- information furnished to him; or
- on representation made to him by any person.

The order shall be made by the Registrar to carry out such inquiry as he deemed fit after giving the company a reasonable opportunity of being heard.

The Registrar shall order inquiry after informing the company of the allegation made against it by a written order.

In this order, the Registrar will call on the company in writing any information or explanation within specified time.

Further, the Central Government may, on satisfaction that circumstance so warrant, direct the Registrar or Inspector for the purpose to carry out the inquiry under this sub-section (4) of section 206.

Provided further that where business of a company has been or is being carried on for a fraudulent or unlawful purpose, every officer of the company who is in default shall be punishable for fraud under Section 447.

Meaning of Fraud- Explanation (i) to Section 447

Explanation (i) to Section 447 has defined fraud in relation to affairs of a company or anybody corporate to include, any act, omission, concealment of any fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss.

'Wrongful gain' in terms of explanation (ii) to Section 447, means "the gain by unlawful means of property to which the person gaining is not entitled".

On the other hand, **explanation (iii) to section 447** has defined **"wrongful loss"** to mean the loss by unlawful means of any property to which the person losing is legally entitled".

Contravention of Section 206- Section 206(7)

If a company fails to furnish any information or explanation or produce any document required under this section, the company and every officer of the company, who is in default shall be punishable with a fine which may extend to one lakh rupees and in the case of a continuing failure, with an additional fine which may extend to five hundred rupees for every day after the first during which the failure continues.

CONDUCT OF INSPECTION AND INQUIRY (SECTION 207)

Where a Registrar or inspector calls for the books of account or other books and papers, it shall be duty of every director, officer or other employee of the company to produce all these documents to the Registrar or inspector. It shall also be duty of these persons to furnish statements, information or explanation as the Registrar or inspector may require and shall render all assistance to the Registrar of inspector in connection with the inspection.

Make Copies or Place Mark – Section 207(2)

The Registrar or inspector, making an inspection or inquiry under section 206 may, during the course of such inspection or inquiry, as the case may be —

(a) make or cause to be made copies of books of account or other books and papers; or

(b) place or cause to be placed any mark of identification in such books in token of the inspection having been made.

Same Powers as CPC – Section 207(3)

The Registrar or inspection making an inspection or inquiry shall have all powers as are vested in civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely –

(a) the discovery and production of books of account and other documents at such place and time as may be specified by such Registrar or Inspector making the inspection or inquiry;

(b) summoning and enforcing the attendance of persons and examining them on oath; and

(c) inspection of any books, registers and other documents of the company at any place.

Contravention of Section 207 – Section 207(4)

(i) If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(ii) If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.

INSPECTION REPORT- SECTION 208

The Registrar or inspector shall, after the inspection of the books of account or an inquiry under section 206 and other books and papers of the company under section 207, submit a report in writing to the Central Government along with such documents, if any, and such report may, if necessary, include a recommendation that further investigation into the affairs of the company is necessary giving his reasons in support.

Central Government has delegated its powers under Section 208 to Regional Director vide Notification No. S.O. 3557(E) dated 31/12/2015.

Further, on receipt of report, the Regional Director –

a) shall examine the report and obtain the legal advise, if required;

b) shall direct initiation of prosecution if he agrees with the recommendation of the Registrar or inspector to initiate prosecution against the company, or any other person connected with the affairs of the company; and

c) shall inform the Central Government about the action taken on the report submitted by the Registrar or inspector.

The Regional Director shall also on receipt of the report from registrar or inspector, where such report recommends action of violation of offences other than violation of offences under the said Act for which imprisonment of less than two years is provided, (except for violation of offences under chapter III, IV, section 127, 177 and 178 for which the report shall be received by the Central Government), examine the same, obtain the legal advise, if required and submit it to the Central Government seeking initiation of prosecution.

SEARCH AND SEIZURE- SECTION 209

Application to Special Court for entering places and seizing documents

Where, upon information in his possession or otherwise, the Registrar or inspector has reasonable ground to believe that the books and papers of a company, or relating to the key managerial personnel or any director or auditor or company secretary in practice if the company has not appointed a company secretary, are likely to be destroyed, mutilated, altered, falsified or secreted, he may, after obtaining an order from the Special Court for the seizure of such books and papers –

(a) enter, with such assistance as may be required, and search, the place or places where such books or papers are kept; and

(b) seize such books and papers as he considers necessary after allowing the company to take copies of, or extracts from, such books or papers at its cost.

For an example a group of creditors of XYZ Limited file a complaint to ROC alleging that BOD of XYZ ltd is involved in falsification & destruction of books of accounts and records of company. The complainant requests the registrar to immediately seize the records of the company to prevent such destruction.

Here, according to Section 209 (1) ROC may enter and search the place where such books and papers are kept and seize them only after obtaining an order from special court.

Returning of Seized Books and Papers in 180 days – Section 209(2)

The Register or inspector shall return the books and papers within one hundred and eighty days after such seizure to the company from whose custody or power such books or papers were seized. These books and papers may be called for by the Registrar or inspector for a further period of one hundred and eighty days by an order in writing if they are needed again.

Registrar or inspector may, therefore returning such books and papers, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the same in such other manner as he considers necessary.

Same Powers as Cr.PC – Section 209(3)

The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizures shall apply, mutatis mutandis, to every search and seizure.

INVESTIGATION (SECTION 210 - 229)

Shareholders have been vested with various rights including the right to elect directors under the Companies Act, 2013. However, shareholders are often ill-equipped to exercise effective control over the affairs of companies, and, particularly in companies whose shareholders are widely scattered and the affairs of such companies are managed to all intents and purposes, by its Board of directors to the exclusion of a predominant majority of shareholders. Such a situation leads to abuse of power by persons in control of the affairs of company. It became, therefore, imperative for the Central Government to assume certain powers to investigate the affairs of the company in appropriate cases particularly where there was reason to believe that the business of the company was being conducted with the intent to defraud its creditors or members or for a fraudulent or unlawful purpose, or in any manner oppressive of any of its members. Sections 210 to 229 of the Companies Act, 2013, contain provisions relating to investigation of the affairs of company.

KINDS OF INVESTIGATION

The Companies Act, 2013 provides for carrying out the following kinds of investigation:

1. Investigation of the affairs of the company if it is necessary to investigate into the affairs of the company in public interest (Section 210);
2. Investigation by Serious Fraud Investigation Office directed by Central government under (Section 212);
3. Investigation on the order of Tribunal (Section 213).
4. Investigation about the ownership of a Company (Section 216);
5. Investigation of the affairs of related companies (Section 219);
6. Investigation of foreign companies (Section 228);

INVESTIGATION INTO AFFAIRS OF COMPANY IN PUBLIC INTEREST- SECTION 210

Investigation on Order of Central Government – Section 210(1)

Where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company,—

(a) on the receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that the affairs of the company ought to be investigated; or

(c) in public interest,

it may order an investigation into the affairs of the company.

Investigation on Order of Court or Tribunal – Section 210(2)

Where an order is passed by a court or the Tribunal in any proceedings before it that the affairs of a company ought to be investigated, the Central Government shall order an investigation into the affairs of that company.

Appointment of Inspectors – Section 210(3)

For the purpose of investigation, the Central Government may appoint one or more inspectors to investigate the affairs of the company. These inspectors shall report on the affairs of the company in such manner as the central government may direct.

According to Rule 5 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the Central Government may before appointing an inspector under sub-section (3) of section 210, require the applicant to give a security not exceeding twenty-five thousand rupees for payment of the costs and expenses of investigation as per the criteria given below –

S. No.	***Turnover as per previous year balance sheet (Rs.)***	***Amount of security (Rs.)***
1	Turnover upto Rs. 50 crore	Rs. 10000
2	Turnover more than Rs. 50 crore and upto 200 crore	Rs. 15000
3	Turnover more than Rs. 200 crore	Rs. 25000

The security shall be refunded to the applicant if the investigation results in prosecution.

Judicial Pronouncements

In *Modi Industries Ltd. v. Union of India [(1982) 52 Comp. Cas. 589]*, the Delhi High Court has observed that in order to order an investigation there may be some circumstances which would lead to the inference that there has been some fraud, misfeasance, breach of trust or misconduct which requires investigation. It is not necessary that the persons concerned should be actually guilty but at least there should seem to be some circumstances which could lead to the inference.

In the matter of *Rohtas Industries v. S.D. Agarwal and Ors., [(1969) 139 Comp Cas 781 (SC), CO.A.(SB) 39/2013 Page 13 of 20]* wherein the Hon'ble Supreme Court set aside a impugned order of the High Court and held that in cases of allegations of fraud on the part of the directors of a company, an investigation must be carried out if there is prima facie evidence of any intent to defraud, fraudulent or unlawful activities, or instances of misconduct.

However, in the case of *Andhra Pradesh State Civil Supply Corpn. Ltd. v. Delta Oils & Fats Ltd. [(1999) 96 Comp. Cas. 303 1 (CLB)]* to show "a mere statement of facts based on the auditor's report without any corroborative evidence will not assist the Company Law Board in framing the requisite opinion for directing investigation into the affairs of the company under Section 235 of the Companies Act, 1956.

In the case of *Binod Kumar Kasera v. Nandlall & Sons Tea Industries (P.) Ltd.[(2010) 175 (CLB - New Delhi)]*, which held that object of investigation under Section 235(2) is to discover something which is not apparently visible to the naked eye and where a petition discloses merely facts which are apparent from the balance sheet of the company, an investigation will not be ordered.

Calcutta High Court in *Mayank Kocher v. Transport & Handling Equipments MFG. Co. P. Ltd, [(2008) 143 Comp Cas 601 (CLB)]*. While discussing Section 235 of the Companies Act, 1956 (Corresponding Section to Section 210 of the Companies Act, 2013 order records that: "Under this Section directing an investigation is only analogous to the issue of a fact-finding commission by a civil court for looking into accounts or making aninvestigation and does not amount to a judgment, so as to enable an aggrieved party to appeal."

ESTABLISHMENT OF SERIOUS FRAUD INVESTIGATION OFFICE (SECTION 211)

As per the Companies Act, 2013, Serious Fraud Investigation Office (SFIO) has been established through the Government of India vide Notification NO. S.O.2005(E) dated 21.07.2015. It is a multi-disciplinary organisation under the Ministry of Corporate Affairs, consisting of experts in the field of accountancy, forensic auditing, banking, law, information technology, investigation, company law, capital market and taxation etc., for detecting and prosecuting or recommending for prosecution white collar crimes/frauds.

SFIO is headed by a Director as Head of Department in the rank of Joint Secretary to the Government of India. The Director is assisted by Additional Directors, Joint Directors, Deputy Directors, Senior Assistant Directors, Assistant Directors Prosecutors, and other secretarial staff. The Headquarter of SFIO is in New Delhi, with five Regional Offices in Mumbai, New Delhi, Chennai, Hyderabad & Kolkata.

The office shall be headed by a Director and consist of experts of following fields:

(a) Banking,

(b) Corporate Affairs,

(c) Taxation,

(d) Forensic auditing,

(e) Capital Market,

(f) Information Technology,

(g) Law, or

(h) Other fields as may be prescribed.

According to Rule 3 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the Central Government may appoint persons having expertise in the fields of investigations, cyber forensics, financial accounting, management accounting, cost accounting and any other fields as may be necessary for the efficient discharge of Serious Fraud Investigation Office (SFIO) functions under the Act.

The Director shall be an officer not below to the rank of a Joint Secretary having knowledge and experience in dealing with matters relating to corporate affairs.

The Central Government may appoint such experts and other officers and employees in the Serious Fraud Investigation Office as it considers necessary for the efficient discharge of its functions under this Act.

The terms and conditions of service of Director, experts, and other officers and employees of the Serious Fraud Investigation Office shall be such as may be prescribed.

According to Rule 4 of the Companies (Inspection, Investigation and Inquiry) Rules, 2014, the terms and conditions of service of Director, experts and other officers and employees of the Serious Fraud Investigation Office under sub-section (5) of section 211 shall be as under-

(a) the terms and conditions of appointment of Director shall be governed by the deputation rules under the Central Staffing Scheme of Government of India;

(b) the terms and conditions of service of experts from the Central Government or the State Government or Union territory Government, Public Sector Undertaking, Autonomous Bodies and such other organizations shall be as per the recruitment rules which may be duly notified by the Central Government under article 309 of the Constitution of India;

(c) the terms and conditions of service of other officers and employees from the Central Government or the State Government or Union territory Government, Public Sector Undertaking, Autonomous Bodies and such other organizations shall be as per the recruitment rules which may be duly notified by the Central Government under article 309 of the Constitution of India;

(d) the Central Government may appoint experts or consultants or other professionals or professional firms on contractual basis as per the scheme of engagement of experts or consultants which may be duly approved by the Central Government.

Assigning of investigation to SFIO by CG: Section 212(1)

(1) Without prejudice to the provisions of section 210, where the Central Government is of the opinion, that it is necessary to investigate into the affairs of a company by the Serious Fraud Investigation Office-

(a) on receipt of a report of the Registrar or inspector under section 208;

(b) on intimation of a special resolution passed by a company that its affairs are required to be investigated;

(c) in the public interest; or

(d) on request from any Department of the Central Government or a State Government,

the Central Government may, by order, assign the investigation into the affairs of the said company to the Serious Fraud Investigation Office and its Director, may designate such number of inspectors, as he may consider necessary for the purpose of such investigation.

No other investigating agency of CG or any SG shall proceed with investigation where case is assigned to SFIO: Section 212(2)

(2) Where any case has been assigned by the Central Government to the Serious Fraud Investigation Office for investigation under this Act, no other investigating agency of Central Government or any State Government shall proceed with investigation in such case in respect of any offence under this Act and in case any such investigation has already been initiated, it shall not be proceeded further with and the concerned agency shall transfer the relevant documents and records in respect of such offences under this Act to Serious Fraud Investigation Office.

Submission of Report to CG: Section 212(3)

(3) Where the investigation into the affairs of a company has been assigned by the Central Government to Serious Fraud Investigation Office, it shall conduct the investigation in the manner and follow the procedure provided in this Chapter; and submit its report to the Central Government within such period as may be specified in the order.

Investigation by investigating Officer: Section 212(4)

(4) The Director, Serious Fraud Investigation Office shall cause the affairs of the company to be investigated by an Investigating Officer who shall have the power of the inspector under section 217.

Providing all assistance to Investigating Officer: Section 212(5)

(5) The company and its officers and employees, who are or have been in employment of the company shall be responsible to provide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation.

Offences are Cognizable & Non- Bailable: Section 212(6)

(6) Notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), offence covered under section 447 of this Act shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond unless-

(i) the Public Prosecutor has been given an opportunity to oppose the application for such release; and

(ii) where the Public Prosecutor opposes the application, the court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while on bail:

Provided that a person, who, is under the age of sixteen years or is a woman or is sick or infirm, may be released on bail, if the Special Court so directs:

Provided further that the Special Court shall not take cognizance of any offence referred to this subsection except upon a complaint in writing made by-

(i) the Director, Serious Fraud Investigation Office; or

(ii) any officer of the Central Government authorised, by a general or special order in writing in this behalf by that Government.

Granting of Bail: Section 212(7)

(7) The limitation on granting of bail specified in sub-section (6) is in addition to the limitations under the Code of Criminal Procedure, 1973 (2 of 1974) or any other law for the time being in force on granting of bail.

Power to Arrest: Section 212(8)

(8) If any officer not below the rank of Assistant Director of Serious Fraud Investigation Office authorised in this behalf by the Central Government by general or special order, has on the basis of material in his possession reason to believe (the reason for such belief to be recorded in writing) that any person has been guilty of any offence punishable under sections referred to in sub-section (6), he may arrest such person and shall, as soon as may be, inform him of the grounds for such arrest.

Forward Copy of Order to SFIO: Section 212(9)

(9) The officer authorized under sub-section (8) shall, immediately after arrest of such person under such sub-section], forward a copy of the order, along with the material in his possession, referred to in that sub-section, to the Serious Fraud Investigation Office in a sealed envelope, in such manner as may be prescribed and the Serious Fraud Investigation Office shall keep such order and material for such period as may be prescribed.

Present before Special Court/JM/MM: Section 212(10)

(10) Every person arrested under sub-section (8) shall within twenty-four hours, be taken to a 4[Special Court or Judicial Magistrate] or a Metropolitan Magistrate, as the case may be, having jurisdiction:

Provided that the period of twenty-four hours shall exclude the time necessary for the journey from the place of arrest to the 5[Special Court or Magistrate's court].

Submission of Interim Report to CG: Section 212(11)

(11) The Central Government if so directs, the Serious Fraud Investigation Office shall submit an interim report to the Central Government.

Submission of Investigation Report to CG: Section 212(12)

(12) On completion of the investigation, the Serious Fraud Investigation Office shall submit the investigation report to the Central Government.

Receiving of copy of investigation report by making application to court: Section 212(13)

(13) Notwithstanding anything contained in this Act or in any other law for the time being in force, a copy of the investigation report may be obtained by any person concerned by making an application in this regard to the court.

CG ma direct SFIO to initiate prosecution: Section 212(14)

(14) On receipt of the investigation report, the Central Government may, after examination of the report (and after taking such legal advice, as it may think fit), direct the Serious Fraud Investigation Office to initiate prosecution against the company and its officers or employees, who are or have been in employment of the company or any other person directly or indirectly connected with the affairs of the company.

(14A) Where the report under sub-section (11) or sub-section (12) states that fraud has taken place in a company and due to such fraud any director, key managerial personnel, other officer of the company or any other person or entity, has taken undue advantage or benefit, whether in the form of any asset, property or cash or in any other manner, the Central Government may file an application before the Tribunal for appropriate orders with regard to disgorgement of such asset, property or cash and also for holding such director, key managerial personnel, other officer or any other person liable personally without any limitation of liability.

Filing of investigation report with SFIO: Section 212(15)

(15) Notwithstanding anything contained in this Act or in any other law for the time being in force, the investigation report filed with the Special Court for framing of charges shall be deemed to be a report filed by a police officer under section 173 of the Code of Criminal Procedure, 1973 (2 of 1974).

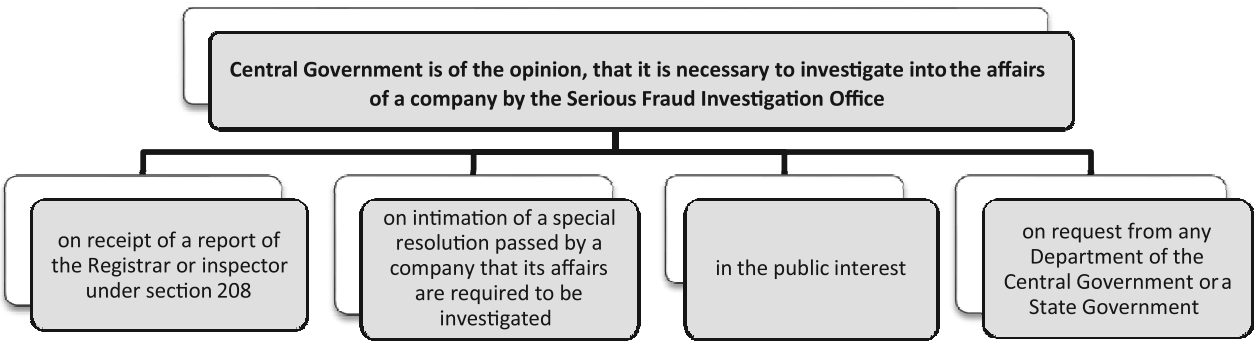
(16) Notwithstanding anything contained in this Act, any investigation or other action taken or initiated by Serious Fraud Investigation Office under the provisions of the Companies Act, 1956 (1 of 1956) shall continue to be proceeded with under that Act as if this Act had not been passed.

Providing of all information to SFIO: Section 212(17)(a)

(17) (a) In case Serious Fraud Investigation Office has been investigating any offence under this Act, any other investigating agency, State Government, police authority, income-tax authorities having any information or documents in respect of such offence shall provide all such information or documents available with it to the Serious Fraud Investigation Office;

Sharing of all information to SFIO: Section 212(17)(b)

(b) The Serious Fraud Investigation Office shall share any information or documents available with it, with any investigating agency, State Government, police authority or income-tax authorities, which may be relevant or useful for such investigating agency, State Government, police authority or income-tax authorities in respect of any offence or matter being investigated or examined by it under any other law.



On receipt of such order from CG, SFIO may designate inspectors as he may consider necessary for thepurpose of such investigation

If investigation is pending with other agencies, such concerned agency shall shall transfer the relevantdocuments and records in respect of such offences to SFIO

SFIO shall conduct the investigation in the manner and follow the procedure provided in Chapter XIV of the Companies Act, 2013 and submit its report to the CG within such period as may be specified in the order.

Investigating Officer who shall have the power of the inspector under section 217 of the Companies Act, 2013

The company and its officers and past and present employees of the company shall be responsible toprovide all information, explanation, documents and assistance to the Investigating Officer as he may require for conduct of the investigation

Offences covered under section 447 of the Companies Act, 2013 shall be cognizable and no person accused of any offence under those sections shall be released on bail or on his own bond except undercertain circumstances

The concerned officers of SFIO may arrest the guilty person if he has reason to believe and inform suchperson ground for his arrest

The concerned officer of SFIO shall immediately after arrest of such person forward a copy of the order,along with the material in his possession to the SFIO

Every person arrested shall within twenty-four hours, be taken to a Special Court or Judicial Magistrate or a Metropolitan Magistrate, as the case may be, having jurisdiction

CASE LAWS

In the case of ***Serious Fraud Investigation Office and Ors.(Appellants) v. Rahul Modi and Ors.*** (*Respondents*) (Criminal Appeal Nos. 538-539 of 2019 (Arising out of Special Leave Petition (Criminal) Nos. 94-95 of 2019) and Transfer Petition (Crl.) No. 35 of 2019) (Supreme Court of India)

Facts of the case: In exercise of powers, the Central Government directed investigation into the affairs of one Group of Companies and LLPs by Officers of Serious Fraud Investigation (SFIO) as nominated by Director, SFIO.

The SFIO shall investigate into following areas in addition to any other issues that it may come across during the investigation.

(i) To ascertain and unearth rotation of funds or identification of quantum of diversion of funds of siphoning including beneficiaries thereof;

(ii) To identify instances of mismanagement, negligence or fraud;

(iii) To ascertain the role of auditors, KMPs or independent directors or any other person in the alleged fraud;

(iv) To examine role of any other entity used as conduit in the alleged fraud;

(v) To identify non-compliance of the statutory provisions of the Act and its impact on Corporate Governance.

That the Inspector(s) so appointed shall exercise all powers available to them Under Section 217 of the Companies Act, 2013 and Chapter IX of LLP Act, 2008. The inspector(s) shall complete their investigation and submit their report to the Central Government within a period of 03 (Three) months from the date of issue of this order.

Accused were accordingly arrested and Judicial Magistrate granted remand and directed they be produced before Special Court. Thereafter, the Accused were produced before the Special Court with a fresh application for remand. The prayer for extension of custody was opposed by the Accused inter alia on the grounds that the period of completion of investigation as stipulated in the order had expired and as such all further proceedings were illegal. The Special Court found that the application seeking further remand was justified and extended the police custody of the Accused. Writ Petition were filed by accused persons in the High Court. It was submitted that with the expiry of period within which the investigation had to be completed in terms of order, all further proceedings including the arrest of the Respondents were illegal and without any authority of law. The High Court directed release of accused persons on interim bail, during the pendency of the writ petitions, on their furnishing personal bond. Appellants challenged the correctness of the common interim order passed by Delhi High Court in the Supreme Court.

Held: The Supreme Court held that, It could not be said that the prescription of period within which a report was to be submitted by SFIO under Sub-section (3) of Section 212 was for completion of period of investigation and on the expiry of that period the mandate in favour of SFIO must come to an end. If it was to come to an end, the legislation would have contemplated certain results including re-transfer of investigation back to the original Investigating Agencies which were directed to transfer the entire record under Sub-section (2) of Section 212. In the absence of any clear stipulation, an interpretation that with the expiry of the period, the mandate in favour of SFIO must come to an end, would cause great violence to the scheme of legislation.

If such interpretation was accepted, with the transfer of investigation in terms of Sub-section (2) of Section 212 the original Investigating Agencies would be denuded of power to investigate and with the expiry of mandate SFIO would also be powerless which would lead to an incongruous situation that serious frauds would remain beyond investigation. That could never have been the idea. The only construction which was, possible therefore, was that the prescription of period within which a report had to be submitted to the Central Government under Sub-section (3) of Section 212 was purely directory. Even after the expiry of such stipulated period, the mandate in favour of the SFIO and the assignment of investigation under Sub-section (1) would not come to an end. The only logical end as contemplated was after completion of investigation when a final report or investigation report was submitted in terms of Sub-section (12) of Section 212. It could not therefore be said that in the instant case the mandate came to an end and the arrest effected under the orders passed by Director, SFIO was in any way illegal or unauthorised by law. In any case, extension was granted in the present case by the Central Government. But that was completely besides the point since the original arrest itself was not in any way illegal. The High Court completely erred in proceeding on that premise and in passing the order under appeal.

If the submission of the Respondents (writ Petitioners) that the compliance of Sub-section (3) of Section 212 of the Act in relation to the submission of the report be held mandatory was accepted, the very purpose of enacting Section 212 of the Act would get defeated and would become nugatory. It was held that Sub-section (3) of Section 212 of the Act was directory in nature, it serves the legislative intent for which Chapter XXIX was enacted.

In the case of *Serious Fraud Investigation Office and Others vs. Sahara Housing Investment Corporation Limited and Others with Civil Appeal No 4300 of 2022*

Supreme Court Agrees to Consider SFIO's Plea challenging stay of look out circulars issued by Central Government against Sahara group companies

Facts of the case: On 31 October 2018, the Central Government, in exercise of its jurisdiction under Section 212(1)(a) & (c) of the Companies Act 2013 formed an opinion, on the basis of a report dated 14 August 2018 submitted to it by the Registrar of Companies, Mumbai under Section 208, that an investigation was required to be conducted into the affairs of: Sahara Q Shop Unique Products Range Limited; Sahara Q Gold Mart Limited; and Sahara Housing Investment Corporation Limited.

On January 2019, the Ministry of Corporate Affairs addressed a communication to the Director of the Serious Fraud Investigation Office, seeking an approval for extending the time for the conclusion of the investigation. On 27 October 2020, a communication was addressed by the SFIO to the Ministry of Corporate Affairs seeking permission under Section 219 to investigate the affairs of six other companies also.

Consequently, a challenge has been set up before the Delhi High Court to impugn the legality of the above orders dated 31 October 2018 and 27 October 2020.

Held by High Court: The Division Bench of the High Court, while staying the operation of the above orders and all consequential steps pursuant to them, has recorded three reasons for coming to the conclusion that the investigation was prima facie required to be stayed:

(i) Section 212(3) of the Companies Act, 2013 empowers the Central Government to direct that an investigation be conducted into the affairs of a company within a stipulated period and, in the present case, the period of three months which was stipulated in the order dated 31 October 2018 had expired;

(ii) The order dated 27 October, 2020 which authorizes an investigation into the affairs of six other companies prima facie appears to be contrary to the provisions of Section 219 since the six companies are neither subsidiaries nor holding companies of the three companies which were ordered to be investigated earlier nor have they been managed by the Managing Director of the earlier three companies under investigation; and

(iii) The orders dated 31 October 2018 and 27 October 2020 do not furnish the reasons or circumstances which compelled the Central Government to form an opinion while ordering the investigation.

Appeal to Supreme Court: The SFIO had filed an appeal against the High Court stay order. The counselor submitted that each of the three reasons which have weighed with the High Court in staying the investigation at the interlocutory stage is contrary to the express provisions of the statute. In this context, it was submitted that:

(i) Section 212(3) of the Companies Act 2013 has expressly been held to be directory in nature by a judgment of this Court in *Serious Fraud Investigation Office* vs. *Rahul Modi and Ors.* Criminal Appeal Nos. 538-539 of 2019 (The Supreme Court of India).

(ii) While staying the investigation directed to be carried out in the order dated 27 October 2020, the Division Bench of the High Court has noted that the six companies are neither subsidiaries nor holding companies of the earlier three companies nor were they managed by the same Managing Director. In coming to this conclusion, the High Court has relied on the provisions of clauses (a) and (b) of Section 219 ignoring the provisions of clause (c) which have specifically been invoked in the order dated 27 October 2020; and

(iii) The Union Government while issuing both the orders was acting within its jurisdiction and it would be an improper construction of the statute to postulate that while ordering an investigation, detailed reasons have to be spelt out. On the contrary, it was submitted that the very purpose of an investigation is to enquire into the affairs of the company and the entirety of the material will emerge only in the course of the investigation.

Held by Supreme Court: The Apex Court set aside High Court order staying SFIO probe against Sahara Group Companies. The High Court was not justified in staying the investigation and in passing the consequential directions which have been passed in the orders at the interlocutory stage. Accordingly, the Supreme Court allowed the appeals and set aside the orders of the High Court.

In ***Modi Industries Ltd. v. Union of India*** *[(1982) 52 Comp. Cas. 589]*, the Delhi High Court has observed that in order to order an investigation there may be some circumstances which would lead to the inference that there has been some fraud, misfeasance, breach of trust or misconduct which requires investigation. It is not necessary that the persons concerned should be actually guilty but at least there should seem to be some circumstances which could lead to the inference.

In the matter of ***Rohtas Industries v. S.D. Agarwal and Ors.,*** *[(1969) 139 Comp Cas 781 (SC), CO.A.(SB) 39/2013 Page 13 of 20]* wherein the Hon'ble Supreme Court set aside a impugned order of the High Court and held that in cases of allegations of fraud on the part of the directors of a company, an investigation must be carried out if there is prima facie evidence of any intent to defraud, fraudulent or unlawful activities, or instances of misconduct.

However, in the case ***of Andhra Pradesh State Civil Supply Corpn. Ltd. v. Delta Oils & Fats Ltd.*** *[[1999] 96 Comp. Cas. 303 1 (CLB)]* to show "a mere statement of facts based on the auditor's report without any corroborative evidence will not assist the Company Law Board in framing the requisite opinion for directing investigation into the affairs of the company under Section 235 of the Companies Act, 1956.

In the case of ***Binod Kumar Kasera v. Nandlall & Sons Tea Industries (P.) Ltd.*** *[[2010] 175 (CLB - New Delhi)]*, which held that object of investigation under Section 235(2) is to discover something which is not apparently visible to the naked eye and where a petition discloses merely facts which are apparent from the balance sheet of the company, an investigation will not be ordered

Calcutta High Court in ***Mayank Kocher v. Transport & Handling Equipments MFG. Co. P. Ltd***, *[(2008) 143 Comp Cas 601 (CLB)]*. While discussing Section 235 of the Companies Act, 1956 (Corresponding Section to Section 210 of the Companies Act, 2013 order records that: "Under this Section directing an investigation is only analogous to the issue of a fact-finding commission by a civil court for looking into accounts or making an investigation and does not amount to a judgment, so as to enable an aggrieved party to appeal."

INVESTIGATION INTO THE COMPANY'S AFFAIRS ON APPLICATION MADE BY MEMBERS OR OTHER PERSONS (SECTION 213)

The Tribunal may order after giving a reasonable opportunity of being heard to the parties concerned that affairs of a company ought to be investigated. Where such an order is passed, the Central Government shall appoint one or more competent persons as inspectors to investigate into the affairs of the company and to report thereupon.

The Tribunal may make this order on an application made by –

(a) not less one hundred members or members holding not less than one – tenth of the total voting power, in case of a company having a share capital; or

(b) not less than one – fifth of the persons on the company's register of members, in case company having no share capital and supported by evidence showing good reason for seeking and order for conducting an investigation into affairs of the company.

The Tribunal may also make such order on an application made to it by any other person or otherwise, if it is satisfied that the circumstance suggest that –

(a) the business of the company is being conducted with intent to defraud its creditors, members or any other person or otherwise for a fraudulent or unlawful purpose or in a manner oppressive to any of its members or that the company was formed for any fraudulent or unlawful purpose;

(b) person concerned in the formation of the company or the management of its affairs have been guilty of fraud, misfeasance or other misconduct towards the company or towards its members; or

(c) the members of the company have not been given all reasonable information including information relating to the calculation of commission payable to a managing or other director or the manager of the company.

If after investigation it is proved that –

(a) the business of the company is being conducted with intent to defraud its creditors, members or any other persons or otherwise for a fraudulent or unlawful purpose, or that the company was formed for any fraudulent or unlawful purpose; or

(b) any person concerned in the formation of the company or the management of its affairs have in connection therewith been guilty of fraud,

then, every officer of the company who is in default and the person or persons concerned in the formation of the company or the management of its affairs shall be punishable for fraud under Section 447.

CASE LAWS

In Re Bhadreshwar Vidyut (P.) Ltd vs. Turbo Aviation (P.) Ltd. (2020) 116 NCLT Hyd.

It was held that, without circumstances suggesting that business of company was being conducted in a fraudulent manner with intent to defraud creditors, instigation into affairs of the said company only on basis of irregularities in financial statements, could not have been ordered.

In Re Comfort Intech Ltd vs. Ravi Kumar Distilleries Ltd (2019) 108 NCLT Chennai

In this case it was held that where petitioner being Lead Manager for IPO issue of company and respondent directors of company had allegedly diverted IPO proceeds of company to their associates, there existed circumstances which prima facie suggest that business of company was being conducted with an intent to defraud its members, thus, it was necessary to investigate into affairs of company under provisions of section 213 of the Act.

SECURITY FOR PAYMENT OF COST AND EXPENSES OF INVESTIGATION (SECTION 214)

Where an investigation is ordered by the Central Government in pursuance of :

- clause (b) of sub-section (1) of section 210, or
- an order made by the Tribunal under section 213,

the Central Government may before appointing an inspector under subsection (3) of section 210 or clause (b) of section 213, require the applicant to give such security not exceeding twenty-five thousand rupees as may be prescribed, as it may think fit, for payment of the costs and expenses of the investigation and such security shall be refunded to the applicant if the investigation results in prosecution.

No firm, body corporate or other association shall be appointed as an inspector. (Section 215)

INVESTIGATION OF OWNERSHIP OF COMPANY (SECTION 216)

Appointment of Inspector by Central Government for determining true persons – Section 216(1)

Where it appears to the Central Government that there is a reason so to do, it may appoint one or more inspectors to investigate and report on matters relating to the company, and its membership for the purpose of determining the true persons –

(a) who are or have been financially interested in the success or failure, whether real or apparent, of the company; or

(b) who are or have been able to control or to materially influence the policy of the company; or

(c) who have or had beneficial interest in shares of a company or who are or have been beneficial owners or significant beneficial owner of a company.

Appointment of inspector by Central Government on direction of Tribunal – Section 216(2)

The Central Government shall appoint one or more inspectors under that sub-section, if the Tribunal, in the course of any proceeding before it, directs by an order that the affairs of the company ought to be investigated

as regards the membership of the company and other matters relating financial control or material influence to the company.

Scope of Investigation – Section 216(3)

The Central Government may define the scope of the investigation and may limit the investigation to particular shares or debentures.

Power of Inspector – Section 216(4)

The powers of inspector shall extend to the investigation of any circumstances suggesting the existence of any arrangement or understanding which, though not legally binding, is or was observed or is likely to be observed in practice and which is relevant for the purposes of his investigation.

PROCEDURE, POWERS, ETC., OF INSPECTORS-SECTION 217

Duty of officer, employee and agent including former officer employee & agent – Section 217(1)

(1) It shall be the duty of all officers and other employees and agents including the former officers, employees and agents of a company which is under investigation in accordance with the provisions contained in this Chapter, and where the affairs of any other body corporate or a person are investigated under section 219, of all officers and other employees and agents including former officers, employees and agents of such body corporate or a person –

(a) to preserve and to produce to an inspector or any person authorised by him in this behalf all books and papers of, or relating to, the company or, as the case may be, relating to the other body corporate or the person, which are in their custody or power; and

(b) otherwise to give to the inspector all assistance in connection with the investigation which they are reasonably able to give.

Inspector may ask any other body corporate to give information – Section 217(2)

(2) The inspector may require any body corporate, other than a body corporate referred to in sub-section (1), to furnish such information to, or produce such books and papers before him or any person authorised by him in this behalf as he may consider necessary, if the furnishing of such information or the production of such books and papers is relevant or necessary for the purposes of his investigation.

Time limit to keep books in custody of inspectors – Section 217(3)

(3) The inspector shall not keep in his custody any books and papers produced under sub-section (1) or sub-section (2) for more than one hundred and eighty days and return the same to the company, body corporate, firm or individual by whom or on whose behalf the books and papers were produced:

Provided that the books and papers may be called for by the inspector if they are needed again for a further period of one hundred and eighty days by an order in writing.

Examining on Oath – Section 217(4)

(4) An inspector may examine on oath –

(a) any of the persons referred to in sub-section (1); and

(b) with the prior approval of the Central Government, any other person,

in relation to the affairs of the company, or other body corporate or person, as the case may be, and for that purpose may require any of those persons to appear before him personally:

Provided that in case of an investigation under section 212, the prior approval of Director, Serious Fraud Investigation Office shall be sufficient under clause (b).

Powers of CPC – Section 217(5)

(5) Notwithstanding anything contained in any other law for the time being in force or in any contract to the contrary, the inspector, being an officer of the Central Government, making an investigation under this Chapter shall have all the powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit in respect of the following matters, namely: –

(a) the discovery and production of books of account and other documents, at such place and time as may be specified by such person;

(b) summoning and enforcing the attendance of persons and examining them on oath; and

(c) inspection of any books, registers and other documents of the company at any place.

Penalty for disobeying direction – Section 217(6)

(6) (i) If any director or officer of the company disobeys the direction issued by the Registrar or the inspector under this section, the director or the officer shall be punishable with imprisonment which may extend to one year and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

(ii) If a director or an officer of the company has been convicted of an offence under this section, the director or the officer shall, on and from the date on which he is so convicted, be deemed to have vacated his office as such and on such vacation of office, shall be disqualified from holding an office in any company.

Notes of examination to be signed by person so examined – Section 217(7)

(7) The notes of any examination under sub-section (4) shall be taken down in writing and shall be read over to, or by, and signed by, the person examined, and may thereafter be used in evidence against him.

Punishment for default – Section 217(8)

(8) If any person fails without reasonable cause or refuses –

(a) to produce to an inspector or any person authorised by him in this behalf any book or paper which is his duty under sub-section (1) or sub-section (2) to produce;

(b) to furnish any information which is his duty under sub-section (2) to furnish;

(c) to appear before the inspector personally when required to do so under subsection (4) or to answer any question which is put to him by the inspector in pursuance of that sub-section; or

(d) to sign the notes of any examination referred to in sub-section (7).

he shall be punishable with imprisonment for a term which may extend to six months and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees, and also with a further fine which may extend to two thousand rupees for every day after the first during which the failure or refusal continues.

C.G., S.G., Police and Statutory Authority to provide assistance – Section 217(9)

(9) The officers of the Central Government, State Government, police or statutory authority shall provide assistance to the inspector for the purpose of inspection, inquiry or investigation, which the inspector may, with the prior approval of the Central Government, require.

Cross-border agreements regarding inspection, inquiry and investigation– Section 217(10)

(10) The Central Government may enter into an agreement with the Government of a foreign State for reciprocal arrangements to assist in any inspection, inquiry or investigation under this Act or under the corresponding law in force in that State and may, by notification, render the application of this Chapter in relation to a foreign State with which reciprocal arrangements have been made subject to such modifications, exceptions, conditions and qualifications as may be deemed expedient for implementing the agreement with that State.

Procedure in case of evidence is available outside India – Sections 217(11) & 217(12)

(11) Notwithstanding anything contained in this Act or in the Code of Criminal Procedure, 1973 if, in the course of an investigation into the affairs of the company, an application is made to the competent court in India by the inspector stating that evidence is, or may be, available in a country or place outside India, such court may issue a letter of request to a court or an authority in such country or place, competent to deal with such request, to examine orally, or otherwise, any person, supposed to be acquainted with the facts and circumstances of the case, to record his statement made in the course of such examination and also to require such person or any other person to produce any document or thing, which may be in his possession pertaining to the case, and to forward all the evidence so taken or collected or the authenticated copies thereof or the things so collected to the court in India which had issued such letter of request:

Provided that the letter of request shall be transmitted in such manner as the Central Government may specify in this behalf:

Provided further that every statement recorded or document or thing received under this sub-section shall be deemed to be the evidence collected during the course of investigation.

(12) Upon receipt of a letter of request from a court or an authority in a country or place outside India, competent to issue such letter in that country or place for the examination of any person or production of any document or thing in relation to affairs of a company under investigation in that country or place, the Central Government may, if it thinks fit, forward such letter of request to the court concerned, which shall thereupon summon the person before it and record his statement or cause any document or thing to be produced, or send the letter to any inspector for investigation, who shall thereupon investigate into the affairs of company in the same manner as the affairs of a company are investigated under this Act and the inspector shall submit the report to such court within thirty days or such extended time as the court may allow for further action:

Provided that the evidence taken or collected under this sub-section or authenticated copies thereof or the things so collected shall be forwarded by the court, to the Central Government for transmission, in such manner as the Central Government may deem fit, to the court or the authority in country or place outside India which had issued the letter of request.

PROTECTION OF EMPLOYEES DURING INVESTIGATION (SECTION 218)

No Action against employees without Tribunal's approval – Section 218(1)

Section 218 provides protection to employees during investigation. During the course of any investigation and during pendency of any proceeding against any person concerned in the conduct and management of the affairs of a company, such company, other body corporate or person shall not discharge or suspend or punish any employee without approval of the Tribunal. This protection is available to employees during the investigation of the affairs or other matters of or relating to a company, other body corporate or person or of the membership, ownership of shares or debentures.

Following action are not permitted without approval of the Tribunal -

(a) To discharge or suspend any employee;

(b) To punish any employee, whether by dismissal, removal, reduction in rank or otherwise; or

(c) To change the terms of employment to his disadvantage.

Action against Employees – Section 218(2)

If the applicant does not receive within thirty days of making of application the approval of the Tribunal, only then applicant concerned may proceed to take against the employee the action proposed.

Appeal against Tribunal to Appellate Tribunal – Section 218(3) and (4)

If the applicant is dissatisfied with the objection raised by the tribunal it may within a period of thirty days of the receipt of the notice of the objection, prefer an appeal to the Appellate Tribunal. The decision of the Appellate Tribunal on such appeal shall be final and binding on the Parties concerned.

Over-riding effect Section 218(5)

For the removal of doubts, it is hereby declared that the provisions of this section shall have without prejudice to the provisions of any other law for the time being in force.

POWER OF INSPECTOR TO CONDUCT INVESTIGATION INTO AFFAIRS OF RELATED COMPANIES - SECTION 219

If an inspector appointed under section 210 or section 212 or section 213 to investigate into the affairs of a company considers it necessary for the purposes of the investigation, to investigate also the affairs of—

(a) any other body corporate which is, or has at any relevant time been the company's subsidiary company or holding company, or a subsidiary company of its holding company;

(b) any other body corporate which is, or has at any relevant time been managed by any person as managing director or as manager, who is, or was, at the relevant time, the managing director or the manager of the company;

(c) any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors; or

(d) any person who is or has at any relevant time been the company's managing director or manager or employee,

he shall, subject to the prior approval of the Central Government, investigate into and report on the affairs of the other body corporate or of the managing director or manager, in so far as he considers that the results of his investigation are relevant to the investigation of the affairs of the company for which he is appointed.

SEIZURE OF DOCUMENTS BY INSPECTOR (SECTION 220)

Seizure of Books and Papers – Section 220(1)

In the course of an investigation, the inspector has reasonable grounds to believe that the books and papers of or relating to any company or other body corporate or managing director or manager of the company are likely to be destroyed, mutilated, altered, falsified or secreted. In such case, the inspector may –

(a) Enter with such assistance as may be required, the place or places such books and papers are kept ; and

(b) Seize books and papers as he considers necessary after allowing the company to take companies of or extract from such books and papers at list cost for the purpose of his investigation.

Time period for keeping Books and Papers in custody of Inspector

The inspector shall keep in his custody the books and papers seized up to the conclusion of the investigation as he considers necessary and thereafter shall return the same to the person from whose custody or power they were seized.

Extract of Books and Papers

The inspector may before returning such books and papers, take copies of, or extracts from them or place identification marks on them or any part thereof or deal with the dame in the manner as he consider necessary.

Same Powers as Cr.PC – Section 220(3)

The provisions of the Code of Criminal Procedure, 1973 relating to searches or seizure shall apply *mutatis mutandis* to every search or seizure under this Section.

FREEZING OF ASSETS OF COMPANY ON INQUIRY AND INVESTIGATION (SECTION 221)

Estopple on transfer, removal are disposal of Funds, Assets, Property of Company – Section 221(1)

Where it appears to the Tribunal –

- on a reference made to it by the Central Government; or
- in connection with any inquiry or investigation into affairs of a company; or
- on any complaint made by members under Section 244(1); or
- a creditor having one lakh amount outstanding against the company; or
- any other person having a reasonable ground to believe;

Transfers done in Contravention of Section 221(1) – Section 221(2)

In case of contravention of this order, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees, or with both.

IMPOSITION OF RESTRICTIONS UPON SECURITIES (SECTION 222)

Restrictive Issue / Transfer – Section 221(1)

The Tribunal may, by order, direct that the securities shall be subject to such restrictions as it may deem fit for such period not exceeding three years as may be specified in the order.

The Tribunal may pass such order where it appears to the Tribunal, in connection with any investigation or on a complaint made by any person in this behalf, that there is good reason to find out the relevant facts about any securities issued or to be issued by a company and the Tribunal is of the opinion that such facts cannot be found out unless certain restrictions, as it may deem fit, are imposed.

Issue/ Transfer done in Contravention of Section 222(1) – Section 222(2)

Where securities in any company are issued or transferred or acted upon in contravention of an order of the Tribunal under sub-section (1), the company shall be punishable with fine which shall not be less than one lakh

rupees but which may extend to twenty-five lakh rupees and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both.

INSPECTOR'S REPORT (SECTION 223)

The report under Section 223 is different from the report made by SFIO under Section 212.

Submission of Interim/Report – Section 223(1)

An inspector, if so directed by the Central Government, shall submit all interim reports to that Government, and on the conclusion of the investigation, final report to the Central Government.

Report to be in Writing – Section 223(2)

Every report shall be in writing or printed as per direction of the Central Government.

Copy to Members on an application and Authentication of Report – Section 223(3) and 223(4)

A copy of the report may be obtained by members, creditors or any other person whose interest is likely to be affected by making an application to the Central Government. The report of an inspector shall be authenticated either –

(a) by the seal, if any of the company investigated; or

(b) by a certificate of a public officer having the custody of the report.

After authentication such report shall be admissible in any legal proceeding as evidence.

EXPENSES OF INVESTIGATION (SECTION 225)

The expenses of, and incidental to an investigation by an inspector other than expenses of inspection under Section 214 shall be defrayed (borne) in the first instance by the Central government. Such expenses incurred by Central Government but shall be reimbursed by the following person to the extent mentioned below, namely –

(a) any person convicted on a prosecution instituted or who is ordered to pay damages or restore any property in proceedings to the extent that he may in the same proceedings be ordered to pay the said expenses as may be specified by the court convicting such person or ordering him to pay such damages or restore such property;

(b) any company or body corporate in whose name proceedings are brought to the extent of the amount or value of any sums or property recovered by it as a result of such proceedings;

(c) unless a prosecution is instituted under Section 224 –

(i) any company, body corporate, managing director or manager dealt with by the report of the inspector; and

(ii) the applicants for the investigation, where the inspector was appointed under section 213, to such extent as the Central Government may direct.

Any amount for which a company or body corporate is liable under clause (b) shall be a first charge in the sums or property mentioned.

VOLUNTARY WINDING UP OF COMPANY, ETC., NOT TO STOP INVESTIGATION PROCEEDINGS – SECTION 226

As per section 226 of the Act, an investigation under Chapter XIV may be initiated notwithstanding, and no such investigation shall be stopped or suspended by reason only of, the fact that–

(a) an application has been made under section 241;

(b) the company has passed a special resolution for voluntary winding up; or

(c) any other proceeding for the winding up of the company is pending before the Tribunal:

It is provided that where a winding up order is passed by the Tribunal in a proceeding referred to in clause (c), the inspector shall inform the Tribunal about the pendency of the investigation proceedings before him and the Tribunal shall pass such order as it may deem fit:

Provided further that nothing in the winding up order shall absolve any director or other employee of the company from participating in the proceedings before the inspector or any liability as a result of the finding by the inspector.

LEGAL ADVISERS AND BANKERS NOT TO DISCLOSE CERTAIN INFORMATION – SECTION 227

Nothing in Chapter XIV shall require the disclosure to the Tribunal or to the Central Government or to the Registrar or to an inspector appointed by the Central Government–

(a) by a legal adviser, of any privileged communication made to him in that capacity, except as respects the name and address of his client; or

(b) by the bankers of any company, body corporate, or other person, of any information as to the affairs of any of their customers, other than such company, body corporate, or person.

INFORMATION, INSPECTION, INQUIRIES AND INVESTIGATION OF FOREIGN COMPANY – SECTION 228

The provisions of this Chapter XIV shall apply mutatis mutandis to inspection, inquiry or investigation in relation to foreign companies.

PREPARATION BY A COMPANY SECRETARY TO FACE INVESTIGATION

Before an inspector commences investigation into the affairs of a company, it is advisable for the Secretary to prepare a report touching upon various aspects of the activities of his company particularly those transactions in respect of which fraud or misfeasance or mismanagement is alleged. This exercise will enable the secretary to handle the investigation into the affairs of his company with courage and confidence.

The aspects which should be considered by the company secretary include:

1. Basic information about the company – Name of the company; date of incorporation; location of the registered office, branches, factories and other offices; status of the company – public or private; objects of the company – capital structure; voting rights attached to the shares; shareholding pattern of the company.
2. Business activities – Nature of existing business, licensed and installed capacities, expansion programme and sources of finance, whether the company belongs to a particular group; if so the names of other companies falling within the same group.
3. Debentures, bank finance and deposits.

4. Whether the Annual filing of the Company is up-to-date.
5. Whether the event based filing is completely done?
6. Foreign collaboration agreements.
7. Management—Brief history of past management set up; existing management set up; composition of Board of Directors; whether the terms and conditions of the appointment of managerial personnel are being adhered to; details regarding appointment of directors and their relatives to an office or place of profit.
8. Whether all the statutory registers including minute's books are being maintained up-to-date?
9. Whether the internal checks and internal control system is being properly followed?
10. Working results and financial position – General assessment of working of the company, evaluation of the level of performance and efficiency of the management, a review of the profits of the company, performance data, financial position of the company in the context of its working results for the last three years.
11. Compliance by the company and its officers with the provisions of the Companies Act, 1956/2013.
12. Compliance with the provisions of other Acts applicable to the company.
13. Whether the loans taken and loans advanced to Directors, the firms in which they are partners or companies in which they are Directors are in accordance with the provisions of the Act.
14. The investments made by the company.
15. Sole selling agency agreement.
16. Instance of mismanagement and other irregularities.
17. Acquisition/disposal of substantial assets.
18. A scrutiny of abnormal/heavy expenditure items.
19. Complaints, if any, against the company and its management and steps taken to redress them.
20. Brief particulars of the litigations against the company and the reasons thereof.
21. Management's relations with the employees and labour.
22. Shareholders – Instance of oppression of minority shareholders, allegations of non-receipt of dividend, notices of meetings, accounts, share certificates, etc.; illegal forfeiture of shares, etc. and steps taken to redress Investors, complaints.
23. Auditors – Name and address of Statutory auditors, Secretarial Auditor and Cost Auditor, compliance as per the provisions of Companies Act, 2013.

LESSON ROUND-UP

- Inquiry is a process questioning and interrogation by way of researching and probing in order to find a solution to the problem. This is the process to bring clarity or clear any doubt on any subject matter. This is basically searching for and acquiring knowledge and information about something.
- The word 'inspection' is not defined under the Act. The word 'inspection' is derived from the Latin word "inspectus" means to look into, inspect.

- An investigation refers to an exploration into the affairs of a company. The main aim of such investigations is to obtain any evidence or facts regarding any malpractice in the course of business.
- Investigations may also be undertaken to identify the profits and losses of a business, the assets and liabilities and so on.
- Under the Companies Act, 2013, inspection may be ordered by registrar under sub- section (3) of section 206, by Regional Director under power delegated to it by Central Government under sub – section (5) of Section 206, and by Central Government by a general or special order.
- The Companies Act, 2013 provides for carrying out the following kinds of investigation:
  1. Investigation of the affairs of the company if it is necessary to investigate into the affairs of the company in public interest (Section 210);
  2. Investigation of the affairs of related companies (Section 219);
  3. Investigation about the ownership of a Company (Section 216);
  4. Investigation of foreign companies (Section 228);
  5. Investigation by Serious Fraud Investigation Office directed by Central government under (section 212);
  6. Investigation on the order of Tribunal (Section 213).

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What are the objective for conducting inspection and under what circumstances the inspection can be ordered by the Registrar of Companies?
2. Describe the provisions relating to Search and Seizure under the Companies Act, 2013.
3. Under what circumstances the tribunal makes order for the investigation in to the affairs of the company.
4. What are the preparatory steps for the company secretary to face investigation?
5. Ramesh, is a Senior Partner in Ramesh Chandra & Co. LLP, Practising Company Secretaries. The firm has good repute in handling corporate related matters including investigations and other representations. Rakesh, Company Secretary of Skylimit Ltd. is a professional acquaintance of Ramesh and has reached out to him for advice on investigation initiated on the Company. Rakesh has requested Ramesh to meet the Board of Directors of Skylimit Ltd. and make a presentation on various statutory aspects involved in investigation. Prepare a detailed note, explaining the provisions of investigation into affairs of a Company under Section 212 of the Companies Act, 2013.
6. P is an employee of ABC Limited and he is being investigated under the provisions of Companies Act, 2013. The Company wants to terminate P on the ground that an investigation is going on against him. They have filed the application to Tribunal for approval of termination. Company has not received any reply from the Tribunal within 30 days of filling the application. The Company considers it as a deemed approval and terminates him. Is the contention of Company valid in law?

   (a) Yes, the termination of P made by the company is totally valid in law

(b) Yes, the termination of P made by the company is totally valid in law, but intimation to SEBI is also required

(c) No, the termination of P made by the company is not valid in law

(d) None of the above.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premiere on Company Law
- Bare Act- The Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks.html

General Meetings

Lesson 13

KEY CONCEPTS

■ General Meetings ■ Adjourned Meeting ■ Notice ■ Quorum ■ Agenda ■ Chairman ■ Class Meeting ■ Poll ■ Postal Ballot ■ E-voting ■ Minutes ■ Virtual Meetings ■ Secretarial Standard-2

Learning Objectives

To understand:

- Procedure to conduct Annual General Meeting/ Extra-ordinary General Meeting
- Types of Resolutions
- Procedure of voting through show of hands/ postal ballot/ e-voting
- Maintenance of Minutes
- Report on AGM
- Virtual meetings

Lesson Outline

- Introduction
- Annual General Meetings
- Extra-ordinary General Meetings
- Other General Meetings
- Types of resolutions
- Notice, Quorum, Poll, Chairman, Proxy
- Meeting and Agenda
- Process of conducting meetings
- Voting and its types- vote on show of hands, Poll, E-voting, Postal Ballot
- Circulation of Members' Resolution
- Secretarial Standards – 2
- Duties of Company Secretaries before, during and after General Meetings
- Virtual Meetings: Technological Advancement in conduct of General Meetings
- Drafting of Notice and Minutes of Annual General Meeting and Extra-Ordinary General Meeting
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section-96 to 118 and 121)
- The Companies (Management and Administration) Rules, 2014
- SS-2- Secretarial Standard on General Meetings
- The SEBI (LODR) Regulations, 2015

INTRODUCTION

A meeting may be generally defined as a gathering or assembly or getting together of a number of persons for transacting any lawful business. There must be at least two persons to constitute a meeting. Therefore, one shareholder usually cannot constitute a company meeting even if he holds proxies for other shareholders. However, in certain exceptional circumstances, even one person may constitute a meeting.

A company is composed of members, though it has its own entity distinct from members. The members of a company are the persons who, for the time being, constitute the company, as a corporate entity. However, a company, being an artificial person, cannot act on its own. It, therefore, expresses its will or takes its decisions through resolutions passed at validly held meetings. The primary purpose of a meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the meeting to take decisions as per the prescribed procedures.

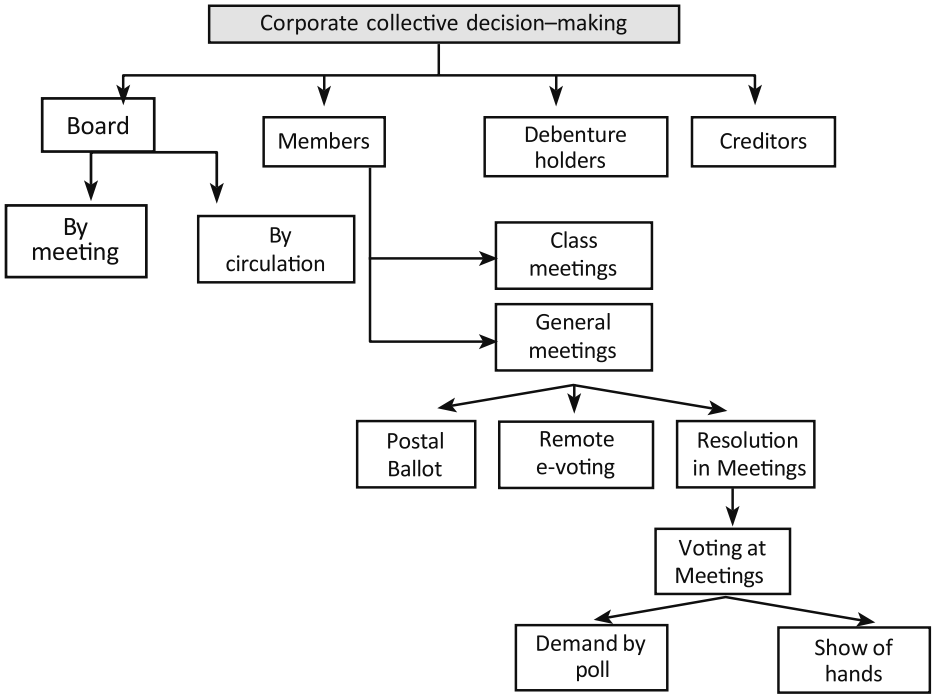
The decision making powers of a company are vested in the members and the directors. They exercise their respective powers through resolutions passed by them. General meetings of the members provide a platform to express their will in regard to the management of the affairs of the company.

The Act mandates holding of Meetings at specified intervals and also prescribes related rules for the same. Such mandate is in recognition of the fact that Meetings play a vital role in the functioning and governance of a company. The primary purpose of a Meeting is to ensure that a company gives reasonable and fair opportunity to those entitled to participate in the Meeting to take decisions as per the prescribed procedures. A company, being an artificial person, can, in respect of matters to be decided at General Meeting, take such decisions through its Members by way of Resolutions passed at validly held Meetings. Meetings of Members are known as General Meetings and determining what constitutes such validly held Meeting is of utmost importance.

Secretarial Standard on General Meetings of companies:

Secretarial Standard on General Meeting (SS-2) issued by the Institute of Company Secretaries of India (ICSI) and approved by central government is to be mandatorily adhered by all companies as per the provision of Section 118(10) of Companies Act, 2013. The objective of secretarial standard is to promote good corporate governance. This Standard is applicable to all types of General Meetings of all companies incorporated under the Act except One Person Company (OPC) and class or classes of companies which are exempted by the Central Government through notification. The revised version of Secretarial Standard is effective from 1st April 2024.

Corporate Meetings and Collective Decision making

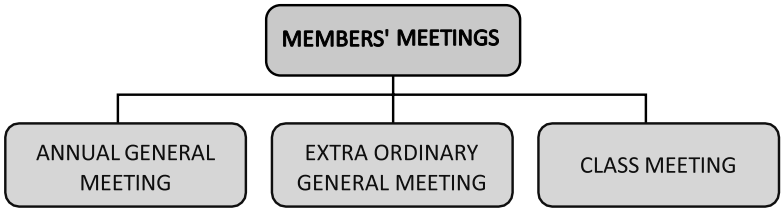


Members' Meetings

A company is required to hold meetings of the members to take approval of certain business items, as prescribed in the Act.

Convening of one such meeting every year is compulsory. Holding of more general meetings is left to the choice of the management or to a given percentage of shareholders to exercise their power to compel the company to convene a meeting. Shareholder democracy, class action suits and protection of interest of investors are the essence and attributes of the Companies Act, 2013.

The meeting to be held annually for seeking approval to certain 'ordinary business' is called Annual General Meeting. A meeting to be held to transact any business other than ordinary business is called extraordinary general meeting. In certain cases, a company may have to hold a meeting of the members of a particular class of members.



1. ANNUAL GENERAL MEETING (SECTION 96)

Annual general meeting (AGM) is an important annual event where members get an opportunity to discuss the activities of the company. Section 96 provides that every company, other than a one person company is required to hold an annual general meeting every year. The importance of the Annual General Meeting arises out of the nature of business transacted at this Meeting. Broadly there are two types of business that are transacted at an Annual General Meeting – Ordinary Business and Special Business. At an Annual General

Meeting, consideration of financial statements & consolidated financial statements, reports of the Board of Directors and the auditors, declaration of dividend, appointment of Directors in place of those retiring and approval of appointment of the Auditors and fixing their remuneration are Ordinary Business. Any other item of business is referred to as Special Business and may also be transacted at an Annual General Meeting.

SS-2 provides that the Board shall, every year, convene or authorize convening of a meeting of its members called the Annual General Meeting to transact items of ordinary business specifically required to be transacted at an annual general meeting as well as special business, if any. If the Board fails to convene its Annual General Meeting in any year, any Member of the company may approach the prescribed authority, which may then direct the calling of the Annual General Meeting of the company. Following are the key provisions regarding the holding of an Annual General Meeting:

Holding of Annual General Meeting

1. Annual general meeting should be held once in each calendar year.
2. First annual general meeting of the company should be held within 9 months from the closing of the first financial year. Hence it shall not be necessary for the company to hold any annual general meeting in the year of its incorporation.
3. Subsequent annual general meeting of the company should be held within 6 months from the date of closing of the relevant financial year.
4. The gap between two annual general meetings shall not exceed 15 months.

Additional Compliance for listed Companies :-

Additionally, for listed entities, Regulation 44(5) and (6) of SEBI (LODR) Regulations, 2015 provides that for the top 100 listed entities by market capitalization, (omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f. 31.12.2024), shall hold their annual general meetings within a period of five months from the date of closing of the financial year.

The top 100 listed entities shall provide one-way live webcast of the proceedings of the annual general meetings.

(Omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f. 31.12.2024 .)

Exemption to OPC: As provided in sub-section (1) of section 96, one person company is not required to hold Annual General meeting.

Illustrations:

1. M/s XYZ Limited company was incorporated on 10th December 2018, "financial year" of that company would end on 31st March 2019, in view of sub-section (41) of Section 2 of the Act and therefore the last date for holding the first Annual General Meeting would be 31st December 2019 (9 months from 31st March 2019).
2. If a company was incorporated on 10th April 2018, its first financial year would end on 31st March 2019, only and therefore, the last date for holding the first Annual General Meeting will be 31st December 2019. In this manner, almost 21 months elapse between the date of incorporation and date of first Annual General Meeting. In this case, the company need not hold any Annual General Meeting in the year of its incorporation i.e. 2018.
3. ABC & Co. is incorporated in August 2021. Its first AGM must be held till 31st December, 2022 and it is not compulsory to hold AGM in 2021. The second will be held till 30th September, 2023.
4. M/s STK & Ltd. was incorporated in August 2020. Its AGM for the year 2021-22 will be held till 30th September, 2022.

Extension of validity period of AGM

In case, it is not possible for a company to hold an annual general meeting within the prescribed time, the Registrar may, for any special reason, extend the time within which any annual general meeting shall be held. Such extension can be for a period not exceeding 3 months. No such extension of time can be granted by the Registrar for the holding of the first annual general meeting.

Test your knowledge:

Question: The gap between two annual general meetings shall not exceed 15 months. Comment.

Answer: According to section 96(1) of the Companies Act, 2013, gap of not more than 15 months shall elapse between the date of one annual general meeting of the company and that of the next year. According to third proviso to section 96(1), the Registrar may, for any special reason, extend the time within which any annual general meeting, other than the first annual general meeting, shall be held, by a period of not exceeding three months.

The company may apply to the Registrar for extension for holding AGM, justifying it as a special reason. The registrar may, after considering it as a special reason, extend the time within which an AGM shall be held which shall be a period not exceeding three months.

Day, Time and Place for holding an Annual General Meeting

An annual general meeting can be called during business hours, that is, between 9 a.m. and 6 p.m. on any day that is not a National Holiday. It should be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated. The Central Government is empowered to exempt any company from these provisions, subject to such conditions as it may impose.

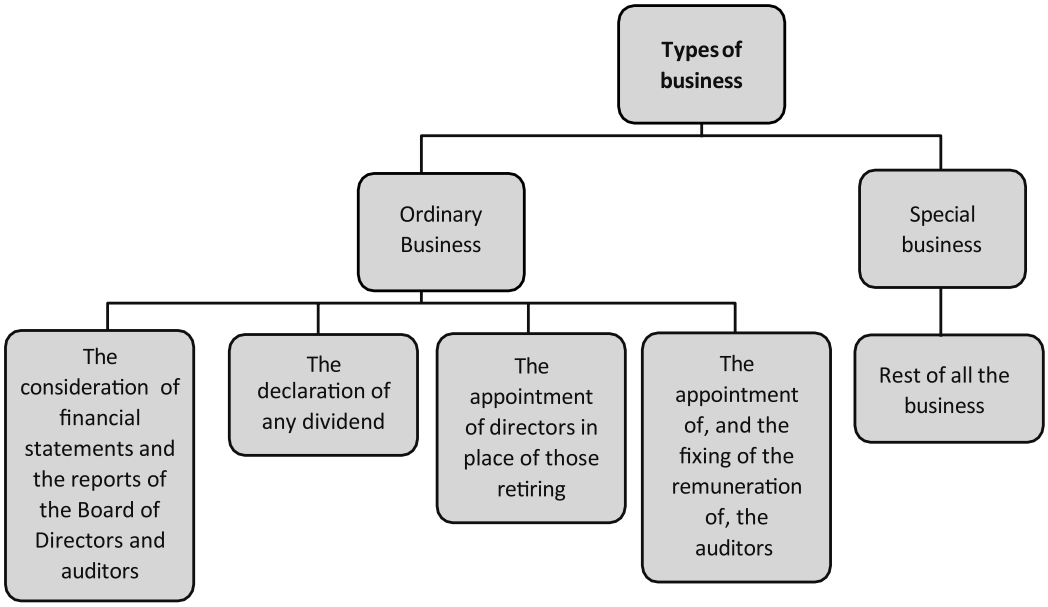
"National Holiday" for this purpose means and includes a day declared as National Holiday by the Central Government. According to SS–2, National Holiday means Republic Day i.e. 26th January, Independence Day i.e. 15th August, Gandhi Jayanti i.e. 2nd October and such other day as may be declared as National Holiday by the Central Government.

Annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance.

- In case of a Government company, the Annual General Meeting (AGM) shall be held at its registered office or some other place within the city, town or village in which the registered office of the company is situated or at any other place with the approval of the Central Government.

  Accordingly, there is no need of Central Government approval, if a Government Company is holding its AGM within the city, town or village in which registered office of the company is situated.
- In case of Section 8 Company, the time, date and place of each AGM are decided upon before-hand by the Board having regard to the directions, if any, given in this regard by such company in the general meeting.
- Further, MCA vide its Notification(s) dated 13th June, 2017 issued in respect of Government Companies, Private Companies, and Section 8 Companies placed a restriction that such exemptions shall be applicable to those companies which have not committed a default in filing its Financial Statements or Annual Return with the Registrar of Companies.

Business to be transacted at Annual General Meeting: [Section 102(2)(a)]



Section 102(2)(a) provides that all other businesses transacted at an Annual General Meeting except the following are special business:

(i) the consideration of financial statements and the reports of the Board of Directors and auditors;

(ii) the declaration of any dividend;

(iii) the appointment of directors in place of those retiring;

(iv) the appointment of, and the fixing of the remuneration of, the auditors.

Accordingly, above mentioned four businesses are ordinary business rest shall be deemed to be special business. Explanatory statement is not required for transacting any item of ordinary business. All business except specified above shall be deemed as special business at an AGM.

In case of meeting other than AGM, all business shall be deemed to be special. Explanatory statement must be annexed to the Notice for transacting every items of special business. In case of non-disclosure or insufficient disclosure in Explanatory Statement being made by a promoter, director, manager or other key managerial personnel, any benefit accrues to such promoter, director, manager or other key managerial personnel or their relatives, such person shall hold such benefit in trust for the company, and shall compensate the company to the extent of benefit derived by him.

Without prejudice to the above mentioned provisions, if any default is made in complying with the provisions of this section, every promoter, director, manager or other key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is higher.

CASE LAWS

1. Where directors of company had failed to hold Annual General Meeting (AGM) of company for several years i.e. from 2015-2016 to 2018-2019, and thus, failed to comply provisions of section 96, penalty was to be imposed on said directors for alleged non-compliance. [*Sulochana Gupta v. RBG Enterprises (P.) Ltd. held by National Company Law Tribunal, Kochi Bench (2021*)]

2. Where there was non-compliance of certain provisions of the Companies Act, 2013 in conducting Annual General Meeting of the company, same amounted to an act of oppression or mismanagement. [*Held by National Company Law Tribunal, Chandigarh Bench in the case of Ramprasad Dalmia v. Board of Directors (2017)*]

3. Where company stated that due to server crash at registered office in India which was linked to main server in US, Applicant Company's account could not be finalized and therefore, the company's Annual General Meeting could not be held on time and ROC stated that this violation could be compounded by levying compounding fee. The Tribunal directs the company and the directors to pay the compounding fees. [*Held by National Company Law Tribunal, Bangaluru Bench (2016)*]

Penalty for default in holding the Annual General Meeting [Section 99]

Section 99 provides that if any default is made in complying or holding a meeting of the company, the company and every officer of the company who is in default shall be punishable with fine which may extend to one lakh rupees and in case of continuing default, with a further fine which may extend to five thousand rupees for each day during which such default continues.

Section 97 provides that if any default is made in holding the annual general meeting of a company, any member of the company may make an application to the Tribunal to call or direct the calling of, an annual general meeting of the company and give such ancillary or consequential directions as the Tribunal thinks expedient. Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

Every listed entity, under Regulation 30 of SEBI (LODR) Regulation, 2015, is required to disclose the proceedings of annual & extraordinary general meeting to the Stock Exchange where its securities are listed within 12 hours of the occurrence of such event.

CASE LAW

It is well settled that the annual general meeting must be called, whether or not the annual accounts are ready for consideration at the meeting. "There is a clear statutory duty on the directors to call the meeting whether or not the accounts the consideration of which is only one of the matters to be dealt with at an Annual General Meeting are ready or not." [*Re. El Sombrero Ltd. (1958) 3 All ER 1 at 6 (1958) 28 Com Cases 619 (Ch D)*].

CONVENING OF A VALID GENERAL MEETING

The business at a meeting is said to have been "validly transacted" if the members of the organisation or body concerned, whether or not they were present, are bound by the decision made thereat. They cannot be so bound unless the meeting is validly held. The essentials of a valid meeting are that the meeting should be:

(a) Properly convened:

(i) The meeting must be called by proper authority; and

(ii) Proper notice must be served in the manner specified under Section 101 and 102 of the Act.

CASE LAW

Service of notice of AGM by hand, under certificate of posting and by publication in newspaper is considered as deemed service of notice [*Held in Ganesh Commercial Co. Ltd. v. Arun Kumar Mohata (2013) by High Court of Calcutta*]

(b) Properly constituted:

(i) Proper quorum must be present in the general meeting (Section 103 of the Act);

(ii) Proper chairman must preside the meeting (Section 104 of the Act);

(c) Properly conducted:

(i) The business must be validly transacted at the meeting i.e. resolutions must be properly moved and passed, and voting by show of hands and on poll and/or by electronic means before and/or during the meeting;

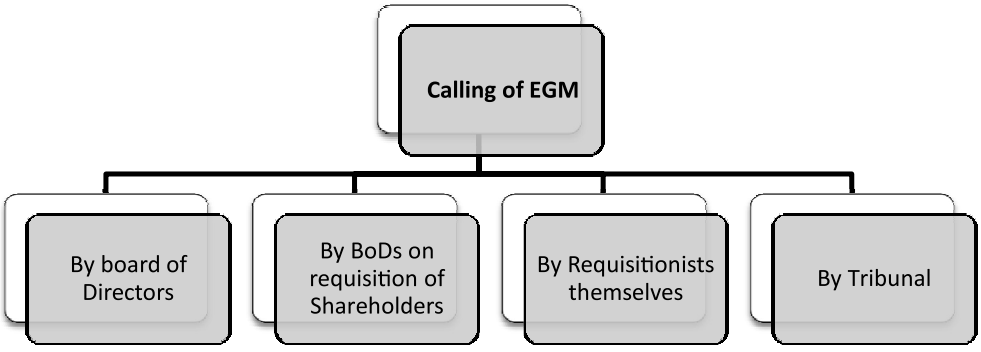
(ii) Proper minutes of the meeting must be prepared (Section 118 of the Act).

CASE LAW

Typographical/inadvertent error in recording of the minutes of the meeting, which is rectified subsequently cannot be termed as an offence, under provisions of Companies Act. [*Held in Usha Martin Telematics Ltd. v. Registrar of Companies (2021) by High Court of Calcutta*]

2. EXTRA-ORDINARY GENERAL MEETING (SECTION 100)

There are so many matters relating to the business of a company, which require approval or consent of members in general meeting. It is not always possible for consideration of such matters to wait until the next annual general meeting. The articles of association of the company make provisions for convening general meeting other than the annual general meeting. All general meetings other than annual general meeting are called extra-ordinary general meetings (EGM). According to SS-2, all items of business other than ordinary business, may be considered at an EGM or by means of a postal ballot, if thought fit by the Board. This means that all the transactions dealt upon in an EGM shall be special business.



Following are the key provisions, regarding calling and holding of an extraordinary general meeting:

(1) By the Board Suo motu [Section 100 (1)]

The Board may, whenever it deems fit, call an EGM of the company. An extraordinary general meeting of the company shall be held at any place in India. An extraordinary general meeting of a company which is wholly owned subsidiary of a company incorporate outside India, may be held outside India.

(2) By the Board on requisition of members [Section 100 (2)]

The Board shall call an extraordinary general meeting on receipt of the requisition from the following number of members:

(a) in the case of a **company having a share capital:** members who hold, on the date of the receipt of the requisition, not less than one-tenth of such of the paid-up share capital of the company as on that date carries the right of voting;

(b) in the case of a **company not having a share capital:** members who have, on the date of receipt of the requisition, not less than one-tenth of the total voting power of all the members having on the said date a right to vote.

Matters set out for consideration in requisition: The requisition made as above, shall set out the matters for the consideration of which the meeting is to be called and shall be signed by the requisitionists and sent to the registered office of the company.

Time period for calling the meeting: The Board is required to proceed to call a meeting within 21 days from the date of receipt of a valid requisition, to convene a meeting which should be held within 45 days of such deposit of the requisition with the company.

CASE LAW
No Court or Tribunal can restrain holding of an EGM as long as requisition of shareholders in that behalf is compliant with procedural and numerical requirements of section 100. [*Held in Invesco Developing Markets Fund v. Zee Entertainment Enterprises Ltd. (2022) by High Court of Bombay*]

(3) By requisitionists [Section 100(4)]

(1) If the Board does not within 21 days from the date of receipt of a valid requisition in regard to any matter, proceed to call a meeting for the consideration of that matter on a day not later than 45 days from the date of receipt of such requisition, the meeting may be called and held by the requisitionists themselves. However, in such case, the meeting should be held within a period of 3 months from the date of the requisition.

Such requisition shall not pertain to any item of business that is required to be transacted mandatorily through postal ballot.

Requisition for convening of EGM by members: The members may requisition convening of an extraordinary general meeting, by providing such requisition in writing or through electronic mode at least clear twenty-one days prior to the proposed date of such extraordinary general meeting.

Reimbursement of expenses in calling a meeting: Reasonable expenses incurred by the requisitionists in calling such a meeting shall be reimbursed by the company to the requisitionists. The company in turn recovers such expenses from any fee or other remuneration under section 197 payable to such of the directors who were in default in calling the meeting.

In case, the quorum is not present within half-an-hour from the time appointed for holding a meeting called by requisitionists, the meeting shall stand cancelled. [Section 103(2)(b)]

CASE LAW
Where a shareholder (respondent) of appellant company had filed petition before NCLT for holding of Extraordinary General Meeting of appellant as soon as possible and the Tribunal by impugned order granted only two days to appellant to file its reply to said petition, NCLT had committed an error in not granting reasonable and sufficient time for filing a reply. **[***Held in Zee Entertainment Enterprises Ltd. v. Invesco Developing Markets Fund (2021) by National Company Law Appellate Tribunal, New Delhi*].

(2) The notice shall specify the place, date, day and hour of the meeting and shall contain the business to be transacted at the meeting. A Meeting called by the requisitionists shall be held either at the registered office of the company or at some other place within the city, town or village in which

the registered office of the company is situated. Such meeting shall be held on any day except national holiday.

(3) If the resolution is to be proposed as a special resolution, the notice shall be given as required by sub-section (2) of section 114.

(4) **Notice to be signed:** The notice shall be signed by all the requisitionists or by a requisitionists duly authorized in writing by all other requisitionists on their behalf or by sending an electronic request attaching therewith a scanned copy of such duly signed requisition.

(5) **No explanatory statement annexed to the notice:** No explanatory statement as required under section 102 need be annexed to the notice of an extraordinary general meeting convened by the requisitionists and the requisitionists may disclose the reasons for the resolution(s) which they propose to move at the meeting.

(6) **Serving of notice of the meeting:** The notice of the meeting shall be given to those members whose names appear in the Register of members of the company within three days on which the requisitionists deposit with the Company a valid requisition for calling an extraordinary general meeting.

(7) **No meeting convened:** Where the meeting is not convened, the requisitionists shall have a right to receive list of members together with their registered address and number of shares held and the company concerned is bound to give a list of members together with their registered address made as on twenty first day from the date of receipt of valid requisition together with such changes, if any, before the expiry of the forty-five days from the date of receipt of a valid requisition.

(8) **Mode of giving notice:** The notice of the meeting shall be given by speed post or registered post or through electronic mode. Any accidental omission to give notice to, or the non-receipt of such notice by any member shall not invalidate the proceedings of the meeting.

Case Law: A company cannot be restrained from holding and convening an Extra Ordinary General Meeting where shareholders have right to exercise their vote in a democratic manner. [*Held in N. Thirumurthy v. Sree Pavithra Steels (P.) Ltd. (2013) by Company Law Board, Chennai Bench*]

(4) By Tribunal [Section 98]

Section 98 provides that if for any reason it is impracticable to call a meeting of a company or to hold or conduct the meeting of the company, other than an annual general meeting, the Tribunal may, either *suo-moto* or on the application of any director or member of the company who would be entitled to vote at the meeting:

(a) order a meeting of the company to be called, held and conducted in such manner as the Tribunal thinks fit; and

(b) give such ancillary or consequential directions as the Tribunal thinks expedient, including directions modifying or supplementing in relation to the calling, holding and conducting of the meeting, the operation of the provisions of this Act or articles of the company.

Such directions may include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting. Meeting held pursuant to such order shall be deemed to be a meeting of the company duly called, held and conducted.

CASE LAW

Relief under section 186 of 1956 Act (Section 98 of Companies Act, 2013) cannot be given in a case where shareholders are present and it is not impracticable to call meeting, more especially in a case where shareholders express their willingness to attend meeting. [*Held in VIL Ltd. v. Raibareilly Allahabad Highway (P.) Ltd. (2016) by Company Law Board, New Delhi Bench*]

3. CLASS MEETINGS

Meetings of members of a company fall into two broad divisions, namely, general meetings and class meetings. Class meetings are meeting of shareholders holding a particular class of shares, which are held to pass a resolution which will bind only the members of the class concerned. Only members of the class concerned may attend and vote at meeting. Usually, the rules to voting apply to class meetings as they govern voting at general meetings. These class meetings must be convened whenever it is necessary to alter or change the rights or privileges of that class as provided by the articles. For effecting such changes, it is necessary that these are approved at a separate meeting of the holders of those shares and supported by a special resolution. Under section 48 of the Companies Act, 2013 (variation of shareholders' rights) class meeting of the holders of different classes of shares shall be held if the rights attaching to these shares are to be varied. Similarly, under Section 232 (Merger and Amalgamation of Companies), where a scheme of arrangement is proposed, meeting of several classes of shareholders and creditors are required to be held. Details of meetings of members or class meetings are required to be mentioned in the Annual Return as per Section 92(1)(f). Such Meetings are required to be convened when it is proposed to vary the rights of the holders of a particular class of shares. Provisions which govern General Meetings are *mutatis mutandis* applicable to such Meetings.

4. MEETINGS OF DEBENTURE HOLDERS, CREDITORS, ETC.

Such Meetings are held to transact business by way of passing Resolutions which bind the debenture holders or creditors, as the case may be, of the company. The debenture holders or creditors, as the case may be, can attend such Meetings and speak as well as vote thereat. Provisions which govern General Meetings are *mutatis mutandis* applicable to such Meetings.

Members of a company can exercise their powers and can bind the company when they act as a body at a validly convened and held Meeting. They should act collectively and not individually. A Member or shareholder, irrespective of his shareholding, cannot bind a company by his individual act.

ADJOURNED MEETING

If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company, the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine.

Notice of an adjourned meeting- Where the meeting stands adjourned to the same day in the next week at the same time and place, or to such other day, not being a National Holiday, or at such other time and place as the Board may determine, the company shall give at least 3 days' notice to the members either individually or by publishing an advertisement in 2 newspapers (one in English and one in vernacular language) which is in circulation at the place where the registered office of the company is situated.

No quorum in an adjourned meeting- If at the adjourned meeting also, a quorum is not present within half- an-hour from the time appointed for holding meeting, the members present, being not less than two in numbers, will constitute the quorum.

PROCEDURE FOR HOLDING ADJOURNED MEETING

Para 15.1 of SS-2 provides that a duly convened Meeting shall not be adjourned unless circumstances so warrant. The Chairman may adjourn a Meeting with the consent of the Members, at which a Quorum is present, and shall adjourn a Meeting if so directed by the Members.

Meetings shall stand adjourned for want of requisite Quorum. The Chairman may also adjourn a Meeting in the event of disorder or other like causes, when it becomes impossible to conduct the Meeting and complete its business.

Para 15.2 provides that if a Meeting is adjourned *sine-die* or for a period of thirty days or more, a Notice of the adjourned Meeting shall be given in accordance with the provisions contained hereinabove relating to Notice.

Para 15.3 provides that if a Meeting is adjourned for a period of less than thirty days, the company shall give not less than three days' Notice specifying the day, date, time and venue of the Meeting, to the Members either individually or by publishing an advertisement in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and in an English newspaper in English language, both having a wide circulation in that district.

Para 15.4 provides that if a Meeting, other than an Annual General Meeting and a requisitioned Meeting, stands adjourned for want of Quorum, the adjourned Meeting shall be held on the same day, in the next week at the same time and place or on such other day, or at such other time and place as may be determined by the Board.

Illustration:

Question: The articles of association of XYZ Ltd. having 700 members as on cutoff date, prescribe for physical presence of 7 members to constitute quorum of general meetings. Following are the status of persons present in a general meeting of XYZ Ltd to consider the appointment of MD. Check the quorum of the meeting.

(a) Mr. A, the representative of Governor of Maharashtra.

(b) Mr. B & Mr. C are preference shareholders.

(c) Mr. D representing ABC Ltd. and SKY Ltd.

(d) Mr. E, Mr. F, Mr. G and Mr. H are proxies of shareholders.

Hint:

(a) Since Mr. A is the representative of the Governor of Maharashtra, shall be treated as a member personally present (Section 112).

(b) Preference shareholders can vote only in relation to such matters which directly affect their rights. In this case, meeting was called to take decision on appointment of MD, which does not affect their rights. Therefore, Mr. B & Mr. C are not members personally present.

(c) Since Mr. D represents two body corporates, he would be treated as two members personally present. (Section 113)

(d) Since Mr. E, Mr. F, Mr. G and Mr. H are proxies of shareholders and members are not personally present. They are not considered while counting quorum.

From the above analysis, it can be concluded that only 3 members are personally present and they do not Constitute proper quorum as fixed by the company.

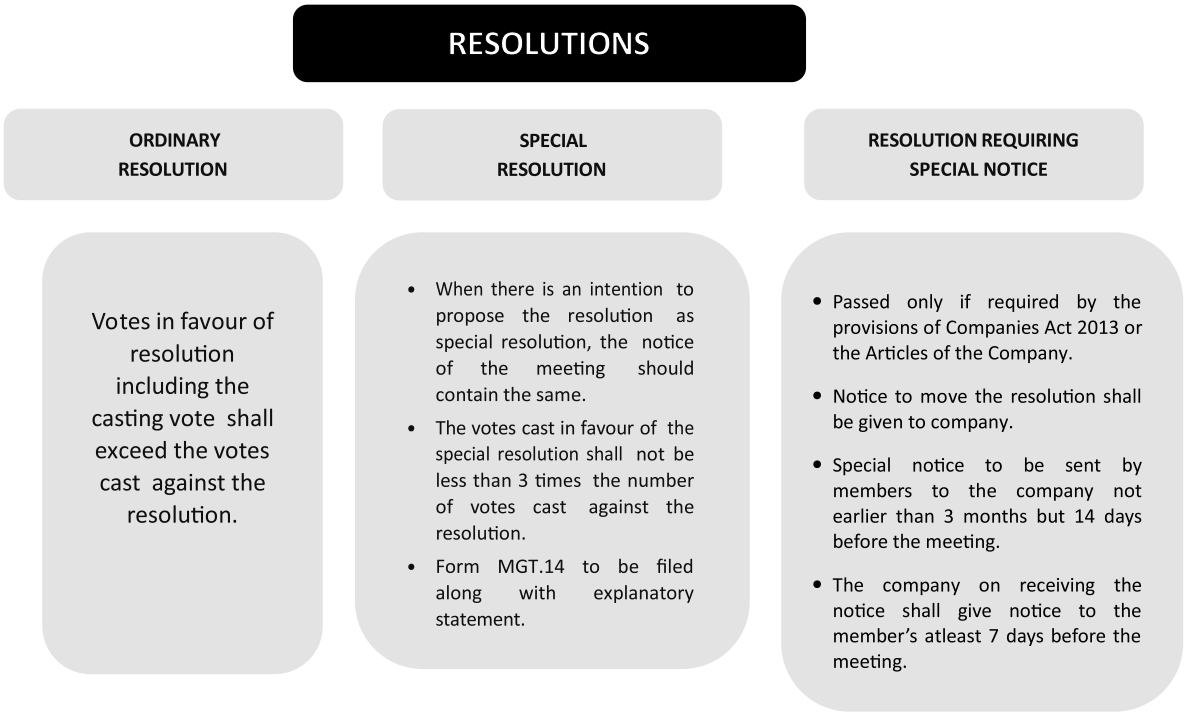
Note: The quorum required in respect of general meeting of a public company is 5 members personally present (in case total number of members is less than 1000) and the quorum can be increased by the articles of the company.

Resolution passed at adjourned meetings

As per Section 116 where a resolution is passed at an adjourned meeting of a company; or the holders of any class of shares in a company; or the Board of Directors, the resolution shall be treated as passed on the day it was actually passed and not on any earlier date.

Para 15.6 of SS-2 provides that at an adjourned Meeting, only the unfinished business of the original Meeting shall be considered. Any Resolution passed at an adjourned Meeting would be deemed to have been passed on the date of the adjourned Meeting and not on any earlier date.

TYPES OF RESOLUTIONS



Ordinary and Special Resolutions

Section 114 relates to Ordinary and Special Resolution:

Ordinary Resolution

A resolution shall be an ordinary resolution if the notice required under this Act has been duly given and it is required to be passed by the votes cast, whether on a show of hands, or electronically or on a poll, as the case may be, in favour of the resolution, including the casting vote, if any, of the Chairman, by members who, being entitled so to do, vote in person, or where proxies are allowed, by proxy or by postal ballot, exceed the votes, if any, cast against the resolution by members, so entitled and voting. The method of voting might be through show of hands, electronic voting, poll or any other permitted method or postal ballot. The number of votes of only the members who are 'entitled and voting' are to be counted. Hence, the persons who abstain from voting or are not allowed to vote are not to be counted. Wherever a provision of the Act or articles simply provides for passing a resolution by the company or authority given by the company in general meeting or approval of the company without mentioning the nature of the resolution to be passed, an ordinary resolution is required to be passed. Further, the notice required to be given may be given either by the company or the member proposing the resolution.

Following business are transacted through Ordinary Resolution:

- Appointment of Auditors;
- Declaration of Dividend;
- Consideration of the financial statements, reports of Board and Auditors; and
- Appointment of director in place of those retiring etc.

Special Resolution

A resolution shall be a special resolution when:

(a) the intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting or other intimation given to the members of the resolution;

(b) the notice required under this Act has been duly given; and

(c) the votes cast in favour of the resolution, whether on a show of hands, or electronically or on a poll, as the case may be, by members who, being entitled so to do, vote in person or by proxy or by postal ballot, are required to be not less than three times the number of the votes, if any, cast against the resolution by members so entitled and voting.

If the notice convening the meeting (where at special business will be transacted) does not state the nature of the special business, the meeting would be deemed to have been convened irregularly. Consequently, that special business cannot be dealt with at the meeting.

The method of voting might be through show of hands, electronic voting, poll or any other permitted method or postal ballot. The number of votes of only the members who are 'entitled and voting' are to be counted. Hence, the persons who abstain from voting or are not allowed to vote (whether under the provisions of this Act or otherwise) are not to be counted. Further, the notice required to be given may be given either by the company or the member proposing the resolution.

For example, following business are transacted through Special Resolution:

- Making change in name of the company;
- Change in Articles of Association; and
- Changing a Private Company to Public Company etc.

RESOLUTIONS REQUIRING SPECIAL NOTICE (SECTION 115)

Section 115 provides that where, by any provision contained in this Act or in the articles of a company, special notice is required of any resolution, notice of the intention to move such resolution shall be given to the company by such number of members holding not less than 1% of total voting power or holding shares on which such aggregate sum not exceeding Rs.5,00,000/-, as may be prescribed, has been paid-up and the company shall give its members notice of the resolution in the following manner as prescribed in Rules.

The matters in respect of which special notice is required are:

(a) A resolution for appointment of a person as auditor at the annual general meeting other than the retiring auditor or providing expressly that the retiring auditor shall not be re-appointed [Section 140(4)];

(b) A resolution for removing a director before the expiry of the period of his office and appointing someone in the place of the director so removed [Section 169(2)].

Procedure for special notice: [Rule 23 of the Companies (Management and Administration) Rules, 2014]

(a) **Signing of special notice:** A special notice required to be given to the company shall be signed, either individually or collectively by such number of members holding not less than one percent of total voting power or holding shares on which an aggregate sum of not less than five lakh rupees has been paid up on the date of the notice.

(b) **Sending of notice to the company:** Such notice shall be sent by members to the company not earlier than three months but at least 14 days before the date of the meeting at which the resolution is to be moved, exclusive of the day on which the notice is given and the day of the meeting.

(c) **On receipt of notice by the company:** The company shall immediately after receipt of the notice, give its members notice of the resolution at least seven days before the meeting, exclusive of the day of dispatch of notice and day of the meeting, in the same manner as it gives notice of any general meetings.

(d) **Publication of notice:** Where it is not practicable to give the notice in the same manner as it gives notice of any general meetings, the notice shall be published in English language in English newspaper and in vernacular language in a vernacular newspaper, both having wide circulation in the State where the registered office of the Company is situated. Such notice shall also be posted on the website, if any, of the Company. Such notice shall be published at least seven days before the meeting, exclusive of the day of publication of the notice and day of the meeting.

CASE LAW

7/11/2017	*Jai Kumar Arya v. Chhaya Devi*	*Delhi High Court*

Facts of the case:

The Company received a requisition, from its shareholders, for convening of an Extra Ordinary General Meeting (hereinafter referred to as "EGM") on 26th May 2017, with the following proposals: "(i) removal of the plaintiff (Chhaya Devi) as Director/Managing Director of the Company, (ii) setting aside a notice, earlier issued, for approval of an agenda item, dated 31st of May 2014, to terminate the directorship of the defendants, and (iii) appointment of Defendant No. 1 (Rukmini Devi) as Managing Director of the Company."

On receiving the said requisition, the plaintiff (Chhaya Devi) responded, on 25th April 2017, alleging that the requisition was not in accordance with Section 169, read with Section 115 of the Companies Act, 2013 (hereinafter referred to as "the Act"), in as much as no Special Notice had been served, by the shareholders, on the Company and, instead, the Company had simply been requested to serve notice under Section 169.

This Appeal is against order of restraining other directors from acting upon notice and for convening Board meeting for removal of managing director.

Notice only called for a meeting of Board to decide whether an EGM should be convened or not-Where managing director filed an interlocutory application for restraining other directors of the company from acting upon notice dated 8-8-2017 for convening board meeting on 26-8-2017 for her removal, and the same was allowed by Single Judge on the ground that there was no proper requisition of shareholders for holding EGM for removal of the MD, but the said notice did not itself convene an EGM, it only called for a meeting of the Board to decide whether an EGM should be convened or not, therefore, the impugned order was to be set aside and the notice dated 8-8-2017 would stand revived.

The court observed that no specific form or format of a "requisition" is prescribed in the Act, or in any cognate legislation, so that any document issued by the requisite number of members of the Company as specified in Section 100(2) of the Act (which calls for convening of an EGM) would be eligible to be styled as a "requisition".

Judgement: The court held that there was no obligation to disclose the reasons for removing a person from the directorship of the company prior to the EGM where such proposal was to be considered.

Further that, the notice dated 8-8-2017 was itself only a notice for fixing a meeting of the Board of the company. It did not itself convene an EGM, but only calls for a meeting of the Board to decide whether an EGM should be convened or not. Therefore, question of requisition of the shareholders for holding the EGM would not arise. Further that, in the proposed Board meeting, no decision of removal of the MD from the company was to be taken. Hence, the impugned order was to be set aside and the notice dated 8-8-2017 would stand revive.

CASE LAW

In re. *Godrej Industries Limited (2014), honorable judge G.S. Patel of Bombay High Court observed* the importance of discussions and deliberations at general meeting of members:

The court observed that the heart of corporate governance lies transparency and a well-established principle of indoor democracy that gives shareholders qualified, yet definite and vital rights in matters relating to the functioning of the company in which they hold equity. Principal among these, to my mind, is not merely a right to vote on any particular item of business, so much as the right to use the vote as an expression of an informed decision. That necessarily means that the shareholder has an inalienable right to ask questions, seek clarifications and receive responses before he decides which way he will vote. It may often happen that a shareholder is undecided on any particular item of business. At a meeting of shareholders, he may, on hearing a fellow shareholder who raises a question, or on hearing an explanation from a director, finally make up his mind. In other cases, he may hold strong views and may desire to convince others of his convictions. This may be in relation to matters that are not immediately obvious to the shareholder merely on receipt of written information or a notice. The right to persuade and the right to be persuaded are, of vital importance. In an effort for greater inclusiveness, these rights cannot be altogether defenestrated. To say, therefore, that no meeting is required and that the shareholder must cast his vote only on the basis of the information that has been sent to him by post or email seems to be completely contrary to the legislative intent and spirit to the express.

CASE LAW

Where special notice issued by respondent for removal of chairman of petitioner company was nothing but to secure needless publicity and defaming company and amounting to abuse the process of law, petitioner company was exempted from publication, circulation, or reading out such notice at forthcoming AGM. [*Held in BSE Ltd. V. Sureshchandra V. Parekh (2014) by Company Law Board, Mumbai Bench*]

PROCESS OF PASSING THE RESOLUTIONS

The resolution is proposed as a 'motion'. A motion becomes a resolution only after the requisite majority of members have adopted it. A motion should be in writing and signed by the mover and put to the vote at the meeting by the chairman. In case of company meetings, only such motions are proposed as are covered by the agenda. However, certain motions may arise out of the discussion and may be allowed where no special resolution is mandated in the Act. Para 7.1 of Secretarial Standard-2 provides that every resolution shall be proposed by a member and seconded by another member.

The motion being discussed may undergo an amendment in the course of discussion. An amendment is any alteration to the main motion proposed by a member before it is voted upon and adopted. Amendment may

be proposed by any member who has not already spoken on the main motion or has not previously moved an amendment, but a formal motion cannot be amended. Like the main motion, an amendment should ordinarily be in writing, signed by the mover. The terms of the amendment should be definite and in the affirmative and it should not raise any question already decided upon at the same meeting. It should be relevant to and in keeping with the main motion which it seeks to amend and must not merely negate the main motion or introduce entirely a new subject.

The Chairman has the absolute discretion to accept or reject an amendment on various grounds such as inconsistency, redundancy, irrelevance etc. When an amendment has been moved, admitted and seconded discussion on the main motion ceases and discussion on the amendment starts. Any one may speak on the amendment even if he has already spoken on the main motion, but no one is allowed to speak twice on the same amendment. After the amendment has been thoroughly discussed, it is put to vote. If the amendment is carried, it is incorporated in the body of the main motion. The altered motion which is known as "substantive motion" is then put before the meeting. If the amendment is lost, discussion on the main motion is resumed, but if the substantive motion is put to vote and lost, the original motion cannot be revived.

Any number of amendments to the main motion can be moved. An amendment to alter another amendment can also be moved, but an amendment can be amended only once. When a large number of amendments to the main motion have been moved, the original motion may be withdrawn by common consent and a new motion incorporating all the amendments may be taken up. The Chairman has the discretion to decide in what order the various amendments should be taken up for consideration.

RESOLUTIONS AND AGREEMENTS TO BE FILED WITH THE REGISTRAR

Section 117 provides that a copy of every resolution or the agreement in respect of matters specified therein together with the explanatory statement shall be filed in **Form No. MGT.14** with the Registrar, within thirty days of its passing or making thereof. The Registrar shall register the same.

Exceptions:

Specified IFSC Public company/Specified IFSC Private Company can file a copy of every resolution or the agreement in respect of matters specified therein together with the explanatory statement in Form No. MGT.14 with the Registrar, within sixty days of its passing or making thereof.

In case the company fails to file the resolution or the agreement before the expiry of the specified period of thirty days, such company shall be liable to a penalty of ten thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of two lakh rupees and every officer of the company who is in default including liquidator of the company, if any, shall be liable to a penalty of ten thousand rupees and in case of continuing failure, with a further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of fifty thousand rupees.

Resolutions and agreements to be filed with the Registrar are as under:

(a) special resolutions;

(b) resolutions which have been agreed to by all the members of a company, but which, if not so agreed to, would not have been effective for their purpose unless they had been passed as special resolutions;

(c) any resolution of the Board of Directors of a company or agreement executed by a company, relating to the appointment, re-appointment or renewal of the appointment, or variation of the terms of appointment, of a managing director;

(d) resolutions or agreements which have been agreed to by any class of members but which, if not so agreed to, would not have been effective for their purpose unless they had been passed by a specified majority or otherwise in some particular manner; and all resolutions or agreements which effectively bind such class of members though not agreed to by all those members;

(e) resolutions requiring a company to be wound up voluntarily passed in pursuance of section 59 of the Insolvency and Bankruptcy Code 2016;

(f) resolutions passed in pursuance of sub-section (3) of section 179.However, no person shall be entitled under Section 399 to inspect or obtain copies of such resolutions.

(i) Nothing contained in this clause shall apply in respect of a resolution passed to grant loans, or give guarantee or provide security in respect of loans under clause (f) of sub-section (3) of section 179 in the ordinary course of its business by,—

(a) a banking company;

(b) any class of non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934, as may be prescribed in consultation with the Reserve Bank of India;

(c) any class of housing finance company registered under the National Housing Bank Act, 1987, as may be prescribed in consultation with the National Housing Bank; and

(ii) Filing of resolutions passed in pursuance of sub-section (3) of section 179 with the Registrar is not applicable to private companies vide exemption notification no GSR 464(E) dated 5th June, 2015 and Specified IFSC Public Company *vide Notification Dated 4th January, 2017.*

(g) any other resolution or agreement as may be prescribed and placed in the public domain.

Test your knowledge:

Question: At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favor of the resolution, 5 voted against it and 5 votes were found in valid. The remaining 10 member abstained from voting. The Chairman of the meeting declared the resolution as passed.

With reference to the provisions of the Companies Act, 2013, examine the validity of the Chairman's declaration?

NOTICE OF MEETING (SECTION 101)

The Notice should be in writing, though no form has been prescribed for this purpose. Oral intimation that it is proposed to have a General Meeting is not a Notice at all and consequently if any Meeting is held, it will be invalid.

Length of notice of meeting

A general meeting of a company may be called by giving not less than 21 clear days' notice either in writing or through electronic mode. Notice through electronic mode shall be given in such manner as may be prescribed.

In case of section 8 company, 14 days' clear notice is required instead of 21 days.

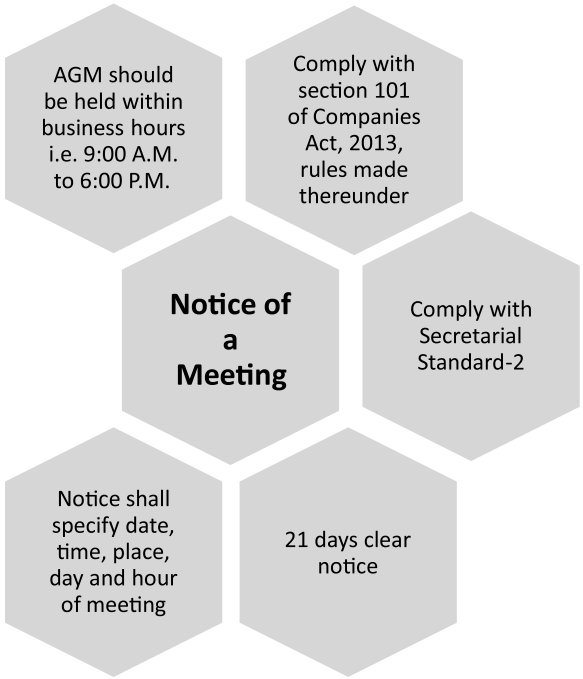
The expression "twenty-one clear days", means that the date of service of Notice and the date of the Meeting are to be excluded when calculating the period of twenty-one days [*N.V.R. Naggappa Chettair v. Madras Race Club (1949) 19 Comp. Cas. 175 (Mad)*].

Further, fractions of days are not to be taken into account i.e. part of the day after the hour at which the Notice is posted cannot be combined with the part of the day before the Meeting commences, to form one day. Each of these days should be a full or a calendar day [*Bharat Kumar Dilwali v. Bharat Carbon & Ribbon Mfg. Co. Ltd. (1973) 43 Comp. Cas. 197 (Del)*]. Intervening holidays are counted within the period of Notice.

Where a notice of general meeting is sent by post, it shall be deemed to be served at the expiration of 48 hours after the letter containing the same is posted (Rule 35(6) of the Companies (Incorporation) Rules, 2014). Each of the 21 days must be full or complete days. The day on which the notice is deemed to be served on the member, and the day of the general meeting have to be in addition to the 21 days.

In case a valid special notice under the Act has been received from Member(s), the company shall give Notice of the Resolution to all its Members at least seven days before the Meeting, exclusive of the day of dispatch of Notice and day of the Meeting, in the same manner as a Notice of any General Meeting is to be given.

Where this is not practicable, the Notice shall be published in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and in an English newspaper in English language, both having a wide circulation in that district, at least seven days before the Meeting, exclusive of the day of publication of the Notice and day of the Meeting. In case of companies having a website, such Notice shall also be hosted on the website. (Para 1.2.6 of SS-2)



Illustration

Question: ABC Ltd. issued a notice on 1st August, 2020 to hold its AGM on 24th August, 2020. Check the validity of the notice referring to the provisions of the relevant act, in case it is sent by post.

Answer: Date of holding AGM: 24th August, 2020; Date of dispatch of notice: 1st August, 2020; Days to be excluded:

(a) Day of holding AGM i.e 24th August, 2020.

(b) Day of dispatch of notice i.e. 1st August, 2020.

(c) 2 additional days for service of notice i.e 2nd & 3rd August, 2020 (SS-2 Para 1.2.6) Number of days' notice given: 20 days.

Number of days' notice required under section 101 of the Act is 21 days. Therefore it is not a case of valid notice. However, shortfall of 1 day can be condoned if consent is given for such shorter notice by at least 95% of the members entitled to vote at such AGM.

Service of notice of AGM by hand, under certificate of posting and by publication in newspaper is considered as deemed service of notice. [*Held in the case of Ganesh Commercial Co. Ltd. v. Arun Kumar Mohata (2013) by High Court of Calcutta*]

Shorter notice

A general meeting may be called after giving a shorter notice also if consent is given in writing or by electronic mode by not less than 95% of the members entitled to vote at such meeting.

As per Section 101 read with Secretarial Standard-2, a general meeting may be called after giving shorter notice if consent, in writing or by electronic mode, is accorded thereto–

(i) in the case of an annual general meeting, consent by not less than ninety-five per cent of the members entitled to vote at such meeting;

However, the Financial Statements and other documents required to be annexed thereto may be given at a shorter period of time if the requisite consent of Members in writing, by physical or electronic means, is accorded thereto:

(a) if the company has a share capital, consent by the majority in number of members entitled to vote and who represent not less than ninety-five per cent of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(b) if the company has no share capital, consent by the members having not less than ninety-five per cent. of the total voting power exercisable at that meeting:

(ii) In case of any other General Meeting-

(a) if the company has a share capital, consent by the majority in number of members entitled to vote and represent not less than ninety-five per cent of such part of the paid-up share capital of the company as gives a right to vote at the Meeting;

(b) if the company has no share capital, consent by the Members having not less than ninety-five per cent of the total voting power exercisable at such Meeting.

The request for consenting to shorter Notice and accompanying documents shall be sent together with the

Notice and the Meeting shall be held only if the requisite consent of Members as stated above is received prior to the time fixed for the Meeting.

Where any Member of a company is entitled to vote only on some resolution or resolutions to be moved at a Meeting and not on the other, then vote of the Member with respect to shorter notice shall only be counted for the purpose of the resolution on which the Member can vote.

In addition, the company shall ensure compliance of provisions relating to appointment of Proxy unless all the Members entitled to vote at such Meeting, consent to holding of the General Meeting at shorter Notice.

In case of a private company, consent for shorter Notice shall be obtained from such number of Members as specified in this paragraph, unless otherwise provided in the Articles.

Where any member of a company is entitled to vote only on some resolution or resolutions to be moved at a meeting and not on the others, those members shall be taken into account in respect of the former resolution or resolutions and not in respect of the latter.

Illustration 1:

Say, a company XYZ Ltd. wish to hold its General Meeting at a shorter notice, immediately after the Board Meeting on same day and the required consent from 95% of the Members entitled to vote at the Meeting is received before the time fixed for commencement of Meeting. Although in such a case the consent of 95% Members entitled to vote at the meeting is received, still the proxy requirements need to be complied with by the Company.

In other words, in the above case the Board Meeting and General Meeting can't be held on the same day.

Illustration 2:

Considering the above illustration, if the consent of all the Members (i.e. 100%) entitled to vote at such Meeting is received before the time fixed for commencement of the Meeting, the proxy requirements need not be complied with. In other words, in such a case the Board Meeting and General Meeting can be held on the same day.

CONTENTS OF NOTICE

Section 101(2) provides that every notice of a meeting shall specify the place, date, day and the hour of the meeting and shall contain a statement of the business to be transacted at such meeting.

Place of meeting (Section 96)

The notice should state the place where the general meeting is scheduled to be held. In case of an annual general meeting, the place of the meeting has to be either the registered office of the company or some other place within the city, town or village in which the registered office of the company is situated. Explanation to Rule 17(2) of Companies (Management and Administration) Rules, 2014 states that requisitionists should convene meeting at Registered Office or in the same city or town where the Registered Office is situated and such meeting should be convened on any day except national holiday.

Annual general meeting of an unlisted company may be held at any place in India if consent is given in writing or by electronic mode by all the members in advance.

The Central Government may exempt any company from the provisions of this sub-section subject to such conditions as it may impose.

In case of Government Company, AGM may be held at registered office of the company or such other place within the city, town or village in which the registered office of the company is situated or such other place as the central government may approve in this behalf.

Para 1.2.4 of SS-2 provides Annual General Meetings shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated, whereas other General Meetings may be held at any place within India.

Notice shall contain complete particulars of the venue of the Meeting including route map and prominent land mark for easy location except in case of –

(i) a company in which only its directors and their relatives are members;

(ii) a wholly owned subsidiary.

Day of meeting (Section 96)

The day and date of the meeting should be clearly stated in the notice. An annual general meeting and a meeting called by the requisitionists shall be called on a day that is not a National Holiday. .

Explanation – For the purposes of this sub-section, "National Holiday" means and includes a day declared as National Holiday by the Central Government.

As explained earlier National Holiday means Republic Day i.e. 26th January, Independence Day i.e. 15th August, Gandhi Jayanti i.e. 2nd October and such other day as may be declared as National Holiday by the Central Government.

Time of meeting [Section 96(2)]

Exact time of holding the meeting should be given in the notice. An annual general meeting and a meeting called by the requisitionists can be called during business hours only, i.e. between 9:00 a.m. and 6:00 p.m. There is no restriction of timings in case of an extraordinary general meeting.

In case of Section 8 Company, the time, date and place of each AGM are decided upon before-hand by the directors having regard to directions, if any, given in this regard by the company in its general meeting.

CASE LAW

Where company convened its Annual General Meeting for financial year ending 31.03.2015 belatedly and, thus, contravened provisions of section 96, since it made reasonable ground for compounding of alleged offence, Tribunal has in exercise of its power conferred under section 441 could grant permission for compounding of such offence [Held in *Uttrakhand Parvatiya Aajeevika Sanvardhan Co., In re* by National Company Law Tribunal, Allahabad Bench (2018)].

Agenda (Section 102)

A statement of the business to be transacted at the general meeting should be given in the notice. In case, the meeting is to transact a special business, an explanatory statement should be attached about such item.

Proxy clause with reasonable prominence [Section 105(2)]

Every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, should carry with reasonable prominence, a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member.

Regulation 44(4) of SEBI (LODR) Regulations, 2015: The listed entity shall send proxy forms to holders of securities in all cases mentioning that a holder may vote either for or against each resolution.

NOTICE OF THE MEETING (RULE 18 OF COMPANIES (MANAGEMENT AND ADMINISTRATION) RULES 2014)

According to Rule 18 of the Companies (Management and Administration) Rules, 2014, the company may serve the notice in electronic mode in following manner:-

(1) A company may give notice through electronic mode. The expression ''electronic mode'' shall mean any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the member.

(2) A notice may be sent through e-mail as a text or as an attachment to e-mail or as a notification providing electronic link or Uniform Resource Locator for accessing such notice.

(3) (i) The e-mail shall be addressed to the person entitled to receive such e-mail as per the records of the company or as provided by the depository:

The company shall provide an advance opportunity at least once in a financial year, to the member to register his e-mail address and changes therein and such request may be made by only those members who have not got their email ID recorded or to update a fresh email ID and not from the members whose e- mail IDs are already registered.

(ii) The subject line in e-mail shall state the name of the company, notice of the type of meeting, place and the date on which the meeting is scheduled.

(iii) If notice is sent in the form of a non-editable attachment to e-mail, such attachment shall be in the Portable Document Format or in a non-editable format together with a 'link or instructions' for recipient for downloading relevant version of the software.

(iv) When notice or notifications of availability of notice are sent by e-mail, the company should ensure that it uses a system which produces confirmation of the total number of recipients e-mailed and a record of each recipient to whom the notice has been sent and copy of such record and any notices of any failed transmissions and subsequent re-sending shall be retained by or on behalf of the company as ''proof of sending''.

(v) The company's obligation shall be satisfied when it transmits the e-mail and the company shall not be held responsible for a failure in transmission beyond its control.

(vi) If a member entitled to receive notice fails to provide or update relevant e-mail address to the company, or to the depository participant as the case may be, the company shall not be in default for not delivering notice via e-mail.

(vii) The company may send e-mail through in-house facility or its registrar and transfer agent or authorise any third party agency providing bulk e-mail facility.

(viii) The notice made available on the electronic link or uniform resource locator has to be readable, and the recipient should be able to obtain and retain copies and the company shall give the complete Uniform Resource Locator or address of the website and full details of how to access the document or information.

(ix) The notice of the general meeting of the company shall be simultaneously placed on the website of the company if any and on the website as may be notified by the Central Government.

Secretarial Standard on issuance of notice:

Para 1.2.2 of SS-2 provides that Notice shall be sent by hand or by ordinary post or by speed post or by registered post or by courier or by facsimile or by e-mail or by any other electronic means. 'Electronic means' means any communication sent by a company through its authorized and secured computer programme which is capable of producing confirmation and keeping record of such communication addressed to the person entitled to receive such communication at the last electronic mail address provided by the Member.

Notice shall be sent to Members by registered post or speed post or courier or e-mail and not by ordinary post in the following cases:

(a) if the company provides the facility of e-voting;

(b) if the item of business is being transacted through postal ballot.

If a Member requests for delivery of notice through a particular mode, other than one of those listed above, he shall pay such fees as may be determined by the company in its Annual General Meeting and the Notice shall be sent to him in such mode.

Notice shall be sent to Members by registered post or speed post or email if the Meeting is called by the requisitionists themselves and where the Board had not proceeded to call the Meeting.

PERSONS ENTITLED TO RECEIVE NOTICE

In terms of Section 101(3), notice of every meeting of the company must be given to:

(a) every member of the company, legal representative of any deceased member or the assignee of an insolvent member;

(b) the auditor or auditors of the company; and

(c) every director of the company.

A private company, which is not, a subsidiary of a public company may prescribe, by its Articles, persons to whom the notice should be given.

It does not always follow that all the members of a company are entitled to receive notice of meetings of the company; the Articles frequently provide that preference shareholders shall not be entitled to receive notice of and vote at general meeting of the company, except in certain circumstances. There is a statutory obligation to send notice to preference shareholders when their dividend is in arrears for more than a certain period [Section 47(2)]. This obligation arises from the fact that preference shareholders whose dividends are in arrears are entitled to attend and vote at the meeting.

The non-receipt of notice or accidental omission to given notice to any member shall not invalidate the proceedings in the meeting [Section 101(4)]. However, omission to serve notice of meeting on a member on the mistaken ground that he is not a shareholder cannot be said to be an accidental omission [*Musselwhite vs. C.H. Musselwhite & Sons Ltd. (1962) 32 Comp. Cas 804].* 'Accidental omission' means that the omission must be not only not designed but also not deliberate *[Maharaja Export vs. Apparels Exports Promotion Council (1986) 60 Comp. Cas 353.].*

Notice to Directors, Auditors & other specified persons under Secretarial Standard-2

Para 1.2.1 of SS-2 provides that notice in writing of every meeting shall be given to every member of the company. Such Notice shall also be given to the Directors and Auditors of the company, to the Secretarial Auditor, to Debenture Trustees, if any, and, wherever applicable or so required, to other specified persons. Court may

direct issuance of Notice to some other persons such as Court-appointed Chairman or observers or persons whose entitlement is under challenge. Considering that Preference Shareholders are Members of the company, Notice of general meetings should also be given to them.

In case of a Nidhi company, Notice may be served individually only on Members who hold shares of more than one thousand rupees in face value or more than one percent of the total paid-up share capital of the company, whichever is less. For other Members, Notice may be served by a public notice in newspaper circulated in the district where the Registered Office of the company is situated and by displaying the same on the Notice Board of the company.

In the case of Members, Notice shall be given at the address registered with the Company or depository. In the case of shares or other securities held jointly by two or more persons, the Notice shall be given to the person whose name appears first as per records of the Company or the depository, as the case may be. In the case of any other person who is entitled to receive Notice, the same shall be given to such person at the address provided by him.

Para 1.2.1 of SS-2 provides that where the company has received intimation of death of a Member, the Notice of Meeting shall be sent as under:

(a) where securities are held singly, to the Nominee of the single holder;

(b) where securities are held by more than one person jointly and any joint holder dies, to the surviving first joint holder;

(c) where securities are held by more than one person jointly and all the joint holders die, to the Nominee appointed by all the joint holders;

  (i) In the absence of a Nominee of member or joint members, the notice shall be sent to the legal representative of the deceased Member or joint members.

  (ii) In case of insolvency of a Member, the Notice shall be sent to the assignee of the insolvent Member.

  (iii) In case the Member is a company or body corporate which is being wound up, Notice shall be sent to the liquidator.

Thus, notice shall be given to:

(a) Every member of the Company.

(b) Nominee/Legal representative of any deceased member.

(c) Assignee of an insolvent member.

(d) The auditor or auditors of the company.

(e) Every director of the company.

(f) Debenture trustee.

(g) Liquidator in case the company is being bound up.

(h) To other specified persons.

The other recipients of the Notice may include-

(i) in the case of a Listed Company, the stock exchanges on which the shares or other securities of the company are listed;

(ii) financial institutions, pursuant to a covenant in the agreement entered into with them for availing financial assistance;

(iii) foreign collaborator(s), if the agreement with them provides for sending of such Notices;

(iv) In case shares of the company are held in dematerialised form, NSDL and CDSL, and in case the company has issued GDRs / ADRs / FCCBs, then to such Depository (ies);

(v) Holders of Stock Options of the company; and

(vi) Any other recipient to whom the company has agreed to give Notice (say, as per the terms of an agreement with any party).

In addition, a Court may direct issuance of Notice to some other person's such as Court-appointed Chairman or observers. In such case the Notice should be given accordingly.

Irregular Notice:

Some instances of irregular Notice are as under:

(1) When the Notice of General Meeting is issued without authorization by the Board.

(2) When the Notice is issued by an invalidly constituted Board.

(3) When the appointment of a Director who has signed the Notice is void and the Notice gets issued even after discovery of invalidity.

(4) When the Notice is not in accordance with the Act.

STATEMENT TO BE ANNEXED TO NOTICE – EXPLANATORY STATEMENT (SECTION 102)

Section 102 requires that a statement detailing the material facts of the businesses to be transacted as special business be annexed to the notice of the general meeting.

Secretarial Standard on annexure to notice of General Meeting:

Para 1.2.5 of SS-2 requires that notice shall clearly specify the nature of the Meeting and the business to be transacted thereat. In respect of items of Special Business, each such item shall be in the form of a resolution and shall be accompanied by an explanatory statement which shall set out all such facts as would enable a Member to understand the meaning, scope and implications of the item of business and to take a decision thereon. In respect of items of ordinary business, resolutions are not required to be stated in the Notice except where the auditors or directors to be appointed are other than the retiring auditors or directors, as the case may be.

CASE LAW

Where applicant had received notice of EGM, he was at liberty to attend meeting and raise his voice, if any and no order to restrain holding of meeting on ground of violation of section 102 was to be passed. [*Held in Yatin Chandulal Davda v. Iberchem India Ltd. (2018) by National Company Law Tribunal, Ahmedabad Bench*.]

Contents of Explanatory Statement:

In case of special business items to be transacted at a general meeting, a statement setting out the following material facts, shall be annexed to the notice calling the meeting:

(i) (a) the nature of concern or interest, financial or otherwise, if any, in respect of each item of:

(i) every director and the manager, if any;

(ii) every other key managerial personnel and relatives of every director, manager and key managerial person.

(b) any other information and facts that may enable members to understand the meaning, scope and implications of the items of business and to take decision thereon.

(a) in the case of an annual general meeting, all business to be transacted thereat shall be deemed special, other than— (i) the consideration of financial statements and the reports of the Board of Directors and auditors; (ii) the declaration of any dividend; (iii) the appointment of directors in place of those retiring; (iv) the appointment of, and the fixing of the remuneration of, the auditors; and (b) in the case of any other meeting, all business shall be deemed to be special.

Where any item of special business to be transacted at a meeting of the company relates to or affects any other company, the extent of shareholding interest in that other company of every promoter, director, manager, if any, and of every other key managerial personnel of the first mentioned company shall, if the extent of such shareholding is not less than 2% of the paid- up share capital of that company, also be set out in the statement.

(ii) Where any item of business refers to any document, which is to be considered at the meeting, the time and place where such document can be inspected shall be specified in the explanatory statement.

Effect of non-disclosure: Where as a result of the non-disclosure or insufficient disclosure in any statement referred as above, being made by a promoter, director, manager, if any, or other key managerial personnel, any benefit which accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

Penalty: If any default is made in complying with the provisions of section 102 of the Companies Act, 2013, every promoter, director, manager or other key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is higher.

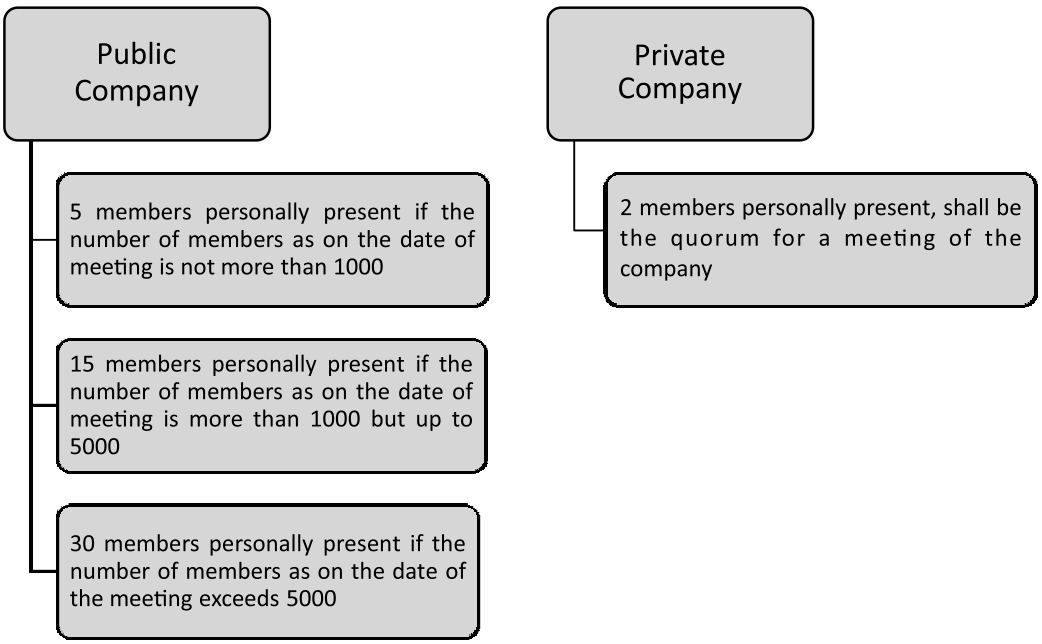
As per regulation 17(11) of SEBI (LODR) Regulations, the statement to be annexed to the notice as referred to in sub-section (1) of section 102 of the Companies Act, 2013 for each item of special business to be transacted at a general meeting shall also set forth clearly the recommendation of the board to the shareholders on each of the specific items.

If the explanatory statement is vague and tricky, or insufficient and misleading, the resolution passed, is bad in law. [*Central Industrial Alliance Ltd. vs. Pravin Kantilal Vakil* (1985) 57 Com. Cases 12 (Bom)].

Explanatory statement need not be annexed to the Notice of an Extra-Ordinary General Meeting convened by the requisitionists and the requisitionists may disclose the reasons for the Resolution(s) which they propose to move at the Meeting.

QUORUM FOR MEETINGS (SECTION-103)

Quorum refers to the minimum number of members required to constitute a valid meeting. Following are the minimum numbers provided in section 103, for various categories of companies. However, the Articles of Association of the company may provide for a higher number.



Secretarial Standard on Quorum:

Para 3.1 of SS-2 provides Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.

Where the Quorum provided in the Articles is higher than that provided under the Act, the Quorum shall conform to such higher requirement. Members need to be personally present at a Meeting to constitute the Quorum. Proxies shall be excluded for determining the Quorum.

Illustration:

Consider a company where the number of Members was originally large, say 500, and the Quorum fixed by the Articles was 100 Members present. Subsequently, 450 Members sold their shares which were acquired by some of the remaining 50 Members. Here, proceedings will be valid if all Members are present in person. In the given case, if less than 50 Members are present, there shall be no Quorum.

Para 3.2 of SS-2 provides that a duly authorized representative of a body corporate or the representative of the President of India or the Governor of a State is deemed to be a Member personally present and enjoys all the rights of a Member present in person.

One person can be an authorized representative of more than one body corporate. In such a case, he is treated as more than one member present in person for the purpose of quorum. However, to constitute a meeting, at least two individuals shall be present in person. Thus, in case of a public company having not more than 1000 members with a quorum requirement of five members, an authorized representative of five bodies corporate cannot form a quorum by himself but can do so if at least one more member is personally present.

This is so because a single Member present cannot by himself constitute a Meeting. There are a number of decisions by which it is now firmly settled that as a general rule a single person cannot constitute a Meeting. Few such cases include *Sharp v. Dawes (1876) 2 QBD 26 (CA), Awadhoot v. State of Maharashtra AIR 1978 Bom 28, etc.*

The words, personally present exclude proxies. Thus Proxies shall be excluded for determining the quorum. However, the representative of a body corporate appointed under Section 113 or the representative of the President or a Governor of a State under Section 112 is a member 'personally present' for purpose of counting a quorum [*Re. Kelantan Coconut Estate Ltd*., 1920 W.N. 274].

A person who represents two different bodies is supposed to act in accordance with the instructions of his principals. Therefore, such representative theoretically carries with him two sets of opinions on the Resolutions.

If two or more bodies corporate, who are Members of a company, are represented by a single individual, each of the bodies corporate should be treated as personally present through that individual representing such bodies corporate. For instance, if a representative represents three bodies corporate, his presence should be counted as three Members being present in person for purpose of Quorum [*Maclead (Neil) & Sons Ltd., Petitioners, 1967 Scottish Law Times 46*].

Members who have voted by remote e-voting have the right to attend the General Meeting and accordingly their presence shall be, counted for the purpose of quorum.

A member who is not entitled to vote on any particular item of business being a related party, if present, shall be counted for the purpose of quorum.

The stipulation regarding the presence of a quorum does not apply with respect to items of business transacted through postal ballot.

One-Man Meeting

It has been clarified by the Department of Company Affairs [now Ministry of Corporate Affairs] that a single Member present cannot, by himself, constitute a Quorum [Circulars and Clarifications Co. Law & SEBI, P1 198 vide File No.8/16/ (1)/61-PR]. Such general rule against a one–man Meeting has also been settled through judicial decisions.

There are, however, some exceptions to this general rule which permit a Meeting to be constituted of only one Member. These are:

- Where a person holds all the shares of a class, that person may constitute a class Meeting.
- Where default is made in holding an Annual General Meeting in accordance with Section 96 of the Act, the Tribunal while ordering the convening of the Meeting, may direct that one Member present in person or by proxy will constitute the Quorum [Proviso to sub-section (1) of Section 97 of the Act].
- Where it is impracticable to call a Meeting in the manner prescribed by the Act or the Articles, the Tribunal may order a Meeting to be held and direct that one Member present in person or by Proxy shall be deemed to constitute a Meeting [Proviso to sub–section (1) of Section 98 of the Act].

Consequences of no quorum- If the quorum is not present within half-an-hour from the time appointed for holding a meeting of the company–

(a) the meeting shall stand adjourned to the same day in the next week at the same time and place, or to such other date and such other time and place as the Board may determine; or

(b) the meeting, if called by requisitionists (under section 100), shall stand cancelled.

Donee of a general power of attorney not deemed as Proxy:

If any Member of a company has given a general power-of-attorney in favour of some other person to make investments on his behalf and to attend to all matters incidental and consequential thereto including attending General Meetings of companies in which investments are so made and if at General Meetings of such companies, the donee is present, then it would be deemed, by virtue of the provisions of Section 3 of the Powers-of-Attorney Act, 1882, that the donor is personally present and the donee will not be deemed to be a Proxy of the donor [*Cf. Tata Iron & Steel Co. Ltd., In Re., AIR 1928 Bom. 80]*.

Chairman of Meetings (Section 104)

Unless the articles of the company otherwise provide, the members personally present at the meeting shall elect one of themselves to be the Chairman thereof on a show of hands.

If a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of this Act and the Chairman elected on a show of hands shall continue to be the Chairman of the meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the meeting.

1. In case of private company - Section 104 shall apply ,unless otherwise specified in respective sections or the articles of the company provide otherwise. - Notification dated 5th June, 2015.
2. In case of Specified IFSC Public Company - Section 104 shall apply, unless otherwise specified in the articles of the company. Notification Date 4th January, 2017.

Secretarial Standard on appointment and role of Chairman:

Para 5 of SS-2 provides that the Chairman of the Board shall take the chair and conduct the Meeting.

If the Chairman is not present within fifteen minutes after the time appointed for holding the Meeting, or if he is unwilling to act as Chairman of the Meeting, or if no Director has been so designated, the Directors present at the Meeting shall elect one of themselves to be the Chairman of the Meeting. If no Director is present within fifteen Minutes after the time appointed for holding the Meeting, or if no Director is willing to take the chair, the Members present shall elect, on a show of hands, one of themselves to be the Chairman of the Meeting, unless otherwise provided in the Articles.

If a poll is demanded on the election of the Chairman, it shall be taken forthwith in accordance with the provisions of the Act and the Chairman elected on a show of hands shall continue to be the Chairman of the Meeting until some other person is elected as Chairman as a result of the poll, and such other person shall be the Chairman for the rest of the Meeting.

The Chairman shall ensure that the Meeting is duly constituted in accordance with the Act and the Articles or any other applicable laws, before it proceeds to transact business. The Chairman shall then conduct the Meeting in a fair and impartial manner and ensure that only such business as has been set out in the Notice is transacted. The Chairman shall regulate the manner in which voting is conducted at the Meeting keeping in view the provisions of the Act.

Para 5.2 of SS-2 requires that the Chairman shall explain the objective and implications of the Resolutions before they are put to vote at the Meeting.

The Chairman shall provide a fair opportunity to Members who are entitled to vote to seek clarifications and/or offer comments related to any item of business and address the same, as warranted.

Para 5.3 of SS-2 provides that in case of public companies, the Chairman shall not propose any Resolution in which he is deemed to be concerned or interested nor shall he conduct the proceedings for that item of business.

If the Chairman is interested in any item of business, without prejudice to his Voting Rights on Resolutions, he shall entrust the conduct of the proceedings in respect of such item to any dis-interested Director or to a Member, with the consent of the Members present, and resume the Chair after that item of business has been transacted.

Para 4.1.1 of SS-2 provides that if any Director is unable to attend the Meeting, the Chairman shall explain such absence at the Meeting.

Para 4.1.2 of SS-2 requires that Directors who attend General Meetings of the company and the Company Secretary shall be seated with the Chairman. The Company Secretary shall assist the Chairman in conducting the Meeting.

PRESENCE OF STATUTORY AUDITOR AND SECRETARIAL AUDITOR

Section 146 of the Act requires the presence to Auditors in general meetings unless otherwise exempted, either himself or through his authorized representative, who shall also be qualified to be an auditor and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor. Para 4.2 of SS-2 also requires the same.

Similarly, para 4.3 of SS-2 requires the secretarial auditor, unless exempted by the company shall, either by himself or through his authorized representative, attend the Annual General Meeting and shall have the right to be heard at such Meeting on that part of the business which concerns him as Secretarial Auditor.

The Chairman may invite the Secretarial Auditor or his authorised representative to attend any other General Meeting, if he considers it necessary.

The authorized representative who attends the General Meeting of the company shall also be qualified to be a Secretarial auditor.

The authorised representative of the Secretarial Auditor attending the General Meeting on behalf of the Secretarial Auditor should be a person who is a member of the Institute of Company Secretaries of India (ICSI) and eligible for appointment as Secretarial Auditor of the company.

PROXIES (SECTION 105)

A person who is appointed by a member to attend and vote at a meeting in the absence of the member at the meeting is termed as proxy. Thus, proxy is an agent of the member appointing him. The term 'proxy' is also used to refer to the instrument by which a person is appointed as proxy. Section 105 of the Companies Act, 2013 provides that a member, who is entitled to attend and to vote, can appoint another person as a proxy to attend and vote at the meeting on his behalf. This section also provides the manner of appointing proxy. The provisions are as follows.

1. **Who can appoint a proxy:** Any member of a company who is entitled to attend and vote at a meeting of the company shall be entitled to appoint another person as a proxy to attend and vote at the meeting on his behalf.

   The SS-2 added that where allowed, a member can appoint one or more proxies, to attend and vote instead of himself and a Proxy need not be a Member.

   A Proxy shall be a Member in case of companies with charitable objects etc. and not for profit registered under the specified provisions of the Act (a company registered under section 8).

   A Proxy can act on behalf of Members not exceeding fifty and holding in the aggregate not more than ten percent of the total share capital of the company carrying Voting Rights.

However, a Member holding more than ten percent of the total share capital of the company carrying Voting Rights may appoint a single person as Proxy for his entire shareholding and such person shall not act as a Proxy for another person or shareholder.

If a Proxy is appointed for more than fifty Members, he shall choose any fifty Members and confirm the same to the company before the commencement of specified period for inspection. In case, the Proxy fails to do so, the company shall consider only the first fifty proxies received as valid.

In every notice calling a meeting of a company which has a share capital, or the articles of which provide for voting by proxy at the meeting, there shall appear with reasonable prominence a statement that a member entitled to attend and vote is entitled to appoint a proxy, or, where that is allowed, one or more proxies, to attend and vote instead of himself, and that a proxy need not be a member.

If default is made in complying with above provision, every officer of the company who is in default shall be liable to penalty of five thousand rupees.

(2) **Disabilities of proxy:** A proxy shall not have the right to speak at the meeting. A proxy cannot vote on a show of hands. A proxy is not counted for the purpose of quorum.

(3) **Rights of proxy:** A proxy has the right to attend the meeting. A proxy has the right to vote only on a poll. A proxy, if eligible under section 109, has the right to demand a poll.

(4) **Restriction on proxy:** A member of a company registered under section 8 (Not for Profit Company) shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

A person appointed as proxy shall not act as proxy on behalf of more than fifty members and members holding in the aggregate more than ten percent of the total share capital of the company carrying voting rights.

A member holding more than 10% of the total share capital of the company carrying voting rights may appoint a single person as proxy, provided that such person shall not act as proxy for any other person or shareholder.

(5) **Time limit for deposit of proxy forms:** The instrument appointing the proxy must be deposited with the company, 48 hours before the meeting. Any provision contained in the articles, requiring a longer period than 48 hours shall have effect as if a period of 48 hours had been specified.

In case of a private company, the proxy shall be deposited with the company in accordance with Section 105, unless otherwise provided in the Articles.

In case of listed companies providing e-voting facilities, there is no need to appoint proxy to vote at the meeting. Further, till the permission is in place and the Companies conduct their shareholders meeting through video conferencing or other audio visual means, a person who will log-in the meeting through provided credentials, he will be deem to be personally present. Therefore, the system of Proxy is not relevant in the event of virtual meetings of shareholders.

(6) **The prescribed form for appointing a proxy is Form No. MGT-11:** It needs to be in writing and signed by the appointer or his attorney duly authorised in writing. If the appointer is a body corporate, the instrument should be under its seal or be signed by an officer or an attorney duly authorised by the body corporate. An instrument appointing a proxy, if in **Form MGT-11,** shall not be questioned on the ground that it fails to comply with any special requirement specified for such instrument by the article of a company.

Other provisions in Secretarial Standard w.r.t. proxies (Para 6):

1. **Deposit of proxies:** Para 6.6.1 of SS-2 provides that proxies shall be deposited with the company either in person or through post not later than forty-eight hours before the commencement of the Meeting in relation to which they are deposited and a Proxy shall be accepted even on a holiday if the last date by which it could be accepted is a holiday.

2. **Records of proxies:** All Proxies received by the company shall be recorded chronologically in a register kept for that purpose. In case any Proxy entered in the register is rejected, the reasons therefor shall be entered in the 'remarks' column.

   The instrument of Proxy shall be signed by the appointer or his attorney duly authorized in writing, or if the appointer is a body corporate, be under its seal or be signed by an officer or an attorney duly authorized by it.

   An instrument of Proxy duly filled, stamped and signed, is valid only for the Meeting to which it relates including any adjournment thereof.

   It is valid only if it is properly stamped as per the applicable law. Unstamped or inadequately stamped Proxies or Proxies upon which the stamps have not been cancelled are invalid.

   The Proxy-holder shall prove his identity at the time of attending the Meeting.

   An authorized representative of a body corporate or of the President of India or of the Governor of a State, holding shares in a company, may appoint a Proxy under his signature.

   The Proxy form which does not state the name of the Proxy shall not be considered valid. Also undated proxy shall not be considered valid.

   If a company receives multiple proxies for the same holdings of a Member, the Proxy which is dated last shall be considered valid; if they are not dated or bear the same date without specific mention of time, all such multiple Proxies shall be treated as invalid.

   ***Let us remember**: The prescribed proxy form is Form No. MGT 11*

   Illustration:

   Assume that the General Meeting of a company is scheduled on 22nd September 2020 and company has received 4 proxies for the same holdings of a Member dated with 5th, 12th, 10th and 20th September 2020. The proxy dated last should be considered valid i.e. 20th. However, if the proxies received are not dated or bear the same date without mention of time, all proxies should be treated as invalid.

3. **Inspection of proxy:** Every member entitled to vote at a meeting of the company, or on any resolution to be moved thereat, is entitled to inspect the proxies lodged with the company, if at least 3 days' notice in writing is given to the company. Such notice shall be received at least three days before the commencement of the Meeting. Such inspection can be taken during the period beginning 24 hours before the time fixed for the commencement of the meeting, during the business hours of the company, and ending with the conclusion of the meeting. Such inspection should be allowed between 9:00 am and 6:00 pm during such period.

   A fresh requisition confirming to the above requirements, shall be given for inspection of Proxies in case the Original Meeting is adjourned.

4. **Revocation of proxy:** If after appointment of proxy, the member himself attends the meeting, it amounts to automatic revocation of proxy. But once the proxy has voted, it cannot be revoked.

   Para 6.7.1 provides that if a Proxy had been appointed for the original meeting and such meeting is

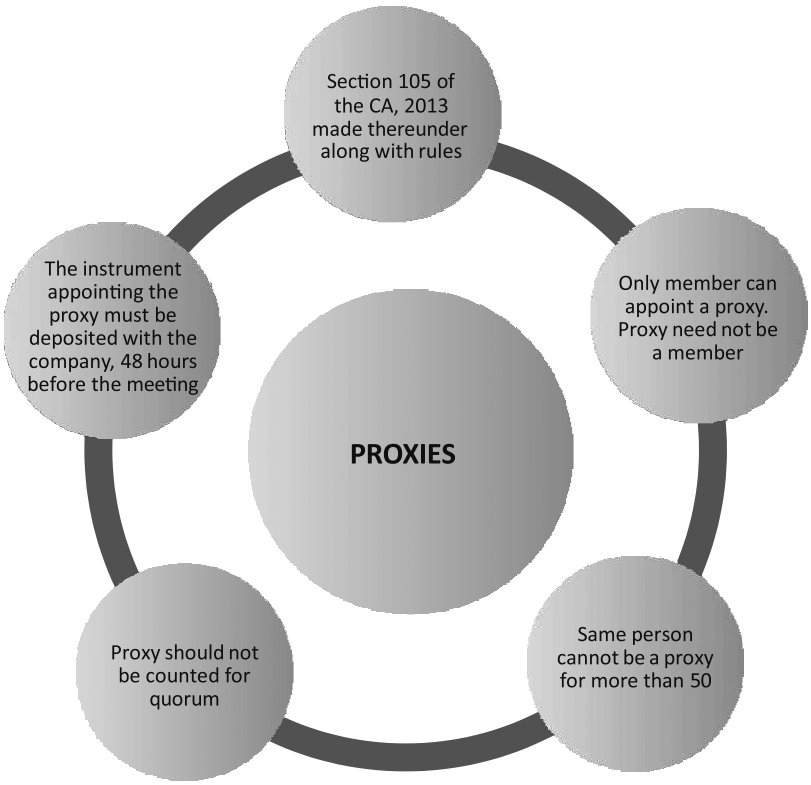
adjourned, any Proxy given for the adjourned Meeting revokes the Proxy given for the original Meeting.

Para 6.7.2 provides that a proxy later in date revokes any Proxy/Proxies dated prior to such Proxy.

Para 6.7.3 provides that a Proxy is valid until written notice of revocation has been received by the company before the commencement of the Meeting or adjourned Meeting, as the case may be.

An undated notice of revocation of Proxy shall not be accepted. A notice of revocation shall be signed by the same Member (s) who had signed the Proxy, in the case of joint Membership.

A Proxy need not be informed of the revocation of the Proxy issued by the Member.



Illustrations:

Question: Annual General Meeting of a Public Company was scheduled to be held on 15.12.2020. Mr. A, a shareholder, issued two Proxies in respect of the shares held by him in favor of Mr. 'X' and Mr. 'Y'. The proxy in favor of 'Y' was lodged on 12.12.2020 and the one in favor of Mr. X was lodged on15.12.2020. The company rejected the proxy in favor of Mr. Y as the proxy in favor of Mr. Y was of dated 12.12.2020 and in favor of Mr. X was of dated15.12.2020. Is the rejection by the company in order?

Hint: As per Section 105 of the Companies Act, 2013 a proxy should be deposited 48 hours before the time of the meeting. In the given case, the proxies should have, therefore, been deposited on or before 13.12.2020 (the date of the meeting being 15.12.2020). Mr. X deposited the proxy on 15.12.2020.

Therefore, proxy in favour of Mr. X has become invalid. Thus, rejecting the proxy in favour of Mr. Y is unsustainable. Proxy in favor of Mr. Y is valid since it is deposited in time.

Question: The Chairman of the meeting of a public company received a Proxy 54 hours before the time fixed for the start of the meeting. He refused to accept the Proxy on the ground that the Articles of the company provided that a Proxy must be filed 60 hours before the start of the meeting. Decide, under the provisions of the Companies Act, 2013 whether the Proxy holder can compel the Chairman to admit the Proxy?

Hint: As per Section 105 of the Companies Act, 2013 proxy shall be deposited with the company within 48 hours before the meeting.

Any provisions contained in the Articles of a company that requires a longer period than 48 hours before a meeting of the company for depositing a proxy shall be void. Thus, contention of Mr X is valid.

Question: Mr. A, a member of XYZ Limited, appoints Mr. B as his proxy to attend the general meeting of the company. Later he (Mr. A) also attends the meeting. Both Mr. A (the member) and Mr. B (the proxy) voted on a particular resolution in the meeting. Mr. A's vote was declared invalid by the chairman stating that since he has appointed the proxy and Mr. B's vote has been considered as valid. Mr. A objects to the decision of the Chairman. Decide, under the provisions of the Companies Act, 2013 whether Mr. A's objection shall be taxable.

Hint: Decision by Chairman is invalid. Since Mr. A i.e. a member himself attended a meeting and voted on resolution, it will amount to revocation of proxy. Thus, any vote put by Mr. B i.e. proxy shall be invalid.

Question: (1) Mr. A holds 10% of the total share capital of the Company and appoints Mr. B as the proxy holder. Can Mr. B accept appointment as proxy by any other shareholder?

Hint : Mr. B cannot accept appointment as proxy by any other shareholder.

(2) Mr. C has been appointed as the proxy holder by 48 members. Mr. D, Mr. E and Mr. F are also interested in appointing Mr. C as their proxy. Can they do so?

Hint : Mr. C cannot be appointed as proxy by more than 50 members and hence he can accept appointment only by 2 members out of the three (i.e. Mr. D, Mr. E and Mr. F). However, the aggregate shareholding of the 50 members should not exceed 10% of the total share capital of the Company.

PROCESS OF CONDUCTING MEETING

The procedure for conducting the Annual General Meeting is explained in detail below:

A. Before the General meeting:

1. **Conduct a Board Meeting (section 173):** The board Meeting will be conducted:

   a) To consider and discuss the report of Audit Committee, if any on the Annual accounts.

   b) To approve the accounts and authorize signing of accounts.

   c) To secure Auditor's report on the accounts.

   d) To approve the draft of the Board's Report incompliance with the provisions of Section 134 of the Companies Act, 2013 and to authorise the Chairman/Director to sign the Report on behalf of the Board.

   e) To consider the payment of Dividend/ Record Date, if any, in case it is to be declared in the Annual General Meeting.

   f) To fix the day, date, time, place and agenda for the Annual General Meeting.

   g) To approve the draft notice of AGM along with explanatory statement.

   h) To fix period of book closure.

i) To authorize Company Secretary or any other officer to issue notice of General Meeting to every member or to every person entitled to receive this notice.

j) The Companies which provide remote e-voting facility shall pass the below mentioned resolutions also:

- To appoint scrutiniser for e-voting;
- To appoint an agency for remote e- voting;
- To decide the cut-off date for the purpose of reckoning the names of members who are entitled to voting rights;
- To authorise the Chairman or in his absence, any other director to receive the Scrutinizer's register, report on e-voting and other related papers with requisite details.

[*prior intimation of at least two working days in advance, excluding the date of the intimation and date of the meeting, to stock exchange about the meeting of the board of directors in which any of the proposals is due to be considered i.e. financial results viz. quarterly, half yearly, or annual, as the case may be; declaration/ recommendation of dividend [Regulation 29 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015*].

2. Notice of General Meeting: Issue notice to the shareholders, for at least 21 clear days before the date of annual general meeting and where it is to be sent by post, it should be posted 48 hours still earlier in terms of section 101. In case of section 8 companies, 14 clear days' notice is sufficient for general meeting.

- ✓ Notice shall have (complete address of the venue, date, time and agenda of the meeting) including documents such as:
- ✓ Attendance slip, Proxy form, Route map, Explanatory statement.
- ✓ Directors Report + all Annexure.
- ✓ Statutory Auditors Report.
- ✓ Financial Statement (including Balance Sheet +Profit & Loss Statement + Cash Flow Statement + Notes to Accounts+ Schedules).
- ✓ A statement setting out the material facts concerning each item of the special business to be transacted at a general meeting shall be annexed to the notice.

As per regulation 17(11) of SEBI (LODR) Regulations, the statement to be annexed to the notice as referred to in sub-section (1) of section 102 of the Companies Act, 2013 for each item of special business to be transacted at a general meeting shall also set forth clearly the recommendation of the board to the shareholders on each of the specific items. In case of companies having a website, such Notice shall simultaneously be hosted on the website.

[*The listed entity shall send Notice of AGM to stock exchange as soon as reasonably possible and not later than twelve hours from the dispatch of notice to shareholders (Regulation 30 of the SEBI (LODR) Regulations, 2015)*].

Regarding Annual Report- The listed entity shall submit to the stock exchange and publish on its website, a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders. In the event of any changes to the annual report, the revised copy along with the details of

and explanation for the changes shall be sent not later than 48 hours after the annual general meeting. (Regulation 34 of the SEBI (LODR) Regulations, 2015).

Any accidental omission to give notice to, or the non-receipt of such notice by, any member or other person who is entitled to such notice for any meeting shall not invalidate the proceedings of the meeting.

3. **Shorter Notice:** Annual General Meeting may be called after giving shorter notice than that specified if consent, in writing or by electronic mode, is accorded thereto, by not less than 95% of the members entitled to vote thereat.

4. **Sending of Notice:** Notice shall be sent by hand delivery/ ordinary post /speed post/ registered post /courier/ facsimile/ email or by any other electronic means. The Notice in case of e-voting should not be served through hand delivery or ordinary post. Notice shall be given to:

   - ✓ Every Member of the company (legal representative of deceased member or assignee of an insolvent member);
   - ✓ All Directors of the Company;
   - ✓ Auditors of the Company;
   - ✓ Debenture Trustees, if any; and,
   - ✓ Wherever applicable or so required, to other specified persons.

5. **Advertisement:**

   In case company is required to pass the resolution through E-Voting an advertisement to be published, immediately on completion of dispatch of notices for the meeting but at least 21 clear days before the date of general meeting, at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having country-wide circulation.

   The listed entity shall send a copy of Advertisement to stock-exchange as soon as reasonably possible and not later than twelve four hours from the publication. (Regulation 30 of the SEBI (LODR) Regulations, 2015.

   In case of book closure, at least 7 days previous notice shall be given, by advertisement at least once in a vernacular newspaper in the principal vernacular language of the district and having a wide circulation in the place where the registered office of the company is situated, and at least once in English language in an English newspaper circulating in that district and having wide circulation in the place where the registered office of the company is situated and publish the notice on the website as may be notified by the Central Government and on the website, if any, of the Company.

   Note : The above provision shall not be applicable to a private company provided that the notice has been served on all members of the private company not less than seven days prior to closure of the register of members or debenture holders or other security holders. The listed entity shall give notice in advance of at least 7 working days (excluding the date of intimation and the record date) to stock exchange(s) of record date specifying the purpose of the record date.

6. **Remote e-voting and ballot at the Meeting:** Remote E-voting has to remain open for at least three days and should close by 5 p.m. preceding the date of AGM.

7. **Proxy Register:** Ensure the proxy forms are received by the Company at least 48 hours before the time fixed for holding the AGM (including major shareholders and representation letters from financial institutions) and shall be recorded chronologically in a register kept for that purpose. In case, any Proxy entered in the Register is rejected, the reasons therefor shall be entered in the Remarks column.

8. **Documents for Inspection at AGM:**

   - ✓ Register of Contracts or Arrangements in which Directors are interested 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.
   - ✓ Register of Directors and KMP
   - ✓ Proxies can be inspected from 24 hours before AGM time till AGM conclusion time
   - ✓ All docs referred to in Notice of AGM/Statutory Registers.

B. Convene a General Meeting:

1. **Documents to be made available at the venue:** Ensure that the copy of Financial Statements, copies of Notice of the Meeting, Ballot Form, Register of Members, Proxy register, Attendance Slips, Attendance Register, Memorandum & Articles of Association of the Company, Annual Report, AGM /EGM Minutes Book, etc. are to be kept ready at the meeting**.**
2. **Presence of Quorum:** Check the presence of Quorum for convening the meeting. Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.
   - ✓ Private Company -2 members personally present
   - ✓ Public Company –
     - 5 members personally present - not more than 1000 members;
     - 15 members personally present - more than 1000 but up to 5000 members;
     - 30 members personally present - if the number of members as on the date of the meeting exceeds 5000.
3. **Chairman:** The Chairman of the Board shall take the Chair and conduct the Meeting. If the Chairman is not present within fifteen Minutes after the time appointed for holding the Meeting, or if he is unwilling to act as Chairman of the Meeting, or if no Director has been so designated, the Directors present at the Meeting shall elect one of themselves to be the Chairman of the Meeting. If no Director is present within fifteen Minutes after the time appointed for holding the Meeting, or if no Director is willing to take the chair, the Members present shall elect, on a show of hands, one of themselves to be the Chairman of the Meeting, unless otherwise provided in the Articles. The chairman's overall job is to ensure the GM is held in a fair and legal manner. In case of equality of votes, he has a casting vote. The Chairman of the Audit Committee is present at annual general meeting to provide any clarification on matters relating to audit and to answer shareholder queries; for listed entities, the Chairperson of the Stakeholders Relationship Committee shall also be present at the annual general meetings to answer queries of the security holders.
4. **Matters to be transacted in the meeting:** Hold AGM to transact the following business:

   Ordinary Business [Section 102(2)]:

   - ✓ Consideration of financial statements and reports of the Board of Directors and the Auditors.

- ✓ Declaration of dividend.
- ✓ Appointment of Directors in place of those retiring.
- ✓ Appointment of and Fixation of the remuneration of the auditors.

Special Business [Section 102(b)]: Apart from the above businesses, the rest are deemed to be a Special business, transacted during the AGM.

5. **The qualifications, observations or comments made by the Auditors [SS-2]:** The qualifications, observations or comments or other remarks on the financial transactions or matters which have any adverse effect on the functioning of the company, if any, mentioned in the Statutory Auditor's Report shall be read at the Annual General Meeting and attention of the Members present shall be drawn to the explanations / comments given by the Board of Directors in their report.
6. **Voting:** Where e-voting is not provided, ever resolution in the notice shall be put to vote by way of show of hands unless a poll is demanded under section 109.

   Where e-voting is provided, every resolution in the notice shall be put to vote by way of electronic ballot or voting. Members who have already voted on that resolution can attend the meeting but cannot vote again.

   [The listed entity shall submit to the stock exchange, within 2 working days of conclusion of its Annual General Meeting, details regarding the voting results in the format specified by the Regulation 44 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015].
7. The top 100 listed entities shall provide one-way live webcast of the proceedings of the Annual General Meetings under Regulation 44(6) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

   [*Omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f. 31.12.2024*].

C. After the Meeting:

1. **Preparation of Minutes:** The Minutes of proceedings of AGM should be entered in the books maintained for that purpose within 30 days from the date of conclusion of AGM along with the date of such entry. Minutes to be signed by the Chairman or in the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for the purpose within 30 days of AGM.
2. **Appointment/Reappointment of Auditors:** Filing of Form ADT- 1 within 15 days of AGM (in case of appointment/re-appointment of auditors).
3. **Appointment/Reappointment of Directors:** Send an intimation to ROC in case of appointment/ re-appointment of directors by filing form DIR-12 within 30 days from the appointment.
4. **Filing of Financial Statements & Annual Return:** File the balance sheet, profit and loss account, reports of the directors and the auditors and the notice of the meeting in Form AOC-4 within 30 days of the meeting. In case of companies covered under XBRL filing, it should be ensured that the annual accounts are filed in XBRL format. Ensure that a copy of Secretarial Audit Report obtained from a Secretary in whole time practice as required under Section 204(1) of the Act, if any, is filed with Registrar of Companies within 30 days from the date of annual general meeting and filing Form MGT 7 within 60 days of AGM (Annual Return).
5. **Filing of Resolutions:** Filing of Special/Board Resolutions in Form MGT 14 as applicable within 30 days of passing the Resolution.

6. **Report of AGM:** In the case of listed companies, a report of the annual general meeting in form MGT-15 should be submitted to ROC within 30 days of the conclusion of the annual general meeting.
7. **Reporting under SEBI (LODR) Regulation, 2015:** As provided in regulation 30 read with Schedule III Part A of SEBI (LODR) Regulations, 2015, every listed company is required to disclose the proceedings of annual general meeting to the stock exchange where its securities are listed within 12 hours of the event.

VOTING

Restriction on Voting Rights (Section 106)

The articles of a company may provide that a member shall not exercise any voting right in respect of any shares registered in his name on which any calls or other sums presently payable by him have not been paid or on which company has exercised any right or lien. No member can be prohibited from exercising his voting right on any other ground.

Voting by Show of Hands (Section 107)

At any general meeting, a resolution put to the vote of the meeting shall in the first instance be decided on a show of hands, unless-

(a) A poll is demanded under section 109 of the Act.

(b) Voting is carried out electronically under section 108 of the Act.

A declaration by the Chairman of the meeting of the passing of a resolution (that the resolution has been passed or failed, as the case may be) on show of hands and an entry to that effect in the minutes book shall be conclusive evidence of the fact of passing of such resolution. No proof of numbers of votes casts in favor of and against the resolution is required.

In case of private company – Section 107 shall apply, unless otherwise specified in respective sections or the articles of the company provide otherwise – Notification dated 5th June, 2015

Voting through Electronic Means (Section 108)

General meetings of companies are held at their registered offices and it is not possible for every member specially members holding minor shares to travel up to the registered office of the company and participate in the general meetings of the company.

To eliminate this type of difficulty and to enhance the participation of minority members, concept of e-voting has been introduced by the Companies Act 2013. Now, a member can cast his vote easily through electronic mode without physically attending the general meeting.

E-voting do not eliminate members right to physically attend and vote at the general meeting. However, member can cast his vote through one mode only. A member after casting his vote through e-voting can go and attend the general meeting but cannot cast vote in that general meeting.

The facility of Remote e-voting does not dispose with the requirements of holding a General Meeting by the company.

Applicability: Section 108 of the Act r/w Rule 20 of the Companies (Management and Administration) Rules, 2014 shall apply to such companies as may be prescribed by the Central Government. The prescribed class of companies, for this purpose, are-

(i) All companies whose equity shares are listed on a recognized stock exchange; and

(ii) All companies having 1000 or more members.

However, the provisions of section 108 shall not apply to a Nidhi, or an enterprise or institutional investor referred to in chapter XB (Companies listed on SME exchange) or chapter XC (Companies listed on institutional trading platform without IPO) of the SEBI (Issue of Capital and Depository Receipt) Regulations, 2009.

Following companies are out of ambit of mandatory e-voting:-

(i) Companies whose debenture/preference shares only are listed.

(ii) Companies listed on SME trading platform.

(iii) Companies listed on institutional trading platform.

Legal Requirement:

(a) A company to which section 108 is applicable, shall provide to its members facility to exercise their right to vote on resolution proposed at general meetings by electronic means.

(b) a resolution proposed to be considered through voting by electronic means shall not be withdrawn.

Voluntary Applicability of Rule 20 (i.e. Voting by Electronic Means)

A member may exercise his right to vote through voting by electronic means in resolutions referred to in Rule 20 (2) of the Companies (Management and Administration) Rules, 2014 and the company shall pass such resolutions in accordance with the provisions of this rule. If a company voluntarily opts or decides to give its shareholders the e-voting facility, in such a case, the whole of procedure specified in rule 20 shall be applicable to such a company. This is necessary so that any piece-meal application does not prejudice the interest of shareholders.

Companies voluntarily adopting Rule 20 of the Companies (Management and Administration) Rules, 2014 dealing with Voting by Electronic Means should follow the procedure wholly and not in piecemeal.

Key Words w.r.t. E-Voting:

(i) **'agency'** means the National Securities Depository Limited, the Central Depository Services (India) Limited or any other entity approved by the Ministry of Corporate Affairs subject to condition that the National Securities Depository Limited, the Central Depository Services (India) Limited or such other entity has obtained a certificate from the Standardisation Testing and Quality Certification Directorate, Department of Information Technology, Ministry of Communications and Information Technology, Government of India regard to compliance with parameters relating to secured system;

(ii) **'cut-off date'** means a date not earlier than seven days before the date of general meeting for determining the eligibility to vote by electronic means or in the general meeting;

(iii) **'cyber security'** means protecting information, equipment, devices, computer, computer resource, communication device and information stored therein from unauthorised access, use, disclosures, disruption, modification or destruction;

(iv) **'electronic voting system'** means a secured system based process of display of electronic ballots, recording of votes of the members and the number of votes polled in favour or against, in such a manner that the entire voting exercised by way of electronic means gets registered and counted in an electronic registry in a centralised server with adequate cyber security;

(v) **'remote e-voting**' means the facility of casting votes by a member using an electronic voting system from a place other than venue of general meeting;

(vi) **'secured system'** means computer hardware, software, and procedure that-

(a) are reasonably secure from unauthorised access and misuse;

(b) provide a reasonable level of reliability and correct operation;

(c) are reasonably suited to performing the intended functions; and

(d) adhere to generally accepted security procedures;

(vii) '**voting by electronic mean'** includes "remote e-voting and voting" at the general meeting through an electronic voting system which may be the same as used for remote e-voting.

Procedure of E-Voting

The Board shall:

(a) Appoint one or more scrutinisers for e-voting or the ballot process:

The scrutiniser(s) may be a Company Secretary in Practice, a Chartered Accountant in Practice, a Cost Accountant in Practice, or an Advocate or any other person of repute who is not in the employment of the company and who can, in the opinion of the Board, scrutinise the e-voting process or the ballot process, as the case may be, in a fair and transparent manner.

The scrutiniser(s) so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the e-voting system. The scrutiniser shall be willing to be appointed and be available for the purpose of ascertaining the requisite majority.

Prior consent to act as a scrutiniser(s) shall be obtained from the scrutiniser(s) and placed before the Board for noting.

(b) Appoint an Agency – NSDL, CDSL or other such agency:

The agency shall be appointed for providing and supervising the electronic platform for voting.

(c) Decide the cut-off date for the purpose of reckoning the names of Members who are entitled to Voting Rights:

The cut-off date for determining the Members who are entitled to vote through Remote e-voting or voting at the meeting shall be a date not earlier than seven days prior to the date fixed for the Meeting.

Only Members as on the cut-off date, who have not exercised their Voting Rights through Remote e-voting, shall be entitled to vote at the Meeting.

SS-2 provides that every company providing e-voting facility shall offer such facility to all Members, irrespective of whether they hold shares in physical form or in dematerialised form.

(d) Authorise the Chairman or in his absence, any other Director to receive the scrutiniser's register, report on e-voting and other related papers with requisite details:

(i) The scrutiniser(s) is required to submit his report within a period of three days from the date of the meeting.

(ii) The Chairman or any other director so authorized shall countersign the scrutiniser's report so received.

(e) Notice:

A company which provides the facility to its members to exercise voting by electronic means shall comply with the following procedure, namely:-

(i) the notice of the meeting shall be sent to all the members, directors and auditors of the company either:-

(a) by registered post or speed post ; or

(b) through electronic means, namely, registered e-mail ID of the recipient; or

(c) by courier service.

The notice shall also be placed on the website, if any, of the company and of the agency forthwith after it is sent to the members.

As per SS-2, such notice shall remain on the website till the date of General Meeting. The notice of the meeting shall clearly state that:-

(i) The company is providing facility for voting by electronic means and the business may be transacted through such voting.

(ii) The facility for voting, either through voting by electronic means or ballot/polling paper shall also be made available at the meeting and members attending the meeting who have not already cast their vote by remote e-voting shall be able to exercise their right at the meeting.

(iii) That the members who have cast their vote by remote e-voting prior to the meeting may also attend the meeting but shall not be entitled to cast their vote again.

(A) Additional Disclosures in notice:

The notice shall –

(i) Indicate the process and manner for voting by electronic means;

(ii) Indicate the time schedule including the time period during which the votes may be cast by remote e-voting;

(iii) Provide the details about the login lD;

(iv) Specify the process and manner for generating or receiving the password and for casting of vote in a secure manner.

(B) Public notice by way of advertisement:

(i) The company shall cause a public notice by way of an advertisement to be published, immediately on completion of dispatch of notice of general meeting.

(ii) The public notice shall be published at least twenty-one days before the date of general meeting, at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having country-wide circulation.

(iii) The public notice shall specify the following matter in the said advertisement;

(a) A statement that the business may be transacted through voting by electronic means;

(b) The date and time of commencement of remote e-voting;

(c) The date and time of end of remote e-voting;

(d) Cut-off date;

(e) The manner in which persons who have acquired shares and become members of the company after the dispatch of notice may obtain the login ID and password;

(f) A statement that –

(i) Remote e-voting shall not be allowed beyond the said date and time;

(ii) The manner in which the company shall provide for voting by members present at the meeting; and

(iii) A member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again in the meeting; and

(iv) A person whose name is recorded in the register of members or in the register of beneficial owners maintained by the depositories as on the cut-off date only shall be entitled to avail the facility of remote e-voting as well as voting in the general meeting;

(g) Website address of the company, if any, and of the agency where notice of the meeting is displayed; and

(h) Name, designation, address, email id and phone number of the person responsible to address the grievances connected with facility for voting by electronic means.

The public notice shall be placed on the website of the company, if any, and of the agency; Such notice shall remain on the website till the date of general meeting.

(C) Remote e-voting:

(i) The facility for remote e-voting shall remain open for not less than three days and shall close at 5.00 p.m. on the date preceding the date of the general meeting.

(ii) During the period when facility for remote e-voting is provided, the members of the company, holding shares either in physical form or in dematerialised form, as on the cut-off date, may opt for remote e-voting.

(iii) Once a member has cast his vote on a resolution, he shall not be allowed to change it subsequently or cast the vote again.

(a) A member may participate in the general meeting even after exercising his right to vote through remote e-voting but shall not be allowed to vote again.

(b) At the end of the remote e-voting period, the facility shall forthwith be blocked.

(D) Register of scrutinizer:

(i) The scrutinizer(s) shall maintain a register either manually or electronically to record the assent or dissent received, mentioning the particulars of name, address, folio number or client ID of the members, number of shares held by them, nominal value of such shares and whether the shares have differential voting rights of members.

(ii) The register and all other papers relating to voting by electronic means shall remain in the safe custody of the scrutinizer(s) until the Chairman considers, approves and signs the minutes and thereafter, the scrutinizer(s) shall hand over the register and other related papers to the company.

(E) Voting at General Meeting:

(i) During general meeting, a company may opt to provide the same electronic voting system as used during remote e-voting, the said facility shall be in operation till all the resolutions are considered

and voted upon in the meeting. In such a case, the members attending the general meeting and who have not exercised their right to vote through remote e-voting, shall be entitled to vote using the electronic voting system.

(ii) At the general meeting, after conclusion of the discussion, the chairman shall, with the assistance of scrutinisers, allow voting on the resolutions, by use of ballot or polling paper or by using an electronic voting system for all those members who are present at the general meeting but have not cast their votes by availing the remote e-voting facility.

(F) Declaration of result of voting:

(i) The scrutinizer shall, immediately after the conclusion of voting at the general meeting, first count the votes cast at the meeting, thereafter unblock the votes cast through remote e-voting in the presence of at least two witnesses not in the employment of the company.

(ii) The scrutinizer shall make, not later than three days of conclusion of the meeting, a consolidated scrutinizer's report of the total votes cast in favor or against, if any, to the Chairman or a person authorized by him in writing who shall countersign the same.

(iii) The Chairman or a person authorized by him in writing shall declare the result of the voting forthwith.

(iv) The result of the voting, with details of the number of votes cast for and against the Resolution, invalid votes and whether the Resolution has been carried or not shall be displayed on the Notice Board of the company at its Registered Office and its Head Office as well as Corporate Office, if any, if such office is situated elsewhere. Further, the results of voting along with the scrutinizer's report shall also be placed on the website of the company, in case of companies having a website and of the Agency, immediately after the results are declared.

(v) The scrutinizers' register, report and other related papers received from the scrutinizer(s) shall be kept in the custody of the Company Secretary or any other person authorised by the Board for this purpose.

(vi) The manner in which members have cast their votes, that is, affirming or negating the resolution, shall remain secret and not available to the Chairman, scrutinizer or any other person till the votes are cast in the general meeting.

(vii) If the requisite number of votes are cast in favor of the resolution, the resolution shall be deemed to be passed on the date of relevant general meeting.

(viii) The results declared along with the report of the scrutinizer shall be placed on the notice board of the company at its registered office and its head office as well as corporate office, if any, if such office is situated elsewhere and on the website of the company, if any, and on the website of the agency immediately after the result is declared by the Chairman.

(ix) In case of companies whose equity shares are listed on a recognized stock exchange, the company shall, simultaneously, forward the results to the concerned stock exchange or exchanges where its equity shares are listed and such stock exchange or exchanges shall place the results on its or their website.

As prescribed under Regulation 44 of SEBI (LODR) Regulations, 2015 –

(1) The listed entity shall provide the facility of remote e-voting facility to its shareholders, in respect of all shareholders' resolutions.

(2) The e-voting facility to be provided to shareholders in terms of sub-regulation (1), shall be provided in compliance with the conditions specified under the Companies (Management and Administration) Rules, 2014, or amendments made thereto.

(3) The listed entity shall submit to the stock exchange, within two working days of conclusion of its General Meeting, details regarding the voting results in the format specified by the Board.

DEMAND FOR POLL (SECTION 109)

Before or on the declaration of the result of the voting on any resolution on show of hands, a poll may be ordered to be taken by the Chairman of the meeting on his own motion, and shall be ordered to be taken by him on a demand made in that behalf by the following person(s):

(a) **in the case a company having a share capital:** by the members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power or holding shares on which an aggregate sum of not less than Rs.5,00,000/- or such higher amount as may be prescribed, has been paid-up; and

(b) **in the case of any other company:** by any member or members present in person or by proxy, where allowed, and having not less than one-tenth of the total voting power.

The Chairman shall get the validity of the demand verified.

The demand for a poll may be withdrawn at any time by the persons who made the demand.

Time for taking poll and declaring the result

A poll shall be taken forthwith, if it is demanded for adjournment of the meeting or appointment of Chairman of the meeting.

A poll shall be taken at such time, not being later than 48 hours from the time when the demand was made on any other question. The Chairman shall announce the date, venue and time of taking the poll to enable members to have adequate and convenient opportunity to exercise their votes.

Further, the Chairman may permit any member who so desires to be present at the time of counting the votes. The Chairman shall inform the members, the modes and the time of such communication, which shall in any case be within 24 hours of closer of meeting in case the date, venue and time of taking poll not announced.

Where a poll is to be taken, the Chairman of the meeting shall appoint such number of persons, as he deems necessary, to scrutinise the poll process and votes given on the poll and to report thereon to him in the manner as may be prescribed.

The result of the poll shall be deemed to be the decision of the meeting on the resolution on which the poll was taken.

MANNER TO GET POLL PROCESS SCRUTINIZED

Rule 21 of Companies (Management and Administration) Rules, 2014 provides that the chairman of a meeting shall ensure that –

- The Scrutinizers are provided with the Register of Members, specimen signatures of the members, Attendance Register and Register of Proxies.
- The Scrutinizers are provided with all the documents received by the Company pursuant to sections 105, 112 and section 113.

- The Scrutinizers arrange the Polling papers and distribute them to the members and proxies present at the meeting. In case of joint shareholders, the polling paper shall be given to the first named holder or in his absence to the joint holder attending the meeting as appearing in the chronological order in the folio. The Polling paper shall be in Form No. MGT-12.
- The Scrutinizers shall keep a record of the polling papers received in response to poll, by initialing it.
- The Scrutinizers lock and seal an empty polling box in the presence of the members and proxies.
- The Scrutinizers open the Polling box in the presence of two persons as witnesses after the voting process is over.
- In case of ambiguity about the validity of a proxy, the Scrutinizers decide the validity in consultation with the Chairman.
- The Scrutinizers shall ensure that if a member who has appointed a proxy has voted in person, the proxy's vote shall be disregarded.
- The Scrutinizers shall count the votes cast on poll and prepare a report thereon addressed to the Chairman.
- Where voting is conducted by electronic means, the company shall provide all the necessary support, technical and otherwise, to the Scrutinizers in orderly conduct of the voting and counting the result thereof.
- The Scrutinizers' report state total votes cast, valid votes, votes in favour and against the resolution including the details of invalid polling papers and votes comprised therein.
- The Scrutinizers submit the Report to the Chairman who shall counter-sign the same.
- The Chairman declare the result of Voting on poll. The result may either be announced by him or a person authorized by him in writing.

The scrutinizer/s appointed for the poll, shall submit a report to the Chairman of the meeting in **Form No. MGT- 13** within 7 days from the date the poll is taken. The report shall be signed by the scrutinizer or by all the scrutinizers, in case there is more than one scrutinizer.

Note: Sections 102, 103, 104, 105, 106, 107 and 109 shall apply in case of private company unless otherwise specified in respective sections of articles of the company provided otherwise.

POSTAL BALLOT (SECTION 110)

Meaning of postal ballot: As per section 2(65) "postal ballot" means voting by post or through any electronic mode. It includes voting by shareholders by postal or electronic mode instead of voting personally for transacting businesses in a general meeting of the company.

Company shall transact such items of business as the Central Government may, by notification, declare to be transacted only by means of postal ballot. Provided that any item of business required to be transacted by means of postal ballot under Section 110(*a*), may be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108, in the manner provided in that section.

A company may use postal ballot for transacting any item of business, other than-

(i) Ordinary business; and

(ii) Any business in respect of which directors or auditors have a right to be heard at any meeting.

Each item proposed to be passed through postal ballot shall be in the form of a Resolution and shall be accompanied by an explanatory statement which shall set out all such facts as would enable a Member to understand the meaning, scope and implications of the item of business and to take a decision thereon.

A company shall send a notice and draft resolution by registered post or speed post, or by courier or by e-mail or by any other electronic means to all shareholders explaining the reasons and requesting them to send their assent or dissent in writing on a postal ballot. If a resolution is assented to by the requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting convened in that behalf.

Meaning of requisite majority: Requisite majority with regard to special resolution means votes cast in favor of the business is three times more than the votes cast against, with regard to ordinary resolution, votes cast in favor is more than the votes cast against.

CASE LAW

It was held in the case of *Wadala Commodities Ltd., In re (2014)* by the High Court of Bombay that resolution approving scheme of amalgamation should not be passed by shareholders only by way of voting through postal ballots or through electronic means in complete substitution of an actual meeting of shareholders.

Business to be transacted through postal ballot: [Rule 22 of the Companies (Management and Administration) Rules, 2014]

The following items of business shall be transacted only by means of voting through postal ballot:

(a) Alteration of the objects clause of the memorandum and in the case of the company in existence immediately before the commencement of the Act, alteration of the main objects of the memorandum;

(b) Alteration of articles of association in relation to insertion or removal of provisions defining a private company;

(c) Change in place of registered office outside the local limits of any city, town or village;

(d) Change in objects for which a company has raised money from public through prospectus and still has any unutilized amount out of the money so raised;

(e) Issue of shares with differential rights as to voting or dividend or otherwise;

(f) Variation in the rights attached to a class of shares or debentures or other securities;

(g) Buy-back of shares by a company;

(h) Election of a 'small shareholders' director;

(i) Sale of the whole or substantially the whole of an undertaking of a company;

(j) Giving loans or extending guarantee or providing security exceeding 60% of its paid up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account;

Any item of business required to be transacted by means of postal ballot (as stated above), may be transacted at a general meeting by a company which is required to provide the facility to members to vote by electronic means under section 108, in the manner provided in that section.

Following companies are not required to transact any business through postal ballot:-

(i) One person company;

(ii) All other companies having members up to 200.

Rule 22 of the Companies (Management and Administration) Rules, 2014 lay down the procedure to be followed for conducting business through postal ballot.

(1) Notice to all shareholders: The company shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent or dissent in writing on a postal ballot because postal ballot means voting by post or through electronic means within a period of thirty days from the date of dispatch of the notice.

(2) Mode of sending documents: The notice shall be sent:-

(a) By Registered Post or speed post, or

(b) Through electronic means like registered e-mail id; or

(c) Through courier service.

Passing of Resolution by Postal Ballot (Part 16 of SS-2)

(i) Every company, except a company having less than or equal to two hundred Members, shall transact items of business as prescribed, only by means of postal ballot instead of transacting such business at a General Meeting. However, such item of business may be transacted at a General Meeting by a company which is required to provide e-voting facility to its Members. Ordinary Business shall not be transacted by means of a postal ballot.

(ii) Every company having its equity shares listed on a recognised stock exchange other than companies whose equity shares are listed on SME Exchange or on the Institutional Trading Platform and other companies which are required to provide e-voting facility shall provide such facility to its Members in respect of those items, which are required to be transacted through postal ballot.

(iii) The Board shall: (a) identify the businesses to be transacted through postal ballot; (b) approve the Notice of postal ballot incorporating proposed Resolution(s) and explanatory statement thereto; (c) authorise the Company Secretary or where there is no Company Secretary, any Director of the company to conduct postal ballot process and sign and send the Notice along with other documents; (d) appoint one scrutiniser for the postal ballot; (e) appoint an Agency in respect of e-voting for the postal ballot; (f) decide the cut-off date for reckoning Voting Rights and ascertaining those Members to whom the Notice and postal ballot forms shall be sent; (g) decide on the calender of events; (h) authorise the chairman or in his absence, any director to receive the scrutinizer's register, report on postal ballot and other related papers with requisite details.

Secretarial Standard-2 on Notice of postal ballot :

(a) Notice of the postal ballot shall be given in writing to every Member of the company. Such Notice shall be sent either by registered post or speed post, or by courier or by e-mail or by any other electronic means at the address registered with the company.

(b) The Notice shall be accompanied by the postal ballot form with the necessary instructions for filling signing and returning the same. In case the Notice and accompanying documents are sent to Members by e-mail, these shall be sent to the Members' e-mail addresses, registered with the company or provided by the depository, in the manner prescribed under the Act.

(c) Such Notice shall also be given to the Directors and Auditors of the company, to the Secretarial Auditor, to Debenture Trustees, if any, and, wherever applicable or so required, to other specified recipients.

(d) In case of companies having a website, Notice of the postal ballot shall simultaneously be placed on the website.

(e) Notice shall specify the day, date, time and venue where the results of the voting by postal ballot will be announced and the link of the website where such results will be displayed. Notice shall also specify the mode of declaration of the results of the voting by postal ballot.

(f) Notice of the postal ballot shall inform the Members about availability of e-voting facility, if any and provide necessary information thereof to enable them to access such facility.

In case the facility of e-voting has been made available, the provisions relating to conduct of e-voting shall apply, *mutatis mutandis*, as far as applicable.

(g) Notice shall describe clearly the e-voting procedure.

(h) Notice shall also clearly specify the date and time of commencement and end of e-voting, if any and contain a statement that voting shall not be allowed beyond the said date and time. Notice shall also contain contact details of the official responsible to address the grievances connected with the e-voting for postal ballot.

(i) Notice shall clearly specify that any Member cannot vote both by post and e-voting and if he votes both by post and e-voting, his vote by post shall be treated as invalid.

(3) Publishing of an advertisement: The company shall issue an advertisement to be published at least once in a vernacular newspaper in the principal vernacular language of the district in which the registered office of the company is situated, and having a wide circulation in that district, and at least once in English language in an English newspaper having a wide circulation in that district, stating that the ballot papers have been dispatched.

The advertisement shall specify the following matters, namely:-

(a) A statement to the effect that the business is to be transacted by postal ballot which includes voting by electronic means;

(b) The date of completion of dispatch of notices;

(c) The date of commencement of voting (postal and e-voting);

(d) The date of end of voting (postal and e-voting);

(e) The statement that any postal ballot form received from the Member after thirty days from the date of dispatch of Notice will not be valid;

(f) A statement to the effect that members, who have not received postal ballot forms may apply to the company and obtain a duplicate thereof;

(g) The Contact details of the person responsible to address the grievances/queries connected with the voting by postal ballot including voting by electronic means; and

(h) Day, date, time and venue of declaration of results and the link of the website where such results will be displayed.

Notice and the advertisement shall clearly mention the cut-off date as on which the right of voting of the Members shall be reckoned and state that a person who is not a Member as on cut-off date should treat this Notice for information purposes only.

(4) Notice to be placed on the website:

The notice of the postal ballot shall also be placed on the website of the company forthwith after the notice is sent to the members.

Such notice shall remain on such website till the last date for receipt of the postal ballots from the members.

(5) Appointment of scrutinizer: The Board of directors shall appoint one scrutinizer, who is not in employment of the company and who, in the opinion of the Board can conduct the postal ballot voting process in a fair and transparent manner.

The scrutinizer may be a Company Secretary in Practice, a Chartered Accountant in Practice, a Cost Accountant in Practice, an Advocate or any other person of repute who is not in the employment of the company and, who can in the opinion of the Board, scrutinise the postal ballot process in a fair and transparent manner.

The scrutinizer shall however not be an officer or employee of the company. The scrutinizer so appointed may take assistance of a person who is not in employment of the company and who is well-versed with the e-voting system.

Prior consent to act as a scrutinizer shall be obtained from the scrutinizer and placed before the Board for noting.

(6) Safe custody of registers and papers: Postal ballot received back from the shareholders shall be kept in the safe custody of the scrutinizer and after the receipt of assent or dissent of the shareholder in writing on a postal ballot, no person shall deface or destroy the ballot paper or declare the identity of the shareholder.

(7) Submission of report of the scrutinizer: The scrutinizer shall submit his report as soon as possible after the last date of receipt of postal ballots but not later than seven days thereof.

(8) Maintenance of register by the Scrutinizer: The scrutinizer shall maintain a register either manually or electronically to record their assent or dissent received, mentioning the particulars of the shareholder and details of postal ballots which are received in defaced or mutilated form and postal ballot forms which are invalid.

(9) Preservation of postal ballots: The postal ballot and all other papers relating to postal ballot including voting by electronic means, shall be under the safe custody of the scrutinizer till the chairman considers, approves and signs the minutes and thereafter, the scrutinizer shall return the ballot papers and other related papers or register to the company who shall preserve such ballot papers and other related papers or register safely.

(10) Reply from members: The assent or dissent received after thirty days from the date of issue of notice shall be treated as if reply from the member has not been received.

(11) Declaration of result: The results shall be declared by placing it, along with the scrutinizer's report, on the website of the company.

(12) Applicability of Rule 20: The provisions of Rule 20 of Companies (Management and Administration) Rules, 2014 regarding voting by electronic means shall apply, as far as applicable, with the necessary changes to this rule in respect of the voting by electronic means.

A postal ballot form shall be considered invalid if:

(a) A form other than one issued by the company has been used;

(b) It has not been signed by or on behalf of the Member;

(c) Signature on the postal ballot form doesn't match the specimen signatures with the company;

(d) It is not possible to determine without any doubt the assent or dissent of the Member;

(e) Neither assent nor dissent is mentioned;

(f) Any competent authority has given directions in writing to the company to freeze the Voting Rights of the Member;

(g) The envelope containing the postal ballot form is received after the last date prescribed;

(h) The postal ballot form, signed in a representative capacity, is not accompanied by a certified copy of the relevant specific authority;

(i) It is received from a Member who is in arrears of payment of calls;

(j) It is defaced or mutilated in such a way that its identity as a genuine form cannot be established;

(k) Member has made any amendment to the Resolution or imposed any condition while exercising his vote (Para 16.5.3 of SS-2).

Rescinding the Resolution

A Resolution passed by postal ballot shall not be rescinded otherwise than by a Resolution passed subsequently through postal ballot or passed at a General Meeting by a company which is required to provide e-voting facility to its Members. (Para 16.8 of SS-2).

Modification to the Resolution

No amendment or modification shall be made to any Resolution circulated to the Members for passing by means of postal ballot (Para 16.9 of SS-2).

CIRCULATION OF MEMBERS' RESOLUTION (SECTION 111)

As per Section 111, a company shall, on requisition in writing of certain number of members, give notice to members of any proposed resolution intended to be moved in the meeting or circulate any statement with respect to matters referred in proposed resolution.

A company shall not be bound under this section to give notice of any resolution or to circulate any statement unless–

(a) a copy of the requisition signed by the requisitionists (or two or more copies which, between them, contain the signatures of all the requisitionists) is deposited at the registered office of the company,–

  (i) in the case of a requisition requiring notice of a resolution, not less than six weeks before the meeting;

  (ii) in the case of any other requisition, not less than two weeks before the meeting; and

(b) there is deposited or tendered with the requisition, a sum reasonably sufficient to meet the company's expenses in giving effect thereto.

Provided that if, after a copy of a requisition requiring notice of a resolution has been deposited at the registered office of the company, an annual general meeting is called on a date within six weeks after the copy has been deposited, the copy, although not deposited within the time required by this sub-section, shall be deemed to have been properly deposited for the purposes thereof.

The company shall not be bound to circulate any statement, if on the application either of the company or of any other person who claims to be aggrieved, the Central Government, by order, declares that the rights conferred by this section are being abused to secure needless publicity for defamatory matter.

An order may also direct that the cost incurred by the company by virtue of this section shall be paid to the company by the requisitionists, notwithstanding that they are not parties to the application.

If default is made the company and every officer of the company shall be liable to a penalty of twenty-five thousand rupees. .

CASE LAW

Company is not bound to circulate any resolution proposed by shareholders who are not eligible to do so on account of their not having requisite qualification as prescribed under section 188(2)(a) or (b) [Held in *Kotak Mahindra Bank Ltd. v. Sureshchandra v. Parekh (2014)* by Company Law Board, Mumbai Bench]

MAINTENANCE OF MINUTES OF MEETINGS

The minutes refer to a written record of business transacted at a meeting. Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every general meeting, including the meeting called by the requisitionists and all proceedings of meeting of any class of shareholders or creditors or Board of Directors or committee of the Board and also resolution passed by postal ballot within thirty days of the conclusion of every such meeting concerned. In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain name of the directors present and also name of dissenting director or a director who has not concurred the resolution. The chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or detrimental to company's interest in the minutes. Minutes kept shall be evidence of the proceedings recorded in a meeting and containing fair and correct summary of the proceeding thereat.

As per section 118(10) every company shall observe Secretarial Standards with respect to General and Board Meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved as such by the Central Government.

In case of Section 8 Company – section 118 shall not apply as a whole except that minutes may be recorded within thirty days of the conclusion of every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation-*Notification dated 5th June, 2015*.

In case of Specified IFSC Public Company/Specified IFSC Private Company - sub-section (10) of section 118 shall not apply.

If any default is made in complying with the provisions of Section 118 in respect of any meeting, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.

If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

Rule 25 of the Companies (Management and Administration) Rules, 2014 contains provisions with regards to minutes of meetings

(A) Distinct minute book for each type of meeting: A distinct minute book shall be maintained for each type of meeting namely:

(i) general meetings of the members;

(ii) meetings of the creditors;

(iii) meetings of the Board; and

(iv) meetings of the committees of the Board.

It may be noted that resolutions passed by postal ballot shall be recorded in the minute book of general meetings as if it has been deemed to be passed in the general meeting.

(B) Manner of maintenance of minutes: Minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry within thirty days of the conclusion of the meeting.

In case of every resolution passed by postal ballot, a brief report on the postal ballot conducted including the resolution proposed, the result of the voting thereon and the summary of the scrutinizer's report shall be entered in the minutes book of general meetings along with the date of such entry within thirty days from the date of passing of resolution.

(C) Manner of signing of minutes: Each page of every minute book shall be initialed or signed and the last page of the record of proceedings of each meeting or each report in such books shall be dated and signed by:

- in the case of minutes of proceedings of a meeting of the Board or of a committee thereof, by the chairman of the said meeting or the chairman of the next succeeding meeting;
- in the case of minutes of proceedings of a general meeting, by the chairman of the same meeting within the aforesaid period of thirty days or in the event of the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose;
- in case of every resolution passed by postal ballot, by the chairman of the Board within the aforesaid period of thirty days or in the event of there being no chairman of the Board or the death or inability of that chairman within that period, by a director duly authorized by the Board for the purpose.

(D) Preservation of minutes book: Minute books of general meetings shall be kept at the registered office of the company and shall be preserved permanently and kept in the custody of the company secretary or any director duly authorised by the board. Minutes of the Board and committee meetings shall be preserved permanently and shall be kept in the custody of the company secretary of the company or any director duly authorized by the Board for the purpose at the registered office or at such other place as may be approved by the Board.

SECRETARIAL STANDARD-2 ON GENERAL MEETINGS

Secretarial Standard-2 (SS-2) on "General Meetings", issued by the Council of the Institute of Company Secretaries of India and approved by the Central Government, seeks to prescribe a set of principles for the convening and conducting of General Meetings and matters related thereto. This Standard also deals with conduct of e-voting and postal ballot.

SCOPE:

This Standard is applicable to all types of General Meetings of all companies incorporated under the Act except One Person Company (OPC) and a company licensed under Section 8 of the Companies Act, 2013 or corresponding provisions of any previous enactment thereof. However, Section 8 companies need to comply with the applicable provisions of the Act relating to General Meetings.

The exemption to a company registered under Section 8 of the Companies Act, 2013 as referred above and the specific exemptions given to a private company and Government company in this Standard shall be available only if it has not committed any default in filing its Financial Statements or Annual Return with the Registrar of Companies.

The principles enunciated in this Standard for General Meetings of Members are applicable mutatis-mutandis to Meetings of debenture-holders and creditors. A Meeting of the Members or class of Members or debenture-holders or creditors of a company under the directions of the Court or the Company Law Board (CLB) or the National Company Law Tribunal (NCLT) or any other prescribed authority shall be governed by this Standard without prejudice to any rules, regulations and directions prescribed for and orders of, such courts, judicial forums and other authorities with respect to the conduct of such Meetings.

This Standard is in conformity with the provisions of the Act. However, if, due to subsequent changes in the Act, a particular Standard or any part thereof becomes inconsistent with the Act, the provisions of the Act shall prevail.

Preservation of Minutes in case of scheme of Merger and Amalgamation

Where, under a scheme of arrangement, a company has been merged or amalgamated with another company, Minutes of all Meetings of the transferor company, as handed over to the transferee company, shall be preserved permanently by the transferee company, notwithstanding that the transferor company might have been dissolved.

REPORT ON ANNUAL GENERAL MEETING

Every listed public company shall prepare in the prescribed manner a report on each annual general meeting including the confirmation to the effect that the meeting was convened, held and conducted as per the provisions of the Companies Act, 2013 and the rules made thereunder.

As per Rule 31 of the Companies (Management & Administration) Rules, 2014, the copy of the report prepared in pursuance of sub-section (1) of section 121 and sub-rule (1), shall be filed with the Registrar in **Form No. MGT.15** within thirty days of the conclusion of the annual general meeting along with the fee.

The report in pursuance of the provisions of sub-section (1) of section 121 shall be prepared in the following manner, namely:-

(a) the report under this section shall be prepared in addition to the minutes of the general meeting;

(b) the report shall be signed and dated by the Chairman of the meeting or in case of his inability to sign, by any two directors of the company, one of whom shall be the Managing director, if there is one and company secretary of the company;

(c) the report shall contain the details in respect of the following, namely:-

  (i) the day, date, hour and venue of the annual general meeting;

  (ii) confirmation with respect to appointment of Chairman of the meeting;

  (iii) number of members attending the meeting;

  (iv) confirmation of quorum;

  (v) confirmation with respect to compliance of the Act and the Rules, secretarial standards made there under with respect to calling, convening and conducting the meeting;

  (vi) business transacted at the meeting and result thereof;

  (vii) particulars with respect to any adjournment, postponement of meeting, change in venue; and

(viii) any other points relevant for inclusion in the report.

(d) the Report shall contain fair and correct summary of the proceedings of the meeting.

If the company fails to file the report under Section 121(2) before the expiry of the period specified therein, such company shall be liable to a penalty of one lakh rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of five lakh rupees and every officer of the company who is in default shall be liable to a penalty which shall not be less than twenty-five thousand rupees and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of one lakh rupees.

DUTIES OF COMPANY SECRETARIES BEFORE, DURING AND AFTER GENERAL MEETING

Before the General Meeting:

1. To convene a Board meeting, after giving notice as per Section 173(3), as soon as the final accounts are ready, invite the Auditors for their report and transact the following business (in case of listed company, give advance notice to stock exchange):

   (a) To consider and discuss the report of Audit Committee on the Annual accounts.

   (b) To approve the accounts and authorise signing of accounts.

   (c) To secure Auditor's report on the accounts.

   (d) To approve the draft of the Board's Report in compliance with the provisions of Section 134 of the Act and to authorise the Chairman to sign the Report on behalf of the Board.

   (e) To consider the payment of dividend, if any, in case it is to be declared in the Annual General Meeting.

   (**Note:** In case of listed company prior intimation have to be sent to stock exchange of the Board meeting where recommendation of dividend is proposed to be considered vide Regulation 29 of SEBI (Listing Obligations and Disclosure Requirements) Regulation, 2015.)

(2) Listed entity to disclose the audit qualifications of any other audit reservations along with financial results in addition to explanatory statement as to how audit qualifications of previous accounting year have been addressed in financial results.

   (a) To fix time, date and place for the annual general meeting, approve the draft notice and also authorise the Secretary to issue Notice for the meeting. The Notice must contain Ordinary Business in accordance with the provisions of Section 102 of the Act, While fixing the time, date and place for the annual general meeting, care should be taken that the time should be during 9 am to 6 pm, the date should not be a National holiday, and the place should be either the registered office of the company or some other place within the same city, town or village in which the registered office of the company is situated.

   (b) To consider the closure of the Register of Members and the Share Transfer Books of the Company in compliance with the provisions of Section 91 of the Act and to authorise the Secretary to arrange for its publication in a newspaper. In case of listed company, a notice in advance of at least 7 working days should be sent to the stock exchange(s) about the proposed dates for such closure and also to comply with the requirement of stock exchange for book closure.

(3) Listed entity shall give prior intimation to stock exchange at least 2 days in advance (excluding date of

intimation and date of meeting) about Board meeting in which financial results are due to be considered [Regulation 29 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015].

(4) In case of listed company, close the registers for the period as advertised and inform the all the stock exchanges by giving a notice in advance of at least 7 working days.

(5) To arrange for the printing of the balance sheet, profit and loss account, reports of the directors and of the auditors and the notice for the meeting.

(6) To issue notice to the shareholders, for at least 21 clear days before the date of annual general meeting and where it is to be sent by post, it should be posted 48 hours still earlier in terms of section 101. Notice of the meeting must also be sent to the directors (whether member or not), auditors and stock exchanges. In case of section 8 companies, 14 clear day's notice is sufficient for general meeting.

(7) If the directors decide for the publication of the Chairman's statement, make arrangements for the same.

(8) Check proxies with the Register of Members as and when they are received, from day to day, so that an up-to- date position is available till the date of the meeting.

(9) To arrange for the printing of attendance slips or attendance register and ballot papers.

(10) In consultation with the chairman or the Managing Director, prepare a detailed agenda for the meeting.

(11) To prepare Dividend List from the Register of Members/beneficial owners, as on the last date of the closure of the Register of Members and the Share Transfer Books.

(12) To make arrangement for the printing of a combined document containing "Notice of Dividend" and "Dividend Warrant".

(B) At the Meeting:

1. To arrange for the collection of admission slips or in the alternative to get the Attendance Register signed by the shareholders, and to make them comfortable in their seats, and to look to the comfort and convenience of the directors and the chairman.

2 To help the Chairman in ascertaining quorum.

3. To read out the notice of the meeting if advised by the Chairman.

4. To read out the Auditor's Report, if advised by the Chairman, when the item relating to adoption of accounts is taken up for consideration.

5. To produce copies of Memorandum and Articles of Association of the company.

6. To help the Chairman in the conduct of the meeting, particularly in the conduct of poll, counting of votes etc.

7. To supply to the Chairman any information which he may require in connection with the queries raised by the shareholders relating to accounts and other connected matters.

8. Give advance information to the members who are to propose and second the resolutions to be passed at the meeting.

9. To take notes of the proceedings for the purpose of preparing minutes thereof.

10. To keep at the meeting Register of Members, Minutes Book of the general meeting containing minutes of the previous annual general meeting(s), copies of the accounts, notice of the meeting and reports of the directors and of the auditors.

11. To ensure that the Chairman of the Audit Committee is present at annual general meeting to provide any clarification on matters relating to audit and to answer shareholder queries; For listed entities, the Chairperson of the Stakeholders Relationship Committee shall also be present at the annual general meetings to answer queries of the security holders.

(C) After the Meeting:

1. To prepare minutes of the proceedings.
2. To record the minutes of the meeting and get them signed by the Chairman within thirty days of the meeting.
3. To send intimation of appointment/re-appointment of directors. File Form DIR-12 with the Registrar of Companies within 30 days of appointment along with filing fee.
4. To send intimation of appointment/re-appointment of auditors. File form ADT-I with the Registrar within 15 days of appointment/re-appointment.
5. To file copies of the special and other resolutions, if any, passed at the meeting, along with Form MGT14 with the Registrar of Companies, within thirty days of the meeting.
6. To file balance sheet, profit and loss account, reports of the directors and the auditors and the notice of the meeting in Form AOC-4/AOC-4 CFS within thirty days of the meeting. In case of companies covered under XBRL filing, it should be ensured that the annual accounts are filed in XBRL format. Ensure that a copy of Secretarial Audit Report obtained from a Secretary in whole time practice as required under Section 204(1) of the Act, if any, is filed with Registrar of Companies within 30 days from the date of annual general meeting.

   The listed entity shall submit to the stock exchange and publish on its website a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders. [Regulation 34 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015].
7. Where the company has invited public deposits, a copy of the Balance sheet shall be forwarded to the RBI.
8. To open a separate bank account known as “Dividend Account for the year” and to deposit the total amount of dividend within five days from the date of declaration of dividend.
9. To get the Dividend Warrants and Notice of Dividend signed by authorised persons.
10. To dispatch Dividend Warrants together with the Notice of Dividend to the shareholders within thirty days of the declaration of dividend after making arrangement with the banker for payment of dividend warrants at prescribed number of branches at par.
11. To file along with the prescribed filing fee, Annual Return, as an attachment to Form MGT-7/MGT-7A with the Registrar of Companies within sixty days of the meeting prepared as at the date of the annual general meeting, as required by Section 92 of the Companies Act, 2013. The Certificate of Company Secretary shall be in Form MGT-8.
12. To take action on other decisions of the shareholders.
13. If the company is listed then to submit to the stock exchange, within 2 working days of conclusion of annual general meeting, details regarding the voting results in the format specified by the Board [Regulation 44 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015].

VIRTUAL MEETINGS: TECHNOLOGICAL ADVANCEMENT IN CONDUCT OF GENERAL MEETINGS

General meetings, particularly when large numbers of shareholders are involved, can be very expensive and are not considered to be a cost-effective. Virtual meetings of members have advantages for companies and their shareholders. Present-day shareholders are spread across the country and also in different countries, and as the AGMs can only conducted in the city or place in which the registered office of the company is located, it makes it more difficult for the shareholders located in faraway locations and cites to attend the meetings as it involves lot of travel time and cost. With less participation, the agenda items are often passed without any discussion with fewer members. Virtual meetings will help in increasing shareholder participation as compared to physical meetings because of improved access, shareholders who cannot attend in person due to location or other reasons can attend virtually and do not have to incur the time and costs of travel to a physical meeting.

Similarly, companies may find virtual meetings help to achieve wider shareholders participation. Virtual annual meetings offer benefits to both companies and shareholders. With companies and investors becoming increasingly global, virtual meetings can save travel time and costs for shareholders, avoid traffic and other logistical delays and be easier to schedule. It will also eliminate the costs of an in-person meeting, including travel for shareholders and a company's directors and management, thereby allowing shareholders more time to attend more meetings in which they hold the shares, as well as minimizing the amount of time that directors and management must spend at meetings. This in turn will increase the participation of shareholders who would otherwise not attend the meetings.

Advantages of Virtual AGM/EGMs

- Increase shareholder participation in meetings.
- Save time on travel and cost because of remote voting.
- Encourages more participation by investors across the world.
- Provides greater accessibility to shareholders who cannot be physically present due to distance.
- Enables institutional investors to attend more than one meeting in a day and protect shareholders interest.
- Reduce the cost of holding and conducting shareholder meeting, including the costs of the venue, stationary, transport and refreshments.
- Saves time of the Company's personnel.

Difficulties in holding Virtual Meetings of Members:

- Security of the systems used.
- Streaming with quality without interruption.
- Providing with secure login and shareholder authentication for attendance, with ease of access for shareholders, and remote voting.
- Combined registration, voting and reporting software.
- Customized instant results screen and detailed audit reporting.
- Data Security of Logins and Passwords.
- Allowing the shareholders, the choice of device.
- The technology used must give all shareholders a reasonable opportunity to participate.

- The technology must be secure and must provide reasonable measures for verifying/validating those allowed to attend and vote at the meeting.
- The company must provide a digital record of the meeting.

It is pertinent to mention that as per Regulation 44 of the SEBI (LODR) Regulations, 2015 the top 100 listed entities shall provide one-way live webcast of the proceedings of the annual general meetings.

[*Omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f. 31.12.2024*]

Voting by electronic means is a facility given to the members of a company to cast their votes on the resolutions through electronic mode. It provides an opportunity to shareholders residing in far-flung area to take part in the decision making process of the company. They may or may not attend the meeting physically. Boards in their fiduciary capacity are now looked upon for greater accountability and transparency for the effectiveness of their overall governance process. E-Voting is a further step to encourage corporate democracy and to promote good corporate governance.

E-voting allows a voter to record his or her secure and secret ballot electronically. E-voting are generally used in government elections like general elections, state legislative assembly elections etc. and considered as a tool of effective governance in voting infrastructure. E-voting is a common Internet infrastructure that enables the investors to vote electronically on resolution of companies. Shareholders normally exercised their votes on resolutions proposed by companies through postal ballot. If a company decides to pass any resolution by resorting to postal ballot, it will send a notice to all the shareholders, requesting them to send their assent or dissent in writing on a postal ballot. The Companies Act, 2013 had ushered in the concept of e-voting to ensure wider shareholder participation in the decision-making process in companies.

Practical Situations arising in Meetings through Video-Conferencing

1) How to accommodate the shareholders who wants to ask questions in view of the large attendance of shareholders throughout the length and breadth of the country?

A. In the notice to the AGM it may be mentioned that shareholders whoever wants to speak to get their names registered and it's also to be mentioned that at the discretion of the Chairman the speakers will be allowed to speak depending upon the availability of time.

2)Why the proxy provisions are dispensed with in case of General meetings held through video conferencing?

A. In case of VC meetings there is no question of proxy attendance. A shareholder can himself attend the meeting from wherever he is located. Same applies to the case with e-voting. In case of e-voting also there is no proxy to vote on behalf of the shareholder.

3) Is it required to give venue of the meeting in the Notice? If so what would be the venue of the meeting, for meetings held through video conferencing?

A. Yes, place of the meeting shall be provided in the Notice. In case of virtual meetings deemed venue is to be given.

4) For conduct of AGMs through VC/OAVM, can the Companies mention in their AGM notices that the Company holds the right to restrict the number of speaker shareholders depending on the availability of time. Are the companies allowed to restrict speakers?

A. Yes, companies can restrict the speakers depending upon the availability of time. The notice calling for meeting should require the speaker shareholders to register themselves in advance and depending upon the time availability, it shall be at the discretion of the Chairman to allow the speakers.

In addition, companies may allow recordings to be sent in advance with the permission of the Chairman and shareholders, in order to avoid scenarios where a speaker shareholder may get disconnected or have an audio/visual connection issue, thus saving time and effectively maintaining the decorum of the meeting.

5) The number of speakers registering to speak at the meeting has gone up considerably. Companies are forced to choose those speakers who are favourably disposed to the company. Is this a correct practice? How can this be managed?

A. If the number of speaker's shareholders registering is considerably more, the Chairman should put a cut-off as it may not be feasible to allow all the registered speakers due to time constraints.

For e.g., giving 3 mins each to 50 registered speakers in a meeting held through VC or OAVM will prolong the meeting with 150 minutes. Therefore, it is at the discretion of Chairman to decide the order (first come first serve, etc.) and the cut-off depending on the situation and time availability.

6) Is it mandatory to share the question / query well in advance with the Company by the Shareholder at the time of registering himself as speaker. Can a shareholder refuse to share the question, even if asked to share, by the Company?

A. Shareholder may share his query well in advance with the Company so that even if he could not get connected, his query may be read out and answered. However, the shareholder may prefer to raise his query at the meeting only and in such case, he need not share his query in advance with the Company.

7) How can the companies keep registers open for inspection at the AGM held via VC or OAVM, if the Company does not maintain the registers in electronic form and nor the company has scanned the same?

A. In case the registers are not maintained in an electronic form, the physical registers/documents should be scanned for uploading in a virtual data room established for the purpose. Login ID and password can be provided for inspection and it is to be ensured that only view rights are given for inspection and the registers/documents cannot be deleted, copied or downloaded or the register/ documents may be made available for inspection on a virtual platform (e.g., Zoom, Microsoft teams, etc.), and displayed in a presentation form. The registers/documents which shall be made available for inspection in connection with the AGM, shall be made available from the time notice is given till the conclusion of the meeting.

8) What are the consequences if during the AGM held through VC or OAVM, the Chairman gets disconnected due to poor net connectivity etc. and unable to join again? How can the Company proceed with the AGM for remaining items?

A. In case, the Chairman of the meeting gets disconnected due to poor connectivity, etc. for 5-10 minutes, it does not necessarily lead to adjournment of the meeting. However, if the Chairman is unable to join again and depending on the size, structure, dynamics of the company, there are two options available: either adjourn the meeting or if the meeting so decides elect another Chairman to proceed with the AGM, the company is required to follow the Articles/Section 104 of the Companies Act, 2013 and proceed accordingly.

9) Do Shareholders and Directors have any rights to ask recording of AGM conducted through VC or OAVM?

A. Recording of the General Meetings held through VC or OAVM is not mandatory as per law and only the recorded transcript has to be maintained. Therefore, a shareholder/director cannot ask for the recording of meeting conducted through VC or OAVM. Even if the company records the meeting its only for their internal purpose.

10) Do Shareholders and Directors have any rights to ask for the copy of recorded transcript of AGM conducted through VC or OAVM?

A. Public companies have to mandatorily upload the recorded transcript on the web site of the company, if any. In case where a company has no website and has not uploaded the transcript, may provide a copy of the same to the shareholder who ever has asked for the same. In case of a private company there is no such requirement of uploading the recorded transcript on the website of the company. However, even in such cases as a good Governance measure copy of the recorded transcript may be made available, since there is no confidentiality as such is involved.

11) How to ascertain the quorum during the proceedings of AGM? In case a person leaves the AGM through VC in between, whether he would be counted for the purpose of quorum or should he be present throughout the meeting?

A. As per para 3.1 of Secretarial Standard – 2 on General Meetings, the quorum shall be present throughout the meeting. It shall be the responsibility of the Chairman and the Company Secretary to keep a check on the attendance throughout the meeting for the purpose of quorum and if the attendance depletes below the required quorum, the meeting should be adjourned.

12) Is it mandatory to engage the services of CDSL or NSDL for the purpose of VC or we can have arrangements with the private service provider viz., Zoom, Google Meet, Webex, etc., especially when e-voting facility is provided by CDSL/NSDL only?

A. It is not mandatory to engage the services of CDSL or NSDL for the purpose of holding a meeting through VC or OAVM, even though they might be the service providers for the purpose of e-voting. The company may use other service providers which depends upon the size of the company, number of shareholders and commercials.

The service providers for e-voting shall be registered / certified and no such requirement is there for service providers who provide the platforms for holding virtual shareholders meetings.

DRAFTING OF NOTICE AND MINUTES OF AGM AND EGM

Specimen Notice of Annual General Meeting

Name of the Company .....

Registered Address .....

CIN - ..... Email- ..... Telephone: ..... Website: .....

NOTICE OF ..... (Meeting Number) ANNUAL GENERAL MEETING

NOTICE is hereby given that the ..... (Meeting Number) Annual General Meeting of the Members of ..... (Name of the Company) will be held on ..... (day), the ..... (date), 20....., at ..... am/ p.m. at ..... (address) to transact the following business:

Ordinary Business:

1. To receive, consider and adopt the standalone and consolidated Financial Statements of the Company for the financial year ended 31st March, ... and the Reports of the Board of Directors and the Auditors.

2. To declare dividend for the financial year ended 31st March, ...

3. To appoint a Director in place of Mr. ..... (DIN .....), who retires by rotation and being eligible, offers himself for reappointment.

4. To appoint Statutory Auditors and to determine their remuneration. For this purpose, to consider and if deemed fit, to pass, with or without modification, the following Resolution as an Ordinary Resolution:

   "**RESOLVED THAT** pursuant to the provisions of Section 139 and other applicable provisions if any, of the Companies Act, 2013 and the Rules framed thereunder, as amended from time to time, M/s. ....., Chartered Accountants, (Firm Registration No.....) be and are hereby appointed as Auditors of the Company to hold office from the conclusion of this Annual General Meeting till the conclusion of the ..... Annual General Meeting of the Company (subject to ratification of their appointment at every AGM), at a remuneration of Rs. ...../- (Rupees ..... only) for the year ..... and Rs. ...../ - (Rupees ..... only) per year for the subsequent ..... years plus reimbursement of out of pocket expenses and service tax, as applicable."

   "**RESOLVED FURTHER THAT** the Board of Directors of the Company (including a Committee thereof), be and is hereby authorised to do all such acts, deeds, matters and things as may be considered necessary, desirable or expedient to give effect to this Resolution."

Special Business:

5. To appoint Mr. ..... as Director

   To consider, and if thought fit, to pass, with or without modification, the following Resolution as an Ordinary Resolution:

   "**RESOLVED THAT** pursuant to the provisions of Section 152 and other applicable provisions of the Companies Act, 2013 read with the Companies (Appointment and Qualification of Directors) Rules, 2014, Mr. ..... (DIN .....), who was appointed as an Additional Director of the Company with effect from ....., 20..... by the Board of Directors of the Company pursuant to Section 161(1) of the Companies Act, 2013 and the Articles of Association of the Company and who holds office upto the date of this Annual General Meeting, and being eligible, offer himself for appointment and in respect of whom the Company has received a notice in writing under Section 160 of the Companies Act, 2013 from a member signifying his intention to propose the candidature of Mr. ..... for the office of Director, be and is hereby appointed with effect from the date of this Meeting as a Director of the Company, liable to retire by rotation."

By Order of the Board of Directors

For .....

.....(Signature)

Place : ....(Name)

Date : ..... 20..... Company Secretary

Notes :

1. The explanatory statement setting out the material facts pursuant to Section 102 of the Companies Act, 2013, relating to special business to be transacted at the Meeting is annexed.
2. A Member entitled to attend and vote at the Meeting is entitled to appoint a Proxy to attend and, on a poll, to vote instead of himself and the Proxy need not be a Member of the Company.
3. Proxies, in order to be effective, must be received in the enclosed Proxy Form at the Registered Office of the Company not less than forty-eight hours before the time fixed for the Meeting.

4. A person can act as a proxy on behalf of Members not exceeding 50 and holding in the aggregate not more than ten percent of the total share capital of the Company carrying voting rights. A Member holding more than ten percent of total share capital of the Company carrying voting rights may appoint a single person as proxy and such person shall not act as a proxy for any other person or shareholder.

5. A Corporate Member intending to send its authorised representatives to attend the Meeting in terms of Section 113 of the Companies Act, 2013 is requested to send to the Company a certified copy of the Board Resolution authorizing such representative to attend and vote on its behalf at the Meeting.

6. Members/Proxies/Authorised Representatives are requested to bring the attendance slips duly filled in for attending the Meeting. Members who hold shares in dematerialised form are requested to write their client ID and DP ID numbers and those who hold shares in physical form are requested to write their Folio Number in the attendance slip for attending the Meeting.

7. During the period beginning 24 hours before the time fixed for the commencement of Meeting and ending with the conclusion of the Meeting, a Member would be entitled to inspect the proxies lodged at any time during the business hours of the Company. All documents referred to in the Notice and accompanying explanatory statement are open for inspection at the Registered Office of the Company on all working days of the Company between 11:00 a.m. and 1:00 p.m. upto the date of the Annual General Meeting and at the venue of the Meeting for the duration of the Meeting.

8. Route-map to the venue of the Meeting is provided at the end of the Notice / Page no. ..... of the Annual Report.

9. The Register of Members and the Share Transfer Books of the Company will remain closed from ..... to ..... (both days inclusive).

10. The dividend on shares as recommended by the Board, if approved at the Annual General Meeting, will be paid within thirty days from the date of declaration to those Members or their mandatees whose names appear:

    (a) as Members in the Register of Members of the Company on ....., and

    (b) as beneficial owners on that date as per the lists to be furnished by ..... in respect of shares held in electronic form.

11. Unclaimed / Unpaid Dividend:

    Pursuant to Section 205A of the Companies Act, 1956 (Section 124 of the Companies Act, 2013, once notified), dividend for the financial year ended 31st March, ... which remains unclaimed for a period of seven years, become due for transfer on ..... (date) to the Investor Education and Protection Fund of the Central Government. Members who have not claimed their dividend for the above mentioned year are requested to make their claim to the Share Department of the Company at the Registered Office of the Company or to the Registrar & Share Transfer Agents of the Company at .. .. (address) as early as possible but not later than ..... (date).

12. Electronic copy of the Annual Report is being sent to all the Members whose email IDs are registered with the Company/Depository Participant(s) for communication purposes unless any Member has requested for a hard copy of the same. For Members who have not registered their email address, physical copy of the Annual Report is being sent in the permitted mode. In case you wish to get a physical copy of the Annual Report, you may send your request to ..... (email) mentioning your folio/DP ID and Client ID. Annual Reports is also available in the Financials section on the website of the Company at .....

13. Members holding shares in physical mode are requested to register their email IDs with the Registrar & Share Transfer Agents of the Company and Members holding shares in demat mode are requested to register their email ID's with their respective DP in case the same is still not registered. Members are also requested to notify any change in their email ID or bank mandates or address to the Company and always quote their Folio Number or DP ID and Client ID Numbers in all correspondence with the Company. In respect of holding in electronic form, Members are requested to notify any change of email ID or bank mandates or address to their Depository Participants.

14. Any query relating to financial statements must be sent to the Company's Registered Office at least seven days before the date of the Meeting.

15. Voting through electronic means

    In compliance with provisions of Section 108 of the Companies Act, 2013 and Rule 20 of the Companies (Management and Administration) Rules, 2014, the Company is pleased to provide members the facility of exercising their right to vote electronically on the items mentioned in this Notice. The Company has appointed Mr. ..... as scrutinizer for conducting the e-voting process in a fair and transparent manner.

    The voting period begins on ....., ..., 201.... at 10:01 hrs. and will end on ....., ..., 201.... at 17:00 hrs. During this period shareholders' of the Company, holding shares either in physical form or in dematerialised form, as on the cut-off date of ....., 201..., may cast their vote electronically. The e-voting module shall be disabled for voting thereafter.

    The Company has signed an agreement with ..... (agency) for facilitating e-voting to enable the Shareholders to cast their vote electronically. The instructions for shareholders voting electronically are given at page no. ..... of the Annual Report.

16. The Results shall be declared on or after the Annual General Meeting of the Company and shall be deemed to be passed on the date of Annual General Meeting. The results alongwith the Scrutinizer's Report shall be placed on the website of the Company ..... within 2 days of passing of the resolutions at the Annual General Meeting of the Company and shall be communicated to ..... (Stock Exchange).

EXPLANATORY STATEMENT

As required by Section 102 of the Companies Act, 2013, the following explanatory statement sets out all material facts relating to the business mentioned under Item No. 7 of the accompanying Notice dated .....

Item No. 5

Mr. ..... who was appointed as an Additional Director of the Company under Section 161(1) of the Companies Act, 2013 effective ....., ... holds office up to the date of this Annual General Meeting, and is eligible for appointment as Director of the Company.

The Company has received notice under Section 160 of the Companies Act, 2013 from a Member signifying her intention to propose the candidature of Mr. ..... for the office of Director.

A brief profile of Mr. ....., as required to be given pursuant to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, has been given elsewhere in this Notice.

Mr. ..... is not a Director of any other public limited company in India. He is a Member of the Audit Committee and the Investment Committee of ..... He does not hold any share in the Company and is not related to any Director or Key Managerial Personnel of the Company in any way.

The Board of Directors considers it in the interest of the Company to appoint Mr. ..... as a Director.

By Order of the Board of Directors

For .....

.....(Signature)

Place : .....

.....(Name)

Date : ..... 20.....

Company Secretary

Specimen Minutes of Annual General Meeting

MINUTES OF THE PROCEEDINGS OF THE ..... (Number of Meeting) ANNUAL GENERAL MEETING OF ..... (Name of the Meeting) HELD ON ..... (day), ... (date) 20... FROM ..... TO ..... A.M/ P.M. AT ..... (address).

The following were present:

1. Mr. W (in the Chair)
2. Mr. B (Director and Member)
3. Mr. C (Director)
4. Mr. D (Director and Member)
5. Mr. E. (Director and Chairman of Audit Committee)
6. Mr. F (Company Secretary)
7. ..... (Members present in person) [state number]
8. ..... representing ..... shares (Members present by Proxy) [state number]

Mr. G, Partner of M/s....., Chartered Accountants, Auditors of the Company, was present.

Mr. H, Practising Company Secretary, Secretarial Auditor of the Company, was also present.

CHAIRMAN

In accordance with Article ..... of the Articles of Association, Mr. W, Chairman of the Board of Directors, took the Chair.

The Chairman welcomed the Members and introduced the Directors seated on the dais.

The Chairman stated that Mr..... and Mr.....Directors, could not attend the Meeting due to..... (Explain the reason for absence).

Quorum was present at the commencement of the Meeting as well as at the time of consideration of each item of business.

The following documents / Registers of the Company remained open and accessible for inspection during the continuance of the AGM:

(a) Financial Statements for the financial year ended 31st March, ..., including the Consolidated Financial Statements for the said financial year, and the Reports of the Board of Directors and the Auditors.

(b) Register of Directors and Key Managerial Personnel and their shareholding.

Register of Contracts or Arrangements in which Directors are interested.

With the consent of the Members present, the Notice convening the Annual General Meeting of the Company was taken as read.

The Chairman delivered his speech.

The business of the Meeting as per the Notice thereof was thereafter taken up item wise.

1. Adoption of Consolidated and Standalone Financial Statements

The Chairman requested Mr. ..... to read the Ordinary Resolution for the adoption of the Financial Statements for the year ended 31st March, 20..... and Mr. ..... read out the Ordinary Resolution as follows:

"**RESOLVED THAT** the Financial Statements of the Company for the year ended 31st March, 20....., including Consolidated Financial Statements for the said financial year, along with the Reports of the Board of Directors and the Auditors, as circulated to the Members and laid before the Meeting, be and are hereby approved and adopted."

After the above Resolution was proposed and seconded, but before it was put to vote, the Chairman invited Members (other than those present by Proxy) to make observations and comments, if any, on the Report and financial statements, as well as on the other Resolutions set out in the Notice convening the Meeting.

Some Members made their observations and comments and raised queries on the Annual Report and Financial Statements and other items set out in the Notice and the Chairman answered their queries.

Before putting the Resolution to vote, the Chairman reminded the Meeting that Proxies were not eligible to vote on a show of hands. Thereafter, the Chairman put the Resolution for the adoption of the Financial Statements, Consolidated Financial Statements and the Reports thereon to vote as an Ordinary Resolution.

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried by the requisite majority.

2. Declaration of Dividend

Mr. ..... read out the following Resolution

"**RESOLVED THAT** the dividend @ Rs. ..... on the equity shares of Rs. 10/Re.1/ - each, fully paid-up, be and is hereby declared for payment, to those Members whose names appear on the Company's Register of Members on .....20...".

The Resolution was proposed by Mr. ..... and seconded by Mr. ....., and was put to vote as an Ordinary Resolution.

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

3. Appointment of Director

Proposed by : Mr. .....

Seconded by : Mr. .....

The following Resolution having been proposed and seconded by the aforementioned two Members, was put to vote as an Ordinary Resolution:

"**RESOLVED THAT** pursuant to Section 152 of the Companies Act, 2013, Mr. A, who retires by rotation and, being eligible for re-appointment, offers himself for reappointment, be and is hereby re-appointed as a Director of the Company liable to retire by rotation."

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

4. Appointment of Auditors

Proposed by : Mr. .....

Seconded by : Mr. .....

The following Resolution having been proposed and seconded by the aforementioned two Members, was put to vote as an Ordinary Resolution:

"**RESOLVED THAT** pursuant to the provisions of Section 139 and other applicable provisions if any, of the Companies Act, 2013 and the Rules framed thereunder, as amended from time to time, M/s....., Chartered Accountants, (Firm Registration No.....) be and are hereby appointed as Auditors of the Company to hold office from the conclusion of this Annual General Meeting till the conclusion of the ..... Annual General Meeting of the Company (subject to ratification of their appointment at every AGM), at a remuneration of Rs. ...../- (Rupees ..... only) for the year ..... and Rs. ...../- (Rupees ..... only) per year for the subsequent ..... years plus reimbursement of out of pocket expenses and service tax, as applicable."

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

5. Appointment of Director

Proposed by : Mr. .....

Seconded by : Mr. .....

The following Resolution having been proposed and seconded by the aforementioned two Members, was put to vote as an Ordinary Resolution:

"**RESOLVED THAT** pursuant to the provisions of Section 152 and other applicable provisions of the Companies Act, 2013 read with the Companies (Appointment and Qualification of Directors) Rules, 2014, Mr. ..... (DIN .....), who was appointed as an Additional Director of the Company with effect from ....., 20..... by the Board of Directors of the Company pursuant to Section 161(1) of the Companies Act, 2013 and the Articles of Association of the Company and who holds office upto the date of this Annual General Meeting, and being eligible, offer himself for appointment and in respect of whom the Company has received a notice in writing under Section 160 of the Companies Act, 2013 from a member signifying his intention to propose the candidature of Mr. ..... for the office of Director, be and is hereby appointed as a Director of the Company, liable to retire by rotation with effect from the date of this Meeting."

On a show of hands, the Chairman declared the aforesaid Ordinary Resolution carried unanimously.

VOTE OF THANKS AND CONCLUSION OF MEETING:

Since there was no other item for discussion and consideration the meeting ended with vote of thanks to the Chair. The Chairman in response, warmly acknowledged the same and thanked the members present and announced the closure of meeting.

Date : ....

Place: ..... CHAIRMAN

Specimen Minutes of Extra-Ordinary General Meeting

MINUTES OF THE PROCEEDINGS OF THE EXTRA-ORDINARY GENERAL MEETING OF ..... (Name of the Company) HELD ON ..... (day), ... (date) 20..... FROM ..... TO ..... A.M./P.M. AT .....(address).

The following were present:

1. Mr. A (in the Chair)
2. Mr. B (Director and Member)
3. Mr. C (Director)
4. Mr. F (Company Secretary)
5. ..... (Members present in person) {state number}
6. ..... (Members present by Proxy) {state number}

Mr. G, Partner of M/s....., Chartered Accountants, Auditors of the Company, was present.

CHAIRMAN

In accordance with Article ..... of the Articles of Association, Mr. A, Chairman of the Board of Directors, took the Chair.

The Chairman welcomed the Members and introduced the Directors seated on the Dias.

The Chairman stated that Mr. ..... and Mr. .....Directors, could not attend the Meeting due to..... (explain the reason for absence).

Quorum was present at the commencement of the Meeting as well as at the time of consideration of each item of business.

With the consent of the Members present, the Notice convening the ExtraOrdinary General Meeting of the Company was taken as read.

The business of the Meeting, as per the Notice thereof, was thereafter taken up item-wise.

Appointment of Independent Director

Proposed by : Mr. .....

Seconded by : Mr. .....

The following Resolution having been proposed and seconded respectively by the aforementioned Members was put to vote as an Ordinary Resolution:

"**RESOLVED THAT** pursuant to the provisions of Sections 149, 150(2), 152 and any other applicable provisions of the Companies Act, 2013 and the rules made there under read with Schedule IV to the Companies Act, 2013, approval of the Company be and is hereby accorded for appointment of Mr. E (DIN No.....), as an Independent Director of the Company to hold the office for a period of 3 years i.e. up to ....., ... AND THAT by virtue of sub-section (13) of Section 149 of the Companies Act, 2013 he shall not be liable to retire by rotation."

The Chairman enquired from the Members present if there were any clarifications required on the same. Since none of the Members required any clarification, the Ordinary Resolution was put to vote and on a show of hands declared carried by the requisite majority.

CLOSE OF THE MEETING

There being no other business to transact the Meeting closed with a vote of thanks to the Chair.

Date : ....

Place: ..... CHAIRMAN

LESSON ROUND-UP

- An annual general meeting is required to be held every year by every company other than a One Person Company (whether public or private, limited by shares or by guarantee, with or without share capital or unlimited company).
- In case of default is made in holding the annual general meeting of a company under section 96, the Tribunal may call or direct the calling of an annual general meeting.
- Class meetings are those meetings which are held by holders of a particular class of shares e.g. preference shares.
- For a General Meeting to be valid, it must be duly convened, properly constituted and the business must be validly transacted.
- In case of public company the quorum shall depend on number of members as on the date of meeting personally present in the meeting:-
  - If members not more than 1000–quorum shall be 5.
  - If members more than 1000 but less than 5000- quorum shall be 15.
  - If members more than 5000- quorum shall be 30.
  - In case of private company 2 members personally present shall be the quorum of the meeting.
- The central government is vested with the power to prescribe a class or classes of companies whose members shall not be entitled to appoint another person as a proxy.
- Chairman plays a very important role in a meeting as he is responsible for successful conduct of a meeting.
- A motion becomes a resolution only after the requisite majority of members have adopted it.
- Various methods which may be adopted for taking votes on a motion properly placed before a meeting are by show of hands, by poll, by postal ballot and by electronic voting.
- In accordance with Section 117 of the Act, certain resolutions are required to be filed with the Registrar for recording within 30 days of its passing at the meeting.
- Every company is required to keep minutes of the proceedings of general meetings and of the meetings of Board of Directors and its Committees. A virtual meeting is when people around the world, regardless of their location, use video, audio, and text to link up online.
- Virtual meeting is a “room” set up online through a website host that allows people from anywhere to “meet” with each other to share information and network in real-time.

GLOSSARY

Book Closure: Book closure refers to the time period when a company will not handle adjustments to the register, or requests to transfer shares. The book closure date is often used to identify the cut-off date determining which investors of record will be sent a given dividend payment or the issue of right or bonus shares or issue of shares for conversion of debentures. This is more relevant in case of physical shares. Also refer Section 91 of Companies Act, 2013.

Suo motu: It is a Latin legal term meaning "on its own motion" mutatis mutandis It is a Latin term meaning "the necessary changes having been made" or "once the necessary changes have been made.

Roll Call: A roll call is nothing but identifying and confirming the attendance of the director participating through Electronic Mode.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. ABC Pvt Limited is incorporated on 31st December, 2019. Up to what time such company can hold its first Annual General Meeting. What would be your answer if company incorporated on 1st January, 2020?
2. Some members have joined the meeting but at the time of transacting business items they left before meeting ends without transacting any business items of the Notice. Does this constitute a valid General Meeting? List out the points in the light of the provisions of Companies Act, 2013 having regard to Quorum of General Meeting?
3. List out the persons whom Notice of the General Meeting is to be given. Explain the provisions with respect to the Notice of the Annual General Meeting.
4. Ram Commodities Private Limited could not hold its 10th annual general meeting for the year 2019-20 by 30th September, 2020. The company sought extension of time for holding the AGM from the Registrar of Companies but failed to hold the meeting within the extended time too. Instead, it held the meeting on 31st March, 2021 and passed resolutions thereat. Certain shareholders have challenged the validity of these resolutions. Referring to the provisions of the Companies Act, 2013, examine whether the contention of the shareholders shall be tenable.
5. What are the items that constitute Ordinary Business in an Annual General Meeting of a company?
6. Who shall be chairman of a general meeting of a company? What are the provisions of the Companies Act, 2013 regarding his election?
7. Every Annual General Meeting of a company shall be called on a day which is not a National holiday. Can an adjourned Annual General Meeting of a company be called on a National holiday?
8. A shareholder having given proxy, personally attends and votes at the meeting. Comment, illustrating a case law.
9. At a general meeting, two joint holders voted on a resolution. Will the votes of both the joint holders be accepted?
10. What are the provision of the Companies Act, in regard to the holding of an Extra Ordinary General Meeting?

11. At a General meeting of a company, a matter was to be passed by a special resolution. Out of 40 members present, 20 voted in favour of the resolution, 5 voted against it and 5 votes were found invalid. The remaining 10 members abstained from voting. The Chairman of the meeting declared the resolution as passed. With reference to the provisions of the Companies Act, 2013, examine the validity of the Chairman's declaration?

12. The Annual General Meeting (AGM) of a company is scheduled to be held on 22nd August, 2022 at 2 p.m. Taking into account the relevant legal provisions contained in the Companies Act, 2013 indicate the latest time for posting notices of the meeting to the members to ensure legal compliance:

    a) The notice must be sent latest by August 03, 2022. Further, if notice is sent by post or courier it must be posted latest by August 01, 2022.

    b) The notice must be sent latest by August 05, 2022. Further, if notice is sent by post or courier it must be posted latest by August 03, 2022.

    c) The notice must be sent latest by August 07, 2022. Further, if notice is sent by post or courier it must be posted latest by August 05, 2022.

    d) The notice must be sent latest by July 31, 2022. Further, if notice is sent by post or courier it must be posted latest by July 29, 2022.

13. Mr. Raghav is a shareholder of M/s Diceball Infra Limited. He wants to have a copy of minutes of General Meeting. Within how many days he will get the copy after applying to the company?

    a) Within ten working days after he has made a request in that behalf to the company, and on payment of such fees as may be prescribed.

    b) Within seven working days after he has made a request in that behalf to the company, and on payment of such fees as may be prescribed.

    c) Immediately on payment of such fees as may be prescribed.

    d) Within fifteen working days after he has made a request in that behalf to the company, and on payment of such fees as may be prescribed.

14. M/s RK Enterprises Limited wants to issue GDR. What resolutions are required to be passed in this case?

    a) After AGM only.

    b) The company can issue after passing a ordinary resolution.

    c) The company can issue after passing a special resolution in its general meeting.

    d) The company can issue after passing a board resolution.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- Companies Act, 2013

- ICSI Guidance Note on SS-2
- ICSI FAQs on Virtual Meetings
- The Law and Practice Relating to Company Meetings, Third Edition by CS Ramaswami Kalidas, FCS, MBA—Bloomsbury Publishing India Pvt. Ltd

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

Directors

Lesson 14

KEY CONCEPTS

■ Director ■ DIN ■ Independent Director ■ Resident Director ■ Inter-Corporate Loan ■ Managing Director ■ Whole-time Director ■ IICA ■ Nominee Director

Learning Objectives

To understand:

- Concept of Directors
- Manner of appointment of Directors
- Procedure for obtaining DIN
- Provisions regarding: disqualifications; resignation; removal; duties and liabilities of Directors
- Vacation of office of Director
- Loans to Directors
- Rights and Duties of Director

Lesson Outline

- Introduction
- DIN requirement
- Types of Directors
- Appointment / Reappointment of Directors
- Disqualifications, Vacation of Office, Retirement, Resignation and Removal of Directors
- Loans to Directors
- Disclosure of Interest of Directors
- Duties and Rights of Directors
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Sections 149-171, 184 & 185)
- The Companies (Appointment and Qualification of Directors) Rules, 2014
- The Companies (Meetings of Board and its Powers) Rules, 2014
- Schedule IV of the Companies Act, 2013
- The Companies (Creation and Maintenance of Databank of Independent Directors) Rules, 2019
- SEBI (LODR) Regulations, 2015

INTRODUCTION

The Companies Act, 2013 contemplates various provisions related to Directors. A Company having separate legal existence in the eyes of law, is an artificial person. The Company has an intangibility i.e. it cannot be touch as it is not a natural person. As such, it cannot act on its own. It acts through only with human intervention.

The Directors are the individuals who are in charge and manage the day to day affairs of the Company. Where the Company needs to have more than one Director, then the total number of Directors are termed as Board of Directors of the Company. Whenever a Company needs to take decision, it will take the decision through the Board of Directors only as it cannot act on its own. For various decisions and managing the day to day affairs, the Board of Directors are required to meet occasionally as well as periodically for taking those decisions by way of passing of resolutions depends on the nature of decision.

For example, ABC Ltd wants to change its registered office from North Delhi to South Delhi. It will have to convene the Board Meeting and has to pass the Board Resolution for such shifting as required by the Companies Act, 2013.

The Companies Act, 2013 defines the term Director in Section 2(34) which prescribed that "director" means a director appointed to the Board of a company.

Section 2(10) of the Companies Act, 2013 defined that "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company.

By virtue of Section 149 of the Companies Act, 2013, the Board of Directors of every company shall consist of individual only. Thus, no body corporate, association or firm shall be appointed as director.

Section 166 (6) of Companies Act, 2013, prohibits assignment (transfer) of office of director to any other person. Any assignment of office made by a director shall be void.

Illustration 1- XY Limited, a Company registered under the Companies Act, 2013, appointed Mr. X and Mr. Y as Directors. Now, XY Limited conducts the Board Meeting and decided to appoint MNO LLP as its Director. XY Ltd by virtue of Section 149 cannot do so.

Illustration 2- XY Limited, a Company registered under the Companies Act, 2013, appointed Mr. X and Mr. Y as Directors. Now, Mr. X wants to transfer his office to Mrs. A, his spouse, for his place Mr. X by virtue of Section 166(6), if do so, will be VOID.

DIN REQUIREMENT

Director Identification Number (DIN) is a unique identification number allotted by the Ministry of Corporate Affairs, Central Government to any individual, intending to be appointed as director or to any existing director of a company, for the purpose of his identification as a director of a company.

DIN is specific to a person, which means even if he is a director in two or more companies, he has to obtain only one DIN and if he leaves a company and joins some other, the same DIN would work in the other company as well.

"Director Identification Number" (DIN) includes the Designated Partnership Identification Number (DPIN) issued under section 7 of the Limited Liability Partnership Act, 2008 and rules made thereunder.

ONE PAN can be obtained by an individual. Likewise, only ONE DIN can be obtained by one individual. If an individual generates two DINs inadvertently, he has to surrender his unused DIN immediately.

Section 152 (4) mandates that every person proposed to be appointed as a director by the company in general meeting or otherwise, shall furnish his Director Identification Number or such other number as may be prescribed under section 153 and a declaration that he is not disqualified become a director under this Act.

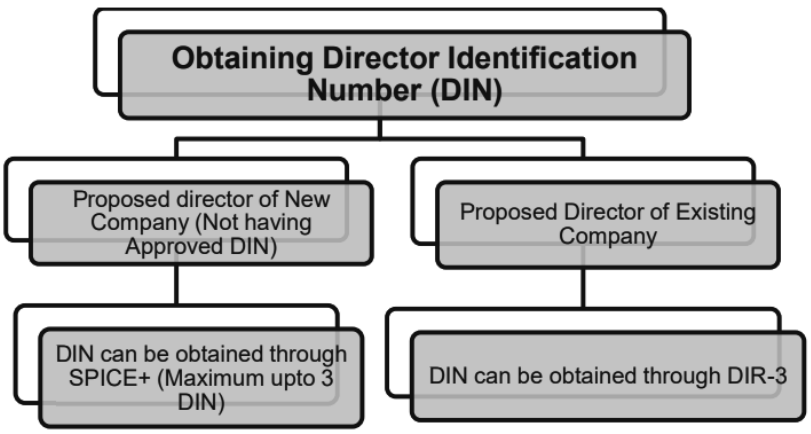
As per Section 153 of the Act, every individual intending to be appointed as director in an existing company shall make an application electronically in Form DIR-3 for allotment of director Identification Number to the Central Government along with the prescribed fees.

Further, DINs to the proposed first directors (not having approved DIN) in respect of new companies would be mandatorily required to apply for it in web form SPICe+ (Simplified Proforma for Incorporating company Electronically Plus: INC-32) forms and DIN may be allotted to maximum three proposed directors through Form INC-32 (SPICe).

However, the Central Government may prescribe any identification number which shall be treated as Director Identification Number for the purposes of this Act and in case any individual holds or acquires such identification number, the requirement of section 153 shall not apply or apply in such manner as may be prescribed.

Prior to the date, 26th January 2018, the Form DIR-3 needs to certified by the Practicing Professional but the Ministry of Corporate Affairs by virtue of notification dated, 26th January, 2018, omits the requirement of certification from the Practicing Professional. Now, the Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital signature certificate and shall be verified digitally by a company secretary in full time employment of the company or by the managing director or director or CEO or CFO of the company in which the applicant is intended to be appointed as director in an existing company.

Illustration 1- Mr. X wants to obtain DIN. He is interested in his appointment as a Director. He wants to obtain DIN for his future appointments. But, at present, he has no offer from any Company for Directorship. He cannot obtain DIN as there is no Company which offers him Directorship and Form DIR-3 cannot be filed because it needs to be certified/ verified from the officials at the employment of the Company by virtue of MCA notification dated 26th January, 2018. But prior to such date, the form can be filed with the Practicing Professional's certification.



DOCUMENTS REQUIRED FOR OBTAINING DIN

DOCUMENTS TO BE ATTACHED IN E-FORM DIR-3	*DESCRIPTION*
Proof of identity of applicant	In case of Indian nationals, duly attested copy of: 1. Income-tax PAN; and 2. Voters Identity Card/ Passport/ Driving License are mandatory requirement for proof of identity. In case of foreign nationals, duly attested copy of passport is a mandatory requirement for proof of identity. Proof of father's name is not required in the case of foreign nationals. In case the name of a person does not have a last name, then his or her father's or grandfather's surname shall be mentioned in the last name along with the declaration in Form No. DIR-3A.
Proof of residence of applicant	Duly attested Address proofs- ANY ONE of the below is mandatory: Latest (not more than two months old) Bank Statement/ Electricity Bill/Telephone Bill/ Mobile bill etc., shall be attached and should be in the name of applicant only. (In case of proofs which are in languages other than Hindi / English, the proofs should be translated in Hindi / English from professional translator carrying his details (name, signature, address) and seal. In the case of foreign nationals, translation done by the notary of home country is also acceptable.)
Photograph	In JPEG
Board resolution	A Board Resolution proposing his appointment as director in an existing company
Specimen signature	A specimen signature duly verified
Digital Signature	Obtain Digital Signature Certificate before applying for DIN and ensure that the applicant does not have any DIN allotted earlier as the Companies Act, 2013 prohibits to obtain and retain more than 1 DIN (Section 155). The Digital Signature Certificate is required and the Form will be signed digitally by the applicant.

Illustration- Mr. X has filed on 01.11.2022, the Form DIR-3 for obtaining the DIN from MCA. He has faced the objection regarding the address proof i.e. Bank Statement should not be older than two months. He had attached the bank statement for the period 01.06.2022 to 31.07.2022. Then, he had resubmitted the Form DIR-3 on 02.11.2022 with attaching the revised Bank Statement for the period 01.09.2022 to 31.10.2022. The Form got approved and DIN allocated successfully.

Procedure for application for allotment of DINs to the proposed first Directors in respect of new companies: e-Form SPICe + (Simplified Proforma for Incorporating company Electronically Plus: INC-32)

Any person (not having approved DIN) proposed to become a first director in a new company shall have to make an application through web form SPICe+ (Simplified Proforma for Incorporating company Electronically Plus: INC-32) for allotment of DIN.

SPICe+ (Simplified Proforma for Incorporating company Electronically Plus: INC-32) is an integrated Web form offering multiple services such as: Name Reservation, Incorporation, DIN allotment, Mandatory issue of PAN, Mandatory issue of TAN, Mandatory issue of EPFO registration, Mandatory issue of ESIC registration, Mandatory issue of Profession Tax registration(Maharashtra), Mandatory Opening of Bank Account for the Company and Allotment of GSTIN (if so applied for).

Allotment of Director Identification Number (DIN) to maximum of three proposed directors shall be permitted in case of proposed directors not having approved Director Identification Number. The applicant is required to attach the proof of Identity and address along with the application. DIN would be allocated to User only after approval of the form. [Section 153 read with rule 9 of the Companies (Appointment and Qualification of Directors) Rules, 2014]

Once the SPICe+ (Simplified Proforma for Incorporating company Electronically Plus: INC-32) is processed and found complete, company would be registered and CIN would be allocated. License Certificate shall also be issued in case of incorporation of a Section 8 company. Also DINs gets issued to the proposed Directors who do not have a valid DIN.

Illustration- Mr. A, Mr. B, Mr C and Mr. D intends to incorporate an Indian Company as Director and Sharehoders. At present, they don't have DIN. They have to file the application in SPICe+ for incorporation. Now, as they are FOUR in number, they can't fill the particulars of all FOUR as allocation of DIN is limited to maximum of three proposed directors in case of proposed directors not having approved DIN. They need to incorporate the Company any THREE directors and after the incorporation, they can file Form DIR-3 for obtaining the DIN of FOURTH person.

Procedure for application for allotment of DIN before Appointment in an existing Company - Section 153 read with Rule 9 of the Companies (Appointment and Qualifications of Directors) Rules, 2014

Every individual, who is to be appointed as director of an existing company shall make an application electronically in Form DIR-3 (Application for allotment of Director Identification Number) to the Central Government for the allotment of a Director Identification Number (DIN) along with such fees as may be prescribed.

MCA 21 portal facilitates submission of application for the allotment of DIN.

The applicant shall fill e-Form DIR-3 by inserting the required particulars and attaching photograph; proof of identity; proof of residence; board resolution proposing his appointment as director in an existing company and specimen signature duly verified and sign the form digitally.

In case the name of a person does not have a last name, then his or her father's or grandfather's surname shall be mentioned in the last name along with declaration in Form-DIR-3A. This declaration will be submitted along with Form DIR-3.

Form DIR-3 shall be signed and submitted electronically by the applicant using his or her own Digital Signature Certificate and shall be verified digitally by a Company Secretary in full time employment of the company or by the Managing Director or Director or CEO or CFO of the existing company in which the applicant is intended to be appointed as a director.

Procedure for Application of DIN for foreign national

Details of a valid passport should be filled and a certified copy of same should be attached with the application. All supporting documents including photograph should be certified by the Indian Embassy or a notary in the home country of the applicant. If a foreign director has a valid multiple-entry Indian visa or Person of Indian Origin card or Overseas Citizen of India card, then the attestation could also be done by Public Notary / Gazetted Officer in India.

Procedure for generation of DIN- Section 154 read with Rule 10 & 10A of the Companies (Appointment and Qualifications of Directors) Rules, 2014

The Central Government shall, within one month from the receipt of the application under section 153, allot a Director Identification Number to an applicant in such manner as mentioned below:

(1) On the submission of the Form DIR-3 on the portal and payment of the requisite amount of fees through online mode an application number shall be generated by the system automatically.

As per the Companies (Appointment and Qualification of Directors) Amendment Rules, 2022 notified on June 01, 2022, no application number shall be generated in case of the person applying for Director Identification Number is a national of a country which shares land border with India, unless necessary security clearance from the Ministry of Home Affairs, Government of India has been attached alongwith application for Director Identification Number.

(2) After generation of the application number, the Central Government shall process the applications received for allotment of DIN under Sub-rule (2) of Rule 9 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 decide on the approval or rejection thereof and communicate the same to the applicant along with DIN allotted in case of approval by way of a letter by post or electronically or in any other mode within a period of one month from the receipt of such application.

(3) If the Central Government, on examination, finds such application to be defective or incomplete in any respect, it shall give intimation of such defect or incompleteness, by placing it on the website and by email to the applicant who has filed such application, directing the applicant to rectify such defects or incompleteness by resubmitting the application within a period of fifteen days of such placing on the website and email. Provided the Central Government shall:

(a) reject the application and direct the applicant to file fresh application with complete and correct information, where the defect has been rectified partially or the information given is still found to be defective;

(b) treat and label such application as invalid in the electronic record in case the defects are not removed within the given time; and

(c) inform the applicant either by way of letter by post or electronically or in any other mode.

(4) In case of rejection or invalidation of application, the fee so paid with the application shall neither be refunded nor adjusted with any other application.

(5) All director Identification Numbers alloted to individual(s) by the Central Government before the commencement of these rules shall be deemed to have been allotted to them under these rules.

(6) The Director Identification Number so allotted under these rules is valid for the life-time of the applicant and shall not be allotted to any other person.

(7) Every director, functioning as a director in one or more companies on or before the 30th June, 2007 and who has not yet intimated his DIN to such company or companies shall, within one month of the receipt of Director Identification Number from the Central Government, intimate his Director Identification Number to the company or all companies wherein he is a director as per Form DIR-3B.

(8) The intimation by the company of Director Identification Number of its directors under section 157 of the Act shall be furnished in Form DIR-3C within fifteen days of receipt of intimation under section 156.

Intimation of changes in particulars of Director- Rule 12 of the Companies (Appointment and Qualifications of Directors) Rules, 2014

There may be a situation when a DIN holder has changed its personal particulars like:

Address; Name; Father's name; Nationality; Date of birth; Gender; Income-tax PAN; Voters Identity card number; Passport number; Driving license number; Permanent residential address; Present residential address; Photograph of Director/ Designated partners; Residential Status; and/or Aadhaar number.

Every individual who has been allotted a DIN in the event of any change in his particulars as stated in Form DIR-3, intimate such change(s) to the Central Government within a period of 30 days of such change(s) in Form DIR-6 (Intimation of change in particulars of Director to be given to the Central Government).

The applicant shall fill in the relevant changes in Form DIR-6, verify the form and attach duly scanned copy of the proof of the changed particulars and submit electronically. Form requires pre-certification by the professional CA/CS/CMA in practice.

The Central Government, upon being satisfied, after verification of such changed particulars from the enclosed proofs, shall incorporate the said changes and inform the applicant by way of a letter by post or electronically or in any other mode confirming the effect of such change in the electronic database maintained by the Ministry.

The DIN cell of the MCA shall also intimate the change(s) in the particulars of the director submitted to it in Form DIR-6 to the concerned Registrar(s) under whose jurisdiction the registered office of the company(s) in which such individual is a director is situated.

The concerned individual shall also intimate the change(s) in his particulars to the company or companies in which he is a director within fifteen days of such change.

Question	***Answer***
Which Form to be filed form for change in particulars	Form DIR-6
Time-limit within which form to be filed	30 days
Mode of filing	Electronically
Certification	By Practicing Professional (No need of certification from Company officials)

Cancellation/Surrender/Deactivation of DIN- Rule 11 of the Companies (Appointment and Qualifications of Directors) Rules, 2014

The [Central Government/RD (North), Noida/ Authorised Officer by the RD] may, upon being satisfied on verification of particulars or documentary proof attached with the application along with specified fee received from any person, cancel or deactivate the DIN in case –

(a) the DIN is found to be duplicated in respect of the same person provided the data related to both the DIN shall be merged with the validly retained number;

(b) the DIN was obtained in a wrongful manner or by fraudulent means;

(c) of the death of the concerned individual;

(d) the concerned individual has been declared as a lunatic or of unsound mind by a competent Court;

(e) if the concerned individual has been adjudicated an insolvent;

Provided that before cancellation or deactivation of DIN pursuant to clause (b), an opportunity of being heard shall be given to the concerned individual;

(f) on an application made in Form DIR-5 by the DIN holder to surrender his or her DIN along with declaration that he has never been appointed as director in any company and the said DIN has never been used for filing of any document with any authority, the Central Government may deactivate such DIN but after verification of e-records.

Once a person is appointed as a Director in any company as per the Companies Act 2013, he cannot relinquish his DIN in the future. Even if he/she doesn't remain a director anymore in that company or in any other company, his/her DIN will exist as it is.

Illustration- Mr. Amit has obtained two DINs inadvertently and both DINs got used in two different appointments as Director. Now, it came into his knowledge. He wants to surrender his second DIN and merge his both appointments in single DIN Can he do so?

The Answer is NO. Because only an unused DIN can be surrendered by filing the Form DIR-5.

Impact of Non Compliance of DIR-3 KYC/DIR-3 KYC Web

The Central Government or Regional Director (Northern Region), or any officer authorized by the Central Government or Regional Director (Northern Region) shall, deactivate the Director Identification Number (DIN), of an individual who does not intimate his particulars in e-form DIR-3-KYC 3 [or the web service DIR-3-KYC-WEB as the case may be] within stipulated time in accordance with rule 12A.

The de-activated DIN shall be re-activated only after e-form DIR-3-KYC 3 [or the web service DIR-3-KYC-WEB as the case may be] is filed along with fee as prescribed under Companies (Registration Offices and Fees) Rules, 2014.

General Provisions Regarding DIN

Prohibition to obtain more than one DIN

According to Section 155, no individual shall apply for/obtain/ possess another Director Identification Number who has already been allotted a Director Identification Number under section 154.

Director to intimate DIN

Section 156 stipulated that every existing director shall intimate his DIN to the company or all companies wherein he is a director within one month of the receipt of DIN from the Central Government.

Company to inform DIN to Registrar

Section 157 (1) provides that every company shall, within fifteen days of the receipt of intimation under section 156, furnish the Director Identification Number of all its directors to the Registrar or any other officer or authority as may be specified by the Central Government with requisite fee in Form DIR-3C.

If any company fails to furnish the Director Identification Number under sub-section (1), such company shall be liable to a penalty of twenty-five thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of one lakh rupees, and every officer of the company who is in default shall be liable to a penalty of not less than twenty-five thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day after the first during which such failure continues, subject to a maximum of one lakh rupees.

Obligation to indicate DIN

Section 158 specified that every person or company shall mention the DIN in return, information or particulars as required to be furnished under the Companies Act, 2013, in case such return etc. relate to the director or contain any reference of any director.

Rule 12A of the Companies (Appointment and Qualifications of Directors) Rules, 2014 – Directors KYC

Every individual who holds a Director Identification Number (DIN) as on 31st March of a financial year as per the Companies (Appointment and Qualifications of Directors) Rules, 2014 shall, submit e-form DIR-3-KYC for the said financial year to the Central Government on or before 30th September of immediate next financial year.

Where an individual who has already submitted e-form DIR-3 KYC in relation to any previous financial year, submits web-form DIR-3 KYC-WEB through the web service in relation to any subsequent financial year it shall be deemed to be compliance of the provisions of this rule for the said financial year.

Provided also that in case an individual desire to update his personal mobile number or the e-mail address, as the case may be, he shall update the same by submitting e-form DIR-3 KYC only.

Provided also that fee for filing e-form DIR-3 KYC or web-form DIR-3 KYC-WEB through the web service, as the case may be, shall be payable as provided in Companies (Registration Offices and Fees) Rules, 2014.

With effect from 01st day of August, 2024, in case an individual desires to update his personal mobile number or the e-mail address, as the case may be, he shall update the same by submitting e-form DIR-3 KYC only on or before 30th September of the financial year.

If an individual intends to update his personal mobile number or the email address again at any time during the financial year in addition to the up-dation allowed under the third proviso, he shall update the same by submitting e-form DIR-3 KYC on payment of fees of five hundred rupees

Illustration 1- Mr. Pramod has obtained the DIN on 30th March, 2022. He has to file the web-form DIR-3 KYC-WEB before 30th September, 2022. He has to enter OTP sent on both registered email id and mobile number.

Illustration 2- Mr. Saurabh has obtained the DIN on 10th March, 2022. Thereafter, he changed his mobile number. He has to file eForm DIR-3 KYC for change of mobile number. Otherwise, he will not be able to file his DIR-3 KYC-WEB because while filing it, the OTP is to be sent on registered mobile number only. After filing the eForm DIR-3 KYC, the mobile number gets auto populated in DIR-3 KYC-WEB.

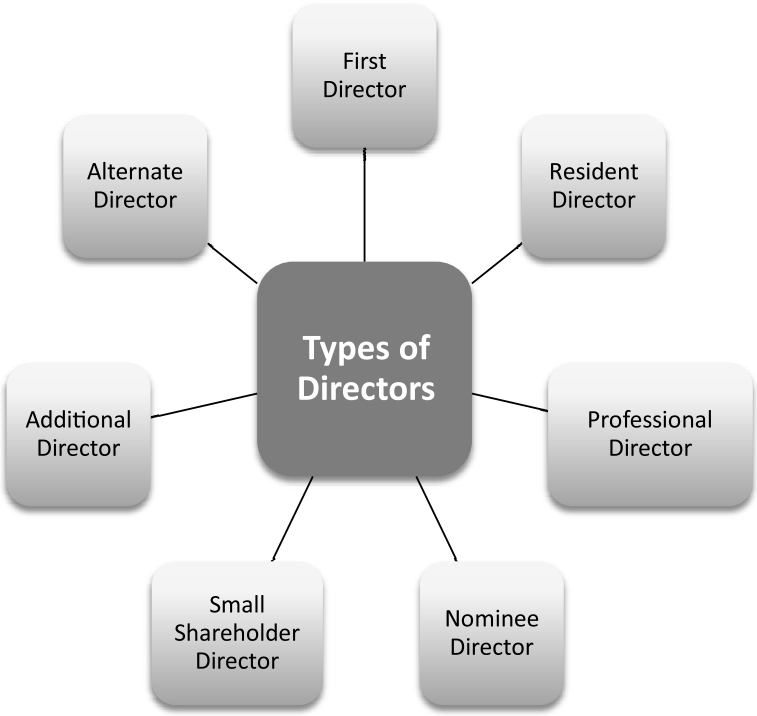
DIR-3 KYC	***DIR-3 KYC Web***
One-time filing	Annually filing
Filing in case of change of mobile number and email id	Annually filing
OTP required on personal email id and mobile number	OTP required on personal email id and mobile number
If not done DIR-3 KYC WEB within due date, then DIR-3 KYC is required to filed and the fee of Rs. 5000 shall be payable.	No fees
It is filed for two purposes: 1. When there is a change in mobile number and email id 2. The DIN holder didn't file DIR-3 KYC WEB within due date	Annually filing

Summary of DIN Forms

Forms	*Purpose*
DIR-3	Application for allotment of Director Identification Number before appointment in an existing company
DIR-6	Intimation of change in particulars of Director to be given to the Central Government
DIR-5	Application for surrender of Director Identification Number
DIR-3B	Intimation of DIN to Company (By every director, functioning as a director in one or more companies on or before the 30th June, 2007 & not yet intimated his DIN)
DIR-3C	Intimation of Director Identification Number by the company to the Registrar DIN services
DIR-3 KYC/DIR-3 KYC Web	Application for KYC of Directors

TYPES OF DIRECTORS

A director to the Board may be appointed as:



First Director

Section 152 of the Act provides that where there is no provision made in Articles of Association of the company for appointment of first directors then the subscribers to the memorandum who are individuals shall be deemed to

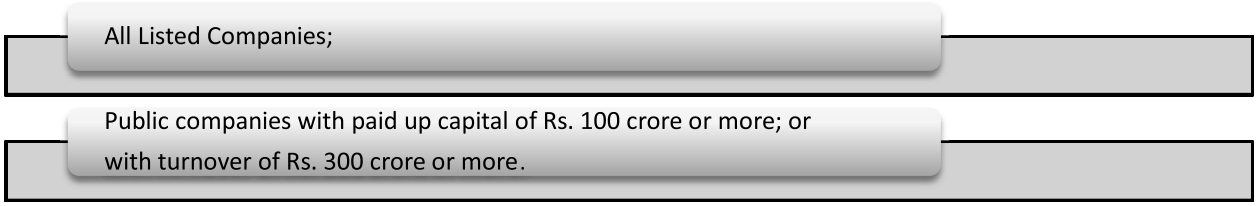
be the first directors of the company until the directors are duly appointed. Section 152(1) of the Act is applicable to all companies, whether public or private. In case of a One Person Company an individual being member shall be deemed to be its first director until the director or directors are duly appointed by the member in accordance with the provisions of this section.

Resident Director

Section 149(3) provides that every company shall have at least one director who has stayed in India for a total period of not less than one hundred and eighty-two days during the financial year. However, in case of a newly incorporated company the requirement under this sub-section shall apply proportionately at the end of the financial year in which it is incorporated. This sub-section shall apply to a Specified IFSC private company in respect of financial years other than the first financial year from the date of its incorporation.

Woman Director

Second proviso to Section 149(1) read Rule 3 of Companies (Appointment and Qualification of Directors) Rules, 2014 following class of companies must have at least one Women Director:



Additionally for listed entities as per Regulation 17 of the SEBI (Listing Obligations and Disclosures Requirements) Regulations, 2015, the Board of directors of the top 500 listed entities shall have at least one independent woman director by April 1, 2019 and the Board of directors of the top 1000 listed entities shall have at least one independent woman director by April 1, 2020.

Explanation: The top 500 and 1000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

In Re Jalpower Corporation Ltd. v. Registrar of Companies C.A. NO. 13/621A (HYD.) OF 2016, it was held that where there was delay of 180 days approximately in appointing woman director and application was filed for compounding of offence, same was permitted for company. All directors had to pay fine and ROC should bring issue of compounding of offence to notice of Special Judge for Economic Offence.

Director elected by Small Shareholders [Section 151]

According to Section 151 of the Act, a listed company may have one director elected by such small shareholders in such manner and on such terms and conditions as may be prescribed.

"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.

Here, the 'nominal value' of shares is relevant. It does not matter how much is the 'paid up value' or 'market value' of shares. However, a small shareholder may be a holder of equity shares or preference shares or both.

Illustration

Mr. A holds 5000 equity shares of Rs. 10 each (Rs. 4 paid up) in XYZ Ltd. However, Mr. A cannot be considered as small shareholder since the nominal value of shares held by him (i.e. Rs. 50,000) exceeds Rs. 20,000.

Terms & Conditions for Small Shareholders' Director

Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014 laid down the following terms and conditions for appointment of small shareholders' director, which are as under:

(i) Election of small shareholders' director:

A listed company, may upon notice of not less than:

(a) One thousand small shareholders; or

(b) one-tenth of the total number of such shareholders,

whichever is lower; have a small shareholders' director elected by the small shareholder.

A 'Small Shareholder's Director' may be elected voluntarily by any listed company. Thus, a listed company, may, on its own, act to appoint a Small Shareholder's Director. In such a case, no notice from small shareholder(s) is required.

(ii) Notice of intention to propose a candidate:

The small shareholders intending to propose a person as a candidate for the post of small shareholder's director shall leave a signed notice of their intention with the company at least 14 days before the meeting under their signatures specifying their details and proposed director's details. The details include name, address, shares held and folio number etc. If the proposer does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

(iii) Statement by the proposed small shareholders' director:

The notice shall be accompanied by a statement signed by the proposed director for the post of small shareholders' director stating:

(a) his Director Identification Number;

(b) that he is not disqualified to become a director under the Act; and

(c) his consent to act as a director of the company.

(iv) Small shareholders' director to be an independent director:

Small shareholders' director shall be considered as an independent director, if-

(a) he is eligible for appointment as an independent director as per sub-section (6) of section 149; and

(b) he gives a declaration of his independence as per sub-section (7) of section 149.

(v) Tenure of office and no retirement by rotation:

The tenure of small shareholders' director shall not exceed a period of 3 consecutive years and he shall not be liable to retire by rotation. Further he shall not be eligible for re-appointment after the expiry of his tenure.

(vi) Grounds of disqualification:

Disqualifications of a small shareholders' director are the same as that of any other director specified under section 164 of the Act.

(vii) Grounds of vacation of office:

A Small shareholders' director shall vacate the office if –

(a) he ceases to be a small shareholder, on and from the date of cessation;

(b) he incurs any of the disqualifications specified in section 164;

(c) the office of the director becomes vacant in pursuance of section 167;

(d) he ceases to meet the criteria of independence as provided section 149(6).

(viii) Number of small shareholders' directorship:

A person shall not hold the office of small shareholders' director in more than two companies. If second company is in competitive business or is in conflict with business of the first company, he shall not be appointed in second company.

(ix) No association with the company for next 3 years:

He shall directly or indirectly not be appointed or associated in any other capacity with the company either directly or indirectly for a period of 3 years from the date of cessation as a small shareholder's director.

Note:

a) A small shareholders' director may be removed by passing an ordinary resolution in the general meeting in accordance with the provisions of section 169 of the Act. At the time of voting on such resolution, every equity shareholder shall have a right to vote irrespective of the fact as to whether he is a small shareholder or not.

b) A small shareholders' director shall be included in the 'total number of directors' as prescribed under section 152 (6) of the Act.

Independent Directors

Section 149(4) read with Rule 4 of Companies (Appointment and Qualification of Directors) Rules, 2014 provides following companies to have specified number of independent directors.

Class of Companies	***Minimum Number of Independent Directors***
All listed public companies	At least 1/3rd of total number of Directors or such other number as provided. (Any fraction contained in such one-third number shall be rounded off as one).
(i) Public companies having: a. with paid up capital of Rs.10 crore or more, or with turnover of Rs.100 crore or more, or b. with outstanding loans, debentures and deposits of Rs.50 crore or more	At least 2 independent Directors.

However, the following classes of unlisted public company shall not be covered under sub-rule as above:

(a) a joint venture;

(b) a wholly owned subsidiary; and

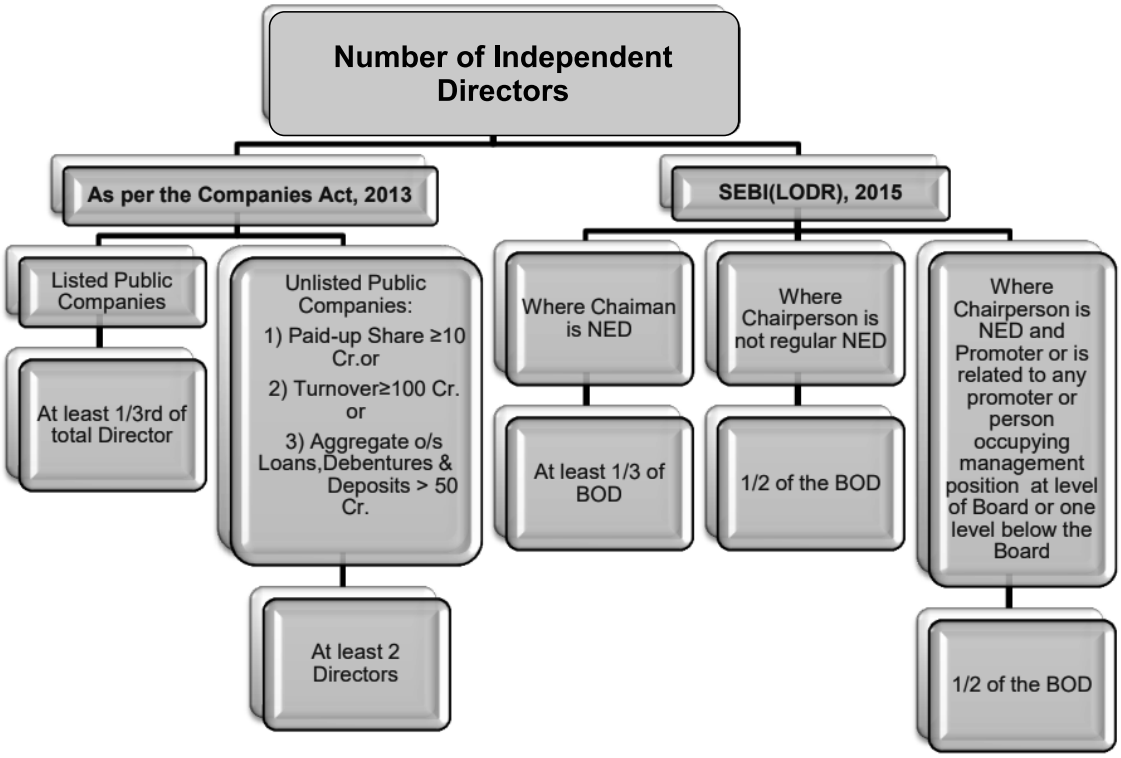
(c) a dormant company as defined under section 455 of the Act.

In case a company covered under this rule is required to appoint higher number of independents directors due to composition of its audit committee and then they shall appoint such higher number of independent directors.

In case of section 8 companies and specified IFSC public companies this sub section is not applicable.

Further, if there is any intermittent vacancy of an independent director then it shall be filled up by the board of directors within 3 months from the date of such vacancy or not later than immediate next board meeting, whichever is later.

Once the company covered under above sub-rule (i) to (iii) of Rule 4 of the Companies (Appointment and Qualification of Directors) Rules, 2014, ceases to fulfil any of three conditions for three consecutive years then it shall not be required to comply these provisions until such time as it meets any of such conditions.



Definition of an Independent Director –

Section 2(47) of the Companies Act, 2013 provides that the "independent director" means an independent director referred to in sub-section (6) of section 149 of the Companies Act, 2013.

An independent director means a director other than a managing director or a whole-time director or a nominee director who does not have any material or pecuniary relationship with the company/ directors. Basically, an

independent director is a non-executive director. Section 149(6) of the Act prescribes the criteria for independent directors which are as follows:

(a) Who in the opinion of the Board, is a person of integrity and possesses relevant industrial expertise and experience;

(b) Such individual shall not be a promoter or related to promoter of the company or its holding, subsidiary or associate company;

(c) Such individual who has or had no pecuniary relationship, other than remuneration as such director or having transaction not exceeding ten per cent. of his total income or such amount as may be prescribed, with the company, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year;

(d) none of whose relatives—

(i) is holding any security of or interest in the company, its holding, subsidiary or associate company during the two immediately preceding financial years or during the current financial year: Provided that the relative may hold security or interest in the company of face value not exceeding fifty lakh rupees or two per cent. of the paid-up capital of the company, its holding, subsidiary or associate company or such higher sum as may be prescribed;

(ii) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors, in excess of such amount as may be prescribed during the two immediately preceding financial years or during the current financial year;

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company, for such amount as may be prescribed during the two immediately preceding financial years or during the current financial year; or

(iv) has any other pecuniary transaction or relationship with the company, or its subsidiary, or its holding or associate company amounting to two per cent. or more of its gross turnover or total income singly or in combination with the transactions referred to in sub-clause (i), (ii) or (iii).

(e) He must not either directly or any of his relatives -

(i) hold or has held the position of a key managerial personnel or is or has been employee of the company or its holding, subsidiary or associate company in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed;

Provided that in case of a relative who is an employee, the restriction under this clause shall not apply for his employment during preceding three financial years.

(ii) is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of–

(A) firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company; or

(B) any legal or a consulting firm that has or had any transaction with the company, its holding, subsidiary or associate company amounting to ten per cent. or more of the gross turnover of such firm.

(iii) holds together with his relatives two per cent or more of the total voting power of the company; or

(iv) is a Chief Executive or director, by whatever name called, of any non-profit organisation that receives 25% or more of its receipts from the company, any of its promoters, directors or its

holding, subsidiary or associate company or that holds 2% or more of the total voting power of the company; or

(f) who possesses such other qualifications as prescribed in Rule 5 of Companies (Appointment and Qualification of Directors) Rules,2014 i.e. as an independent director he shall possess appropriate skills, experience and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations or other disciplines related to the company's business.

None of the relatives of an independent director, for the purposes of sub-clauses (ii) and (iii) of clause (d) of sub-section (6) of section 149:

(i) is indebted to the company, its holding, subsidiary or associate company or their promoters, or directors; or

(ii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, its holding, subsidiary or associate company or their promoters, or directors of such holding company,

for an amount of fifty lakhs rupees, at any time during the two immediately preceding financial years or during the current financial year."

In case of Government company – clause (c) of Section 149(6) shall not apply i.e. no such restriction levied on Government Company related to Pecuniary relationship of Independent director - Notification dated 5th June, 2015.

Issue: Whether the spouse of Secretarial Auditor or Statutory Auditors of the company, be appointed as an independent director in the company?

View: According to Section 149(6)(e)(ii) of the Act, an independent director in relation to a company, means who neither himself nor any of his relatives is or has been an employee or proprietor or a partner, in any of the three financial years immediately preceding the financial year in which he is proposed to be appointed, of a firm of auditors or company secretaries in practice or cost auditors of the company or its holding, subsidiary or associate company. Hence such a person whose spouse is the secretarial auditor/ statutory auditor of the company cannot be appointed as an independent director in that company.

Issue: Can a friend of a director be considered as independent?

View: Law does not prohibit the appointment of a friend of a director of the company as an independent director, if he fulfils all the legal requirements.

Issue: Can a Spouse of an independent director be appointed as an independent director?

View: No, a Spouse of an independent director cannot be appointed as an independent director. Refer to Section 149(6)(b)(ii) which provides that an independent director in relation to a company means one who is not related to promoters or directors in the company, its holding, subsidiary or associate company.

Declaration by an Independent Director- Section 149 (7)

Section 149 (7) of the Act, prescribed that every independent director shall give a declaration that he meets the criteria of independence when:

(a) he attends the first meeting of the Board as a director;

(b) thereafter at the first meeting of the Board in every financial year; and

(c) whenever there is any change in the circumstances which may affect his status as an independent director.

Additionally for listed entities SEBI vide notification dated 9th May, 2018 (effective from April 1, 2019) provides that every independent director shall, at the first meeting of the board in which he participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director, submit a declaration that he meets the criteria of independence and that he is not aware of any circumstance or situation, which exist or may be reasonably anticipated, that could impair or impact his ability to discharge his duties with an objective independent judgment and without any external influence. The board of directors of the listed entity shall take on record the declaration and confirmation submitted by the independent director after undertaking due assessment of the veracity of the same.

With effect from October 1, 2018, the top 500 listed entities by market capitalization calculated as on March 31 of the preceding financial year, shall undertake Directors and Officers insurance ('D and O insurance') for all their independent directors of such quantum and for such risks as may be determined by its board of directors."

"Nominee Director" means a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government or any other person to represent its interests.

Remuneration of an Independent Director- Section 149(9)

As per section 149(9) of the Act an independent director shall not be entitled to any stock option. He may receive remuneration by way of fee as provided under section 197(5) of the Companies Act, 2013, reimbursement of expenses incurred for participation in the Board and other meetings and profit related commission as may be approved by the members.

Provided that if a company has no profits or its profits are inadequate, an independent director may receive remuneration, exclusive of any fees payable under sub-section (5) of section 197, in accordance with the provisions of Schedule V.

Exemptions:

MCA has exempted section 8 companies vide notification dated June 05, 2015 and Specified IFSC public company vide notification dated 4th January 2017 from the provisions of section 149(4) to (11), Section 149 (12) (i) and Section 149(13). This means all the provisions relating to requirement of independent directors, definition of independent directors and other provisions shall not be applicable to section 8 companies and Specified IFSC public companies.

Term of an Independent Director- Section 149(10)

Subject to the provisions of Section 152, an independent director can be appointed for a term of up to five consecutive years on the Board. However, in case of his reappointment for further five year then special resolution passed in general meeting and disclosure of such appointment is made in the Board's report shall be required [Section 149(10)].

Further independent director can be considered for re-appointment (after two consecutive terms) only after expiration of three years of ceasing to become an independent director but he must not be appointed/associated with the company directly or indirectly in any other capacity during the said period of three years. Any tenure of an independent director on the date of commencement of this Act is not considered for the above term [Section 149(11)].

It has been clarified that as such while appointment of an ID for a term of less than 5 years would be permissible, appointment for any term (whether for 5 years or less) is to be treated as a one term under section 149(10) of

the Act. Further, under section 149(11) of the Act, no person can hold office of ID for more than two consecutive term's such a person shall have to demit office after two consecutive terms, even if the total number of years of his appointment in such two consecutive terms is less than 10 years. In such a case the person completing 'consecutive terms of less than 10 years' shall be eligible for appointment only after the expiry of the requisite cooling-off period of 3 years.

Section 149(12) of the Companies Act, 2013 is a non-obstante clause which provides that an independent director and a non-executive director not being 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.

In Re V. Selvaraj vs. Reserve Bank of India, Madras High Court W.P. NO. 43433 OF 2016, in this matter Petitioner was non-executive independent director on board of respondent company, the RBI conducted annual inspection in year 2013 into books of account of respondent company and found accounting malpractices in company and issued various directors in order to protect public interest. Petitioner had been classified as a wilful defaulter. Petitioner filed writ petition for direction to respondents to declassify petitioner from list of wilful defaulters. Petitioner stated that he had no role in either verifying accounts or in maintaining accounts of company and where no materials had been brought on record to show that petitioner actively participated in day-to-day affairs of company or in board meeting and commissions and omissions alleged against company had taken place with knowledge, consent or connivance of petitioner to satisfy ingredients of section 149(12). It was held that since there was absolutely no evidence available to declare petitioner as a wilful defaulter, petitioner was to be declassified from list of wilful defaulters.

The provisions of retirement of directors by rotation are not applicable on Independent director [Section 149 (13)].

Further, in case of independent directors, the explanatory statement relating to their appointment should contain a declaration from the Board that in their opinion, the independent directors satisfy the conditions provided in the Act for such appointment. [Proviso to Section 152 (5)].

Requirement for Independent Director:

1. Applicable on Listed Companies: 1/3rd of total directors be the Independent Director.
2. Public companies having capital more than 10 crore: At least 2 directors as Independent Directors.
3. Appointment Term of Independent Director: Term shall be of maximum 5 years. And term shall not be more than 2 consecutive terms. And shall be re-appointed only by Special Resolution by the company.
4. Remuneration of Independent Director: may receive remuneration by way of fee provided under sub-section (5) of section 197, reimbursement of expenses for participation in the Board and other meetings and profit related commission as may be approved by the members.
5. Retirement by Rotation of Independent Director in AGM: shall not be applicable to appointment of independent directors.
6. Vacancy of Independent Director: To be filled in the very next Board Meeting or within 3 months of such vacancy, whichever is later.
7. Separate Meeting of Independent Director: The independent directors of the company shall hold at least one meeting in a financial year, without the attendance of non-independent directors and members of management.

Presence of Independent Director in Committees	
Name of the Committees	***Composition***
Audit committee	The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.
Nomination and Remuneration Committee	The Nomination and Remuneration Committee shall consist of three or more non-executive directors out of which not less than one-half shall be independent directors.
Corporate Social Responsibility	Corporate Social Responsibility Committee shall consist of three or more directors out of which at least one should be an independent director.

PAYMENT OF SITTING FEE/COMMISSION

According to Section 149(9), the independent director is entitled to receive:

(a) sitting fee for Board/Committee meetings as may be prescribed under second proviso under Section 197(5). Sitting fee to a director for attending meetings of the Board or committees thereof, such sum as may be decided by the Board of directors thereof shall not exceed one lakh rupees per meeting of the Board or committee thereof;

(b) reimbursement of expenses for attending the board/committee meetings;

(c) commission related to profits of the company subject to the provisions of Section 197 and 198 (one percent of the net profits if there is a Managing Director or Whole-Time Director or Manager and three percent of the net profits in any other case). The net profits shall be computed in accordance with Section 198. The independent director, however, shall not be entitled to receive any "stock option".

Provided that if a company has no profits or its profits are inadequate, an independent director may receive remuneration, exclusive of any fees payable under sub-section (5) of section 197, in accordance with the provisions of Schedule V.

Role of Independent Director:

Independent directors are required because they perform the following important role:

(i) Balance the often conflicting interests of the stakeholders.

(ii) Facilitate withstanding and countering pressures from owners.

(iii) Fulfill a useful role in succession planning.

(iv) Act as a coach, mentor and sounding Board for their full time colleagues.

(v) Provide independent judgment and wider perspectives.

As per Schedule IV (Code for Independent Directors) of the Companies Act, 2013, the Independent Director shall –

1. Uphold ethical standards of integrity and probity;
2. Act objectively and constructively while exercising his duties;
3. Exercise his responsibilities in a bonafide manner in the interest of the company;
4. Devote sufficient time and attention to his professional obligations for informed and balanced decision making;
5. Not allow any extraneous considerations that will vitiate his exercise of objective independent

judgment in the paramount interest of the company as a whole, while concurring in or dissenting from the collective judgment of the Board in its decision making;

6. Avoid abusing his position to the detriment of the company or its shareholders or for the purpose of gaining direct or indirect personal advantage or advantage for any associated person;
7. Refrain from any action that would lead to the loss of his independence;
8. Inform the Board immediately whose circumstances arise which makes an Independent Director lose his independence;
9. Assist the company in ensuring best corporate governance practices.

Separate Meeting of Independent Director:

The independent directors of the company shall hold at least one meeting in a financial year, without the attendance of non-independent directors and members of management.

Additional Director

Section 161(1) of the Companies Act, 2013, provides that the articles of a company may confer on its Board of Directors the power to appoint any person, other than a person who fails to get appointed as a director in a general meeting, as an additional director at any time who shall hold office up to the date of the next annual general meeting or the last date on which the annual general meeting should have been held, whichever is earlier.

In case of default in holding annual general meeting, the additional director shall vacate his office on the last day on which the annual general meeting ought to held. A person who fails to get appointed as a director in a general meeting cannot be appointed as Additional Director. Section 161(1) of the Act applies to all companies, whether public or private.

The Company is required to file e-Form DIR-12 for appointment of Director with duly attached the board resolution, consent of director in Form DIR-2 with KYC, interest in other entities etc.

Illustration- Mr. Sumit was appointed as an Additional Director in Ramesh Suresh Limited on 10th January, 2022 by the Board of Directors in their meeting held on 10th January, 2022. Mr. Sumit is appointed till the date of next Annual General Meeting. The Company convened the AGM on 30th September, 2022. In the AGM Mr. Sumit was regularized as Director.

CASE LAWS

January 20, 2023	***Surendra Kumar Singhi (Petitioner)*** ***vs.*** ***Registrar of Companies (Respondent)***	***High Court of Calcutta***

Additional Directors equally responsible for company affairs as other Directors

Facts of the Case:

The petitioner's case is that the Opposite party has filed a complaint before the learned Chief Metropolitan Magistrate, Kolkata against the petitioner stating there in that, M/s Mani Square Limited was incorporated under the Companies Act, 1956 and according to the provisions of Section 217(3) (Board's Report) of the Companies Act, 1956, the Board of the company was bound to give fullest information and explanation in its report on every reservation, qualification or adverse remark contained in Auditor's report.

Opposite party upon scrutiny of the Balance-sheet and other documents found that the Board of Directors did not furnish fullest information and explanation in their Director's report with respect to the Auditors in their report on Balance Sheet on their remark of that "there are no dues of Service Tax, VAT, Provident Fund, ESIC which had been deposited on account of any dispute except disputed amount of WBST/VAT". This has resulted in violation of provisions of Section 217(3) of the Companies Act, 1956 and the said violation was pointed out to the Directors of the company vide Show Cause Notice. On account of receipt of not satisfactory reply, the competent authority has issued instruction to launch prosecution for the aforesaid violation.

Consequently, the petitioner being a director of a company was accused of violating the provisions of Section 217(3) of the Companies Act. The Metropolitan Magistrate issued summons against the petitioner and other accused persons. The petitioner stating himself to be innocent and having no connection with the circumstances of the case chose not to take the course adopted by the rest of the accused persons and prayed for discharge by filing a petition but the same got rejected.

Following were the two issues before the High Court:

1. What post was held by the petitioner on the date of filing the report?
2. Whether the petitioner is responsible/liable for the offence alleged?

The High Court with regard to the first issue noted, "Form No. DIR – 11 clearly shows that on the date of resignation (30.12.2016) the petitioner was the "Director" of the Company..... Inspite of being shown on the portal as "Additional Director /Director" the petitioner did not lodge any complaint with the Ministry about the alleged wrong information. There is no case that the petitioner had filed any objection to the said wrong information (as alleged) on the portal."

With regard to the second issue, the Court said that from the records it is seen that the petitioner was then an "Additional Director" of the Company and that admittedly the other accused persons pleaded guilty.

"ROC must be informed by filing a new Form DIR 12 that the additional director has been regularized as a director in the Company", the Court further said.

It was further observed by the Court that the petitioner was an Additional Director on the date the board report was filed and that to counter the same, the evidence is required to be adduced during the trial.

Decision:

The Court, therefore, held, "The responsibility of an Additional Director being the same as that of a director they remain responsible, as the statute provides for the same. Thus to quash the proceedings by exercising this Courts inherent powers would amount to an abuse of the process of Court and would also amount to serious miscarriage of justice."

Accordingly, the Court dismissed the plea of the petitioner.

Alternate Director

Section 161(2) of the Act empowers the Board, if so authorized by its articles or by a resolution passed by the company in general meeting, to appoint a person, not being a person holding any alternate directorship for any other director in the company or holding directorship in the same company, to act as an alternate director for a director during his absence for a period of not less than three months from India: The provisions applicable to an alternate director are as follows:

(i) Applicability:

Section 161(2) of the Act applies to all companies, whether public or private.

(ii) Conditions for appointment of an alternate director:

(a) The Board of Directors of a company must be authorised by its articles or by a resolution passed by the company in general meeting for appointment of the alternate director.

(b) The person in whose place the Alternate Director is being appointed should be absent for a period of not less than 3 months from India.

(c) The person to be appointed as the Alternate Director shall be the person other than the person holding any alternate directorship for any other Director in the company or holding directorship in the same company.

(d) If it is proposed to appoint an Alternate Director to an Independent Director, it must be ensured that the proposed appointee also satisfies the criteria of Independence as per section 149(6) of the Act.

(iii) Power to appoint:

The Board may appoint an alternate director only if it is authorized by the articles or by an ordinary resolution passed at a general meeting. The right to appoint an alternate director vests in the Board. The original director has no right to appoint an alternate director. The members have no right to appoint an alternate director, the members can only empower to appoint alternate director as and when board thinks fit.

(iv) Method of appointment:

There is no condition that an alternate director shall be appointed only by passing a resolution at a Board meeting. Therefore, an alternate director can be appointed by passing a resolution by circulation.

(v) Terms of office of an alternate director:

(a) Not exceeding the term permissible to original director:

An alternate director shall not hold office for a period longer than that permissible to the director in whose place he has been appointed. If the original director ceases to be a director by reason of death or vacation of office under section 167, the alternate director shall immediately cease to hold his office.

(b) The alternate director shall vacate his office when the original director in whose place he has been appointed returns to India.

(vi) Automatic reappointment applies to the original director:

If the term of office of an original director expires before he returns back to India, the provision for automatic reappointment of a director as envisaged under section 152(7)(b) shall be applicable to the original director, and not to the alternate director.

SEBI vide notification with effect from October 1, 2018 provides that no person shall be appointed or continue as an alternate director for an independent director of a listed entity.

As per section 165, an alternate directorship in a company shall also be included while counting the number of directorships held by a director.

Nominee Director

Section 161(3) of the Companies Act, 2013, provides that subject to the articles of a company, the Board may appoint any person as a director nominated by any institution in pursuance of the provisions of any law for the time being in force or of any agreement or by the Central Government or the State Government by virtue of its

shareholding in a Government company. However, there is an exception to this sub section in case of specified IFSC public company and specified IFSC private company.

Illustration- Durga Proj Limited secured a loan of INR 200 crores from HDFC Bank Limited. The HDFC Bank in order to be more secured has entered into an agreement with the Company that it will appoint Mr. Ashish as Nominee Director on the Board of Durga Proj Limited in order to have the knowledge of day to day affairs of the Company. They have added in the clause that the appointment will come to an end once the loan gets fully paid.

Professional Director

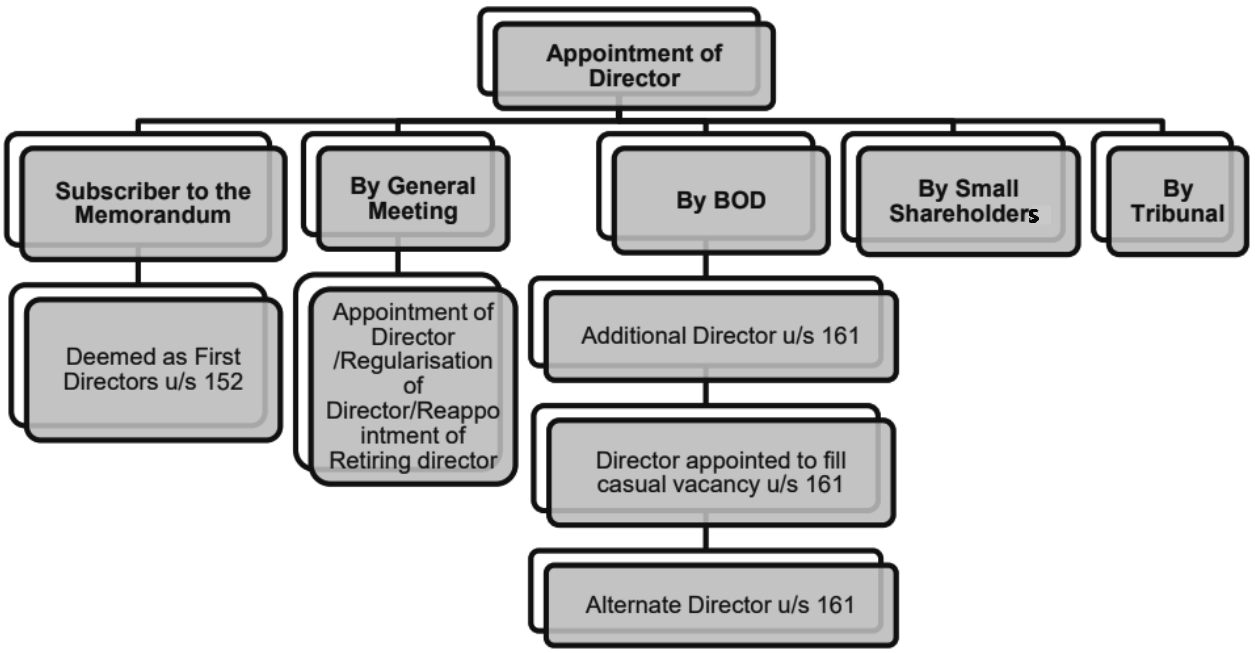
The term "professional director" has not been defined in the Companies Act, 2013. However, Proviso to sub-section (4) of Section 197 of the Companies Act, 2013 has reference to professional services by a director. Section 200 has reference to the professional qualification in relation to managerial remuneration.

The dictionary defines word "professional" as a person is related to or belonging to a profession and competent or skilled in a particular activity. Accordingly, director having specialized knowledge and skill in a particular field and contribute decision making of the board may be appointed as professional director.

Appointment of Directors in Casual Vacancy

Section 161(4), if the office of any director appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy may, in default of and subject to any regulations in the articles of the company, be filled by the Board of Directors at a meeting of the Board which shall subsequently approved by the members in the immediate next general meeting. The person so appointed shall hold office only upto the day upto which the director in whose place he has been appointed, would have held office if he had not vacated as aforesaid. Where a person appointed by the Board vacates his office, it is not a case of casual vacancy and cannot be filled by the Board in the place.

APPOINTMENT / REAPPOINTMENT, DISQUALIFICATIONS, VACATION OF OFFICE, RETIREMENT, RESIGNATION AND REMOVAL OF DIRECTORS



Appointment of directors to be voted individually- Section 162(1)

A single resolution shall not be moved for the appointment of two or more persons as directors of the company unless a proposal to move such a motion has first been agreed to at the meeting without any vote being cast against it. A resolution moved in contravention of aforesaid provision shall be void, whether or not any objection was taken when it was moved. A motion for approving a person for appointment, or for nominating a person for appointment as a director, shall be treated as a motion for his appointment.

This provision shall not apply to-

(a) private company and specified IFSC public company;

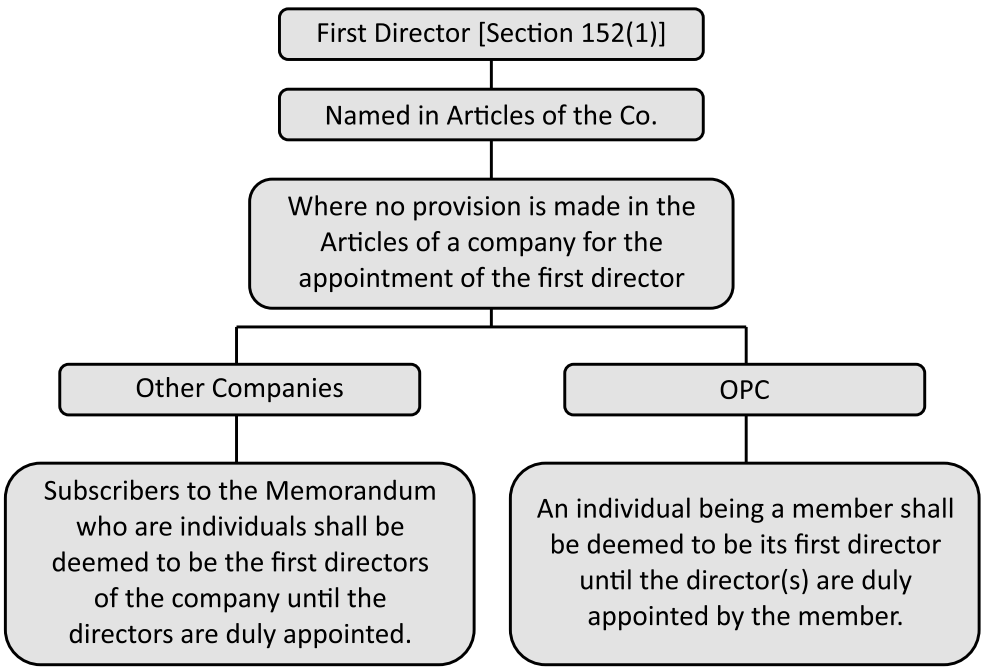
(b) a Government Company in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;

(c) a subsidiary of a Government company, referred to in (a) above, in which the entire paid up share capital is held by that Government company.

Appointment of First Director

The first directors of most of the companies are named in their articles. Regulation 60 of Table F provides that the number of the directors and the names of the first directors shall be determined in writing by the subscribers of the memorandum or a majority of them. If they are not so named in the articles of a company, then subscribers to the memorandum who are individuals shall be deemed to be the first directors of the company until the directors are duly appointed.

In the case of a One Person Company, an individual being a member shall be deemed to be its first director until the director(s) are duly appointed by the member in accordance with the provisions of Section 152.



APPOINTMENT OF DIRECTORS BY BOARD

Procedure for appointment of Additional Director

- Ensure that the Articles of the company authorise the Board to appoint an additional director and such appointment is within the maximum limit of directors mentioned in the Articles.
- Ensure that individual proposed to be appointed as an additional director, does not suffer from any disqualification mentioned.
- Before appointing a person as an additional director, his consent (Form No. DIR-2) to act as director should be obtained.
- Check whether the additional director to be appointed in the board meeting has obtained Director Identification Number (DIN). If not then ask such director to make application to Central Government for obtaining DIN as per Section 153 and ensure that the Director has intimated his Directors Identification Number to the Company.
- Issue not less 7 days notice and agenda of Board Meeting (comply with Secretarial Stnadard-1) and pass board resolution for appointment of an additional director to hold office upto the date of next annual general meeting or due date of next annual general meeting, whichever is earlier.
- Obtain the declaration from the appointed Director regarding his interest in other entities in Form MBP-1.
- File a return containing the particulars of appointment of director with RoC in E Form DIR-12 along with such fees as may be provided in the Companies (Registration offices and fees) Rules, 2014 within 30 days of such appointment.
- Lodging of entries in the register of directors and key managerial personnel and their shareholding.
- Inform all concerned government authorities about the appointment.

Procedure for appointing Directors in casual vacancy

- Where it is proposed by the Board to appoint a person to fill a casual vacancy, his written consent to act as a director has to be obtained before appointment.
- Ensure that individual proposed to be appointed as an additional director, does not suffer from any disqualification mentioned.
- Check whether the director to be appointed in the casual vacancy in the board meeting has obtained Director Identification Number (DIN). If not then ask such director to make application to Central Government for obtaining DIN as per Section 153 and ensure that the Director has intimated his Directors Identification Number to the Company.
- If the casual vacancy is in respect of independent director, then ensure the person proposed to be appointed as director in casual vacancy also fulfills the conditions mentioned in section 149(6) and rule 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014.
- Issue not less 7 days notice and agenda of Board Meeting (comply with Secretarial Stnadard-1) and pass board resolution for appointment of director to hold office upto the date till which the director in whose place he is appointed would have held office.
- Obtain the declaration from the appointed Director regarding his interest in other entities in Form MBP-1.
- File a return containing the particulars of appointment of director with RoC in E Form DIR-12 along with

such fees as may be provided in the Companies (Registration offices and fees) Rules, 2014 within 30 days of such appointment.

- Lodging of entries in the register of directors and key managerial personnel and their shareholding.
- Inform all concerned government authorities about the appointment.

In case of a private company, the procedure for appointment will be governed by its Articles.

Procedure for appointment of an Alternate Director

- Consult the Articles of Association of the company to see whether they authorize the Board to appoint an alternate director. Otherwise, either alter them accordingly or pass a resolution in company's general meeting authorizing the Board to make such appointment.
- Where it is proposed to appoint a person as an alternate director his written consent to act as director shall be obtained.
- Check whether alternate director to be appointed in board meeting has obtained Director Identification Number (DIN). If not then ask such director to make application to Central Government for obtaining DIN as per Section 153 and ensure that the Director has intimated his Directors Identification Number to the Company.
- Ensure that individual proposed to be appointed as an additional director, does not suffer from any disqualification mentioned.
- If the alternate director is to be appointment in respect of independent director, then ensure the person proposed to be appointed also fulfills the conditions mentioned in section 149(6) and rule 5 of the Companies (Appointment and Qualification of Directors) Rules, 2014.
- Issue not less 7 days notice and agenda of Board Meeting (comply with Secretarial Stnadard-1) and pass board resolution for appointment of alternate director to act for original director during his absence from India and shall vacate office when the original director comes to India or the tenure of original director expires, whichever is earlier.
- Obtain the declaration from the appointed Director regarding his interest in other entities in Form MBP-1.
- File a return containing the particulars of appointment of director with RoC in E Form DIR-12 along with such fees as may be provided in the Companies (Registration offices and fees) Rules, 2014 within 30 days of such appointment.
- Lodging of entries in the register of directors and key managerial personnel and their shareholding.

APPOINTMENT OF DIRECTORS BY TRIBUNAL

While giving order on an application made under section 241, i.e., for relief in cases of oppression the Tribunal may provide order for appointment of such numbers of persons as directors of the company and ask them to report to the Tribunal on matters as the Tribunal may direct. [Section 242(2)(k)].

The directors, so appointed, may or may not be the members of the company. For the purpose of reckoning two thirds or any other proportion of the total number of directors of the company, any director or directors appointed by the Tribunal shall not be taken into account. Such director or directors shall not liable to determination by retirement of directors by rotation. But they can be removed by the Tribunal at any time and other persons can be appointed by it in their place. Where the directors have been appointed by the Tribunal, it may also issue such directions to the company, as it may consider necessary or appropriate in regard to their affairs.

APPOINTMENT OF DIRECTOR BY SYSTEM OF PROPORTIONAL REPRESENTATION

According to section 163 the articles of a company may provide for the appointment of not less than two-thirds of the total number of the directors of a company in accordance with the principle of proportional representation, whether by the single transferable vote or by a system of cumulative voting or otherwise and such appointments may be made once in every three years and casual vacancies of such directors shall be filled as provided in sub-section (1) of section 161.

In case of Government Companies, section 163 shall not apply to –

(a) a Government Companies in which the entire paid up share capital is held by the Central Government, or by any State Government or Governments or by the Central Government and one or more state Governments;

(b) a subsidiary of a Government Company, referred to in (a) above, in which the entire paid up share capital is held by that Government company.

APPOINTMENT OF NOMINEE DIRECTORS

Explanation to Section 149(7) defines, "nominee director" as a director nominated by any financial institution in pursuance of the provisions of any law for the time being in force, or of any agreement, or appointed by any Government, or any other person to represent its interests. Nominee Director shall not be deemed to be independent director as per Section 149(6). [Section 149(7) is not applicable to a Specified IFSC public company as per notification dated 4th January 2017]

Companies, which secure financial assistance from financial institutions, banks, major shareholders, debenture holders, etc. usually confer on their lenders, power to appoint and terminate the appointments of their nominees on their Boards. Such power is conferred by incorporating appropriate provisions in the financial assistance agreements.

These institutions/banks etc. also insist on borrowing companies to alter their articles of association so as to empower them to appoint and terminate the services of their nominee directors on the Board of the company as and when they like. These directors are known as nominee directors. They are not liable to retire by rotation and hold office at the pleasure of their nominating agencies. They cannot be removed by the company.

Procedure to appoint a nominee director is same as appointment as additional director by the Board or appointment of director other than retiring director by the company in general meeting. Depending upon the term and condition of agreement with the appointing bank/institution/Government, the company may choose any of these two methods.

PROCEDURE FOR APPOINTMENT OF DIRECTORS TO BE ELECTED BY SMALL SHAREHOLDERS

A listed company may have one director elected by small shareholders. Small shareholder means a shareholder holding shares of nominal value of not more than twenty thousand rupees or such other sum prescribed [Section 151 r/w Rule 7 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

1. A listed company, may upon notice of not less than one thousand small shareholders or one-tenth of the total number of such shareholders, whichever is lower, have a small shareholders' director elected by the small shareholders.
2. Small shareholders intending to propose a person as a candidate for the post of small shareholders' director shall leave a notice of their intention with the company at least fourteen days before the meeting under their signature specifying the name, address, shares held and folio number of the person whose name is being proposed for the post of director and of the small shareholders who are proposing such person for the office of director.

If the person being proposed does not hold any shares in the company, the details of shares held and folio number need not be specified in the notice.

3. The notice shall be accompanied by statement of proposed director stating his DIN, that he is not disqualified and his consent to act as director of the company.
4. Such director shall be considered as an independent director subject to being eligible and giving a declaration of his independence in accordance with sub-section (6) and (7) of section 149 of the Act.
5. The small shareholder director shall be elected through postal ballot.
6. Ensure that the proposed director shall not hold the position of small shareholder director in more than 2 companies at the same time. Provided that the second company in which he has been appointed shall not be in a business which is competing or is in conflict with the business of the first company.
7. Such director shall not be retire by rotation and shall have tenure of continuous three years.
8. After completion of tenure small shareholders director shall not be eligible for reappointment.
9. When small shareholders directors cease to be a small shareholder, he cease to be a small shareholders director.
10. The company has to file particulars of director in Form DIR-12 with the Registrar of Companies within thirty days of the appointment after paying the requisite fee electronically.
11. Ensure that said Form is digitally signed by managing director or manager or secretary of the company and also certified by a Company Secretary or Chartered accountant or Cost accountant in Whole time practice by digitally signing it.
12. For the purpose of filing Form DIR-12, the following attachments are required:
    (a) Letter of appointment
    (b) Declaration by the first director
    (c) Declaration of the appointee Director, in Form DIR-2
    (d) Interest in other entities.
13. In case of listed company, the particulars of appointment of director should also be given to the stock exchange where the shares of the company are listed.
14. The particulars of the director and other aspects of the director have to be entered by the company in the registers maintained under Sections 170 and 189.
15. After appointment the director concerned has to inform other companies in which he is director about his appointment.

Appointment of Directors by Members at General Meeting

A person appointed as director shall not act as director unless he gives his consent to hold office of director and such consent in Form DIR - 2 has been filed with the registrar within thirty days of his appointment. The company shall within thirty days of appointment of a director, file such consent with the Registrar in form DIR12. However, a specified IFSC public company shall file such consent in sixty days. In case of section 8 company and Government companies this provision is not applicable. According to Section 152, every director shall be appointed by the company in general meeting.

Separate motion should move for the appointment of each director as per section 162. A motion for approving a person for appointment or for nomination a person for appointment shall also be treated as motion for his appointment.

Under section 152(6), articles of a company may provide that all directors of the company shall be retiring by rotation. Where article does not provide for retirement by rotation for all directors, not less than two – thirds of total number of directors of a public company shall be liable to be retired by rotation and be appointed by company in general meeting. At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed and at every subsequent annual general meeting, one-third of such of the directors for the time being as are liable to retire by rotation, or if their number is neither three nor a multiple of three, then, the number nearest to one-third, shall retire from office. The directors to retire by rotation at every annual general meeting shall be those who have been longest in office since their last appointment, but as between persons who became directors on the same day, those who are to retire shall, in default of and subject to any agreement among themselves, be determined by lot.

As per Section 152(7) (a) if the vacancy of the retiring director is not filled-up and the meeting has not expressly resolved not to fill the vacancy, the meeting shall stand adjourned till the same day in the next week, at the same time and place, or if that day is a national holiday, till the next succeeding day which is not a holiday, at the same time and place.

As per Section 152(7)(b), if at the adjourned meeting also, the vacancy of the retiring director is not filled up and that meeting also has not expressly resolved not to fill the vacancy, the retiring director shall be deemed to have been re-appointed at the adjourned meeting, unless –

i. at that meeting or at the previous meeting a resolution for the re-appointment of such director has been put to the meeting and lost;

ii. the retiring director has, by a notice in writing addressed to the company or its Board of directors, expressed his unwillingness to be so re-appointed;

iii. he is not qualified or is disqualified for appointment;

iv. a resolution, whether special or ordinary, is required for his appointment or re-appointment by virtue of any provisions of this Act; or

v. section 162 is applicable to the case. For the purposes of this section and section 160, the expression "retiring director" means a director retiring by rotation.

Sub-section (6) and (7) of Section 152 shall not apply to:

(a) a Government company, which is not a listed company, in which not less than fifty-one per cent. of paid up share capital is held- by- the Central Government, or by any State Government or Governments or by the Central Government and one or more State Governments;

(b) a subsidiary of a Government company, referred to in (a) above.". - Notification Dated 13th June, 2017.

Procedure for re-appointment of the retiring director at the Annual General Meeting

1. Ascertain which directors are due to retire by rotation. As a general principle, the directors to retire shall be those who have been longest in office since their last appointment. This is applicable only in case of Public Companies.
2. Ensure that the retiring director is not subject to any disqualification for re-appointment as director of the Company under sections 164 and 165 of the Companies Act, 2013.
3. Ensure that the consent of the director as well as the declaration from the director has been obtained.
4. Convene a Board meeting after giving notice to all directors of the company in accordance with Section 173 of the Act, to consider the re-appointment of retiring director.

5. Fix the time, place and agenda of the annual general meeting to pass an ordinary resolution for the reappointment of retiring director.
6. Send the notice in writing at least 21 clear days before the date of annual general meeting to the members such notice is required to be sent to the Stock Exchanges where the shares of company are listed.
7. Hold the annual general meeting and pass an ordinary resolution for re-appointment of the retiring director.
8. In case of listed companies, forward a copy of the proceedings of the annual general meeting to the stock exchanges where the company's shares are listed. [Schedule III of SEBI (Listing Obligation and Disclosure) Regulations 2015].

Right of persons other than retiring directors to stand for directorship [Section 160]

1. A person who is not a retiring director shall be eligible for appointment to the office of a director at any general meeting, if he, or some member intending to propose him as a director, has, not less than fourteen days before the meeting, left at the registered office of the company, a notice in writing under his hand signifying his candidature as a director or, as the case may be, the intention of such member to propose him as a candidate for that office. Such a person may be a member or a non-member, an additional director or a director to fill a casual vacancy or an alternate director or a nominee director.
2. Such notice must come along with the deposit of one lakh rupees or such higher amount as may be prescribed which shall be refunded to such person or, as the case may be, to the member, if the person proposed gets elected as a director or gets more than twenty five per cent of total valid votes cast either on show of hands or on poll on such resolution.

   The requirements of deposit of amount shall not apply in case of appointment of an independent director or a director recommended by the Nomination and Remuneration Committee, if any, constituted under sub-section (1) of section 178 or a director recommended by the Board of Directors of the Company, in the case of a company not required to constitute Nomination and Remuneration Committee
3. Section 160 is not applicable to Government Company where the entire paid up share capital is held by Central Government jointly or severally or in case of subsidiary of Government Company in which the entire paid up capital is held by that Government Company.

Further, Section 160 is not applicable to Private Companies, Section 8 Companies whose article provide for election of directors by Ballot.

Procedure for appointment of a director other than a retiring director at the Annual General Meeting

In case of a public company, the following procedure is to be adopted:

– The candidate for directorship or any member proposing other person for appointment to office of director, is required to give a notice in writing not less than fourteen days before the meeting at the office of the company, signifying candidature for the office of director or intention to propose other person as a candidate for that office, as the case may be, along with a deposit of one lakh rupees which shall be refunded to such person, or as the case may be, to such member, if the person succeeds in getting elected as a director.

  The requirements of deposit of amount shall not apply in case of appointment of an independent director or a director recommended by the Nomination and Remuneration Committee, if any, constituted under

sub-section (1) of section 178 or a director recommended by the Board of Directors of the Company, in the case of a company not required to constitute Nomination and Remuneration Committee.

- On receipt of notice, the company will inform its members of the candidature of a person for the office of director or intention of the member to propose such person as candidate for that office by serving individual notice on the members, not less than seven days before the meeting.
- Where individual notice is not practicable, publish notice not less than seven days before the meeting, in at least two newspapers (one in English and the other in regional language) circulating in the place where the registered office of the company is situated.
- In case of listed company, forward copies of this notice also to the stock exchange, where the shares of the company are listed.
- Check whether the director to be appointed in the general meeting has obtained Director Identification Number (DIN). If not then ask such person to make application to Central Government for obtaining DIN and ensure that the Director has intimated his DIN to the Company.
- Ensure that the consent of the director as well as the declaration from the director has been obtained in Form DIR-2.
- At the general meeting, the motion to appoint a person other than the retiring director will be taken up. Where more than one such proposals are to be decided, they are to be discussed one by one and the decision of the meeting to be arrived at in respect of each proposal separately.
- In case of listed company, send the notice and a copy of the proceedings of the general meeting to the stock exchange with which the company is listed.
- In case the person is appointed as a director, the company shall refund the deposit of one lakh rupees to such person or to such other member, who had proposed his name for directorship.
- The company has to file particulars of director in Form DIR-12 with the Registrar of Companies within thirty days of the appointment after paying the requisite fee electronically.

  Ensure that said Form is digitally signed by managing director or manager or secretary of the company and also certified by a Company Secretary or Chartered accountant or Cost accountant in Whole time practice by digitally signing it.

  For the purpose of filing Form DIR-12, the following attachments are required:

  (a) Letter of appointment

  (b) Declaration by the first director

  (c) Declaration of the appointee Director in Form DIR-2

  (d) Interest in other entities.
- In case of listed company, particulars of appointment of director should also be given to the stock exchange if the shares of the company are listed.
- The particulars of the director and other aspects of the director have to be entered by the company in the registers maintained under Sections 170 and 189.
- After appointment the director concerned has to inform other companies in which he is director about his appointment.

Appointment of Independent directors

(1) Appointment process of independent directors shall be independent of the company management; while selecting independent directors the Board shall ensure that there is appropriate balance of skills, experience and knowledge in the Board so as to enable the Board to discharge its functions and duties effectively. Independent director may be selected from Databank.

(2) The appointment of independent director(s) of the company shall be approved by the company at the meeting of the shareholders.

(3) The explanatory statement attached to the notice of the meeting for approving the appointment of independent director shall include a statement that in the opinion of the Board, the independent director proposed to be appointed fulfils the conditions specified in the Act and the rules made thereunder and that the proposed director is independent of the management. It shall also indicate the justification for choosing the appointee for appointment as Independent Director.

(4) Section 178(3) of the Act provides that the Nomination and Remuneration Committee (NRC) shall formulate the criteria for determining qualifications, positive attributes and independence of a director.

(5) The appointment of independent directors shall be formalized through a letter of appointment, which shall set out:

(a) The term of appointment;

(b) The expectation of the Board from the appointed director; the Board-level committee(s) in which the director is expected to serve and its tasks;

(c) The fiduciary duties that come with such an appointment along with accompanying liabilities;

(d) Provision for Directors and Officers (D and O) insurance, if any;

(e) The Code of Business Ethics that the company expects its directors and employees to follow;

(f) The list of actions that a director should not do while functioning as such in the company; and

(g) The remuneration, mentioning periodic fees, reimbursement of expenses for participation in the Boards and other meetings and profit related commission, if any.

(6) The terms and conditions of appointment of independent directors shall be open for inspection at the registered office of the company by any member during normal business hours.

(7) The terms and conditions of appointment of independent directors shall also be posted on the company's website.

(8) He shall be hold office for a term of upto 5 consecutive years of a company. [Section 149(10)]

Appointment and removal requirements for IDs in case of listed companies-Regulation 25(2A) of SEBI (LODR) Regulations, 2015

The Securities and Exchange Board of India has notified SEBI (LODR) Sixth Amendment Regulations on 14th November, 2022, specifying that the appointment, re-appointment or removal of an independent director of a listed entity, shall be subject to the approval of shareholders by way of a special resolution.

Provided that where a special resolution for the appointment of an independent director fails to get the requisite majority of votes but the votes cast in favour of the resolution exceed the votes cast against the resolution

and the votes cast by the public shareholders in favour of the resolution exceed the votes cast against the resolution, then the appointment of such an independent director shall be deemed to have been made.

Provided further that an independent director appointed under the first proviso shall be removed only if the votes cast in favour of the resolution proposing the removal exceed the votes cast against the resolution and the votes cast by the public shareholders in favour of the resolution exceed the votes cast against the resolution.

In Re Invesco Developing Markets Fund vs. Zee Entertainment Enterprises Ltd. High Court of Bombay Appeal (L) No. 25420 of 2021, it was held that appointment of Independent director of listed company will be made at general meeting and not by Board of Directors.

Appointment of independent director on unlisted material subsidiary company

As per Regulation 24(1) of the SEBI (LODR) Regulations, 2015 at least one independent director on the Board of Directors of the listed company shall be a director on the Board of Directors of an unlisted material subsidiary, whether incorporated in India or not.

"Material Subsidiary" shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed company and its subsidiaries in the immediately preceding accounting year.

Re-appointment of Independent directors

The re-appointment of independent director shall be on the basis of report of performance evaluation. (Schedule IV – Code for Independent Directors) Section 149(11) provides that the Independent Director shall be eligible for re-appointment on passing of special resolution. He shall not hold office for more than 2 consecutive terms, but such independent director shall be eligible for appointment after the expiration of 3 years (cooling period) of ceasing to become an independent director.

However, he shall not, during the said period of 3 years, be appointed in or be associated with the company in any other capacity, either directly or indirectly.

Selection of Independent Directors [Section 150]

(1) An independent director may be selected from a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, maintained by any body, institute or association, as may by notified by the Central Government, having expertise in creation and maintenance of such data bank and put on their website for the use by the company making the appointment of such directors:

Responsibility of exercising due diligence before selecting a person from the data bank referred to above, as an independent director shall lie with the company making such appointment.

(2) The appointment of independent director shall be approved by the company in general meeting as provided in sub-section (2) of section 152 and the explanatory statement annexed to the notice of the general meeting called to consider the said appointment shall indicate the justification for choosing the appointee for appointment as independent director.

(3) The data bank shall create and maintain data of persons willing to act as independent director in accordance to Rule 6 of the Companies (Appointment and Qualifications of Directors) Rules, 2014.

In case of section 8 company - Section 150 shall not apply- Notification dated 5th June, 2015.

On 22nd October, 2019, the Central Government notifies the Indian Institute of Corporate Affairs (IICA) at Manesar (Haryana), as an institute to create and maintain a data bank containing names, addresses and qualifications of persons who are eligible and willing to act as independent directors, for the use of the company making the appointment of such directors. The same came into force with effect from the 1st day of December, 2019.

Enrollment in Data Bank of Independent Director [Rule 6 of the Companies (Appointment and Qualifications of Directors) Rules, 2014

Compliances required by a person eligible and willing to be appointed as an independent director.

(1) Every individual –

(a) who has been appointed as an independent director in a company, on the date of commencement of the Companies (Appointment and Qualification of Directors) Fifth Amendment Rules, 2019, shall within a period of ten months from such commencement; or

(b) who intends to get appointed as an independent director in a company after such commencement, shall before such appointment,

is required to apply online at the website https://iica.nic.in/ to the institute i.e. IICA for inclusion of his name in the data bank for a period of one year or five years or for his life-time and from time to time take steps as specified in Rule 6 (2) of the Companies (Appointment and Qualification of Directors) Rules, 2014, till he continues to hold the office of an independent director in any company.

The expression "institute" means the 'Indian Institute of Corporate Affairs at Manesar' notified under sub-section (1) of section 150 of the Companies Act, 2013 as the institute for the creation and maintenance of data bank of Independent Directors;

(2) Any individual, including an individual not having DIN, may voluntarily apply to the institute for inclusion of his name in the data bank;

(3) Every individual whose name has been so included in the data bank shall file an application for renewal for a further period of one year or five years or for his life-time, within a period of thirty days from the date of expiry of the period upto which the name of the individual was applied for inclusion in the data bank, failing which, the name of such individual shall stand removed from the data bank of the institute. Provided that no application for renewal shall be filed by an individual who has paid life-time fees for inclusion of his name in the data bank;

(4) No application for renewal shall be filed by an individual who has paid life-time fees for inclusion of his name in the data bank;

(5) Every independent director shall submit a declaration of compliance relating to eligibility and registration with IICA databank to the Board, each time he submits the declaration required under sub-section (7) of section 149 of the Act;

(6) Every individual whose name is so included in the data bank shall pass an online proficiency self-assessment test conducted by the institute within a period of 2 years from the date of inclusion of his name in the data bank, failing which, his name shall stand removed from the databank of the institute;

(7) An individual who has obtained a score of not less than fifty percent. in aggregate in the online proficiency self-assessment test shall be deemed to have passed such test;

(8) There shall be no limit on the number of attempts an individual may take for passing the online proficiency self-assessment test.

Exemptions from Online Proficiency Test for inclusion of Individual name in Independent Director's Databank:

An individual shall not be required to pass the online proficiency self-assessment test when he has served for a total period of not less than three years as on the date of inclusion of his name in the data bank,-

(A) as a director or key managerial personnel, as on the date of inclusion of his name in the databank, in one or more of the following, namely:-

(a) listed public company; or

(b) unlisted public company having a paid-up share capital of rupees ten crore or more; or

(c) body corporate listed on any recognized stock exchange or in a country which is a member State of the Financial Action Task Force on Money Laundering and the regulator of the securities market in such member State is a member of the International Organization of Securities Commissions; or

(d) bodies corporate incorporated outside India having a paid-up share capital of US$ 2 million or more; or

(e) statutory corporations set up under an Act of Parliament or any State Legislature carrying on commercial activities; or

(B) in the pay scale of Director or equivalent or above in any Ministry or Department, of the Central Government or any State Government, and having experience in handling,—

(i) the matters relating to commerce, corporate affairs, finance, industry or public enterprises; or

(ii) the affairs related to Government companies or statutory corporations set up under an Act of Parliament or any State Act and carrying on commercial activities.

(C) in the pay scale of Chief General Manager or above in the Securities and Exchange Board or the Reserve Bank of India or the Insurance Regulatory and Exchange Board or the Reserve Bank of India or the Insurance Regulatory and Development Authority of India or the Pension Fund Regulatory and Development Authority and having experience in handling the matters relating to corporate laws or securities laws or economic laws

Further, for the purpose of calculation of the period of three years referred to in the first proviso,any period during which an individual was acting as a director or as a key managerial personnel in two or more companies or bodies corporate or statutory corporations at the same time shall be counted only once. Provided also that the following individuals, who are or have been, for at least ten years :—

(A) an advocate of a court, or

(B) in practice as a chartered accountant, or

(C) in practice as a cost accountant, or

(D) in practice as a company secretary,

shall not be required to pass the online proficiency.

Disqualifications for Appointment of Director- Section 164

1. A person shall not be eligible for appointment as a director of a company, if —

(a) he is of unsound mind and stands so declared by a competent court;

(b) he is an undischarged insolvent;

(c) he has applied to be adjudicated as an insolvent and his application is pending;

(d) he has been convicted by a court of any offence, whether involving moral turpitude or otherwise, and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of expiry of the sentence:

Provided that if a person has been convicted of any offence and sentenced in respect thereof to imprisonment for a period of seven years or more, he shall not be eligible to be appointed as a director in any company;

(e) an order disqualifying him for appointment as a director has been passed by a court or Tribunal and the order is in force;

(f) he has not paid any calls in respect of any shares of the company held by him, whether alone or jointly with others, and six months have elapsed from the last day fixed for the payment of the call;

(g) he has been convicted of the offence dealing with related party transactions under section 188 at any time during the last preceding five years; or

(h) he has not complied with sub-section (3) of section 152;

(i) he has not complied with the provisions of sub-section (1) of section 165.

2. No person who is or has been a director of a company which –

(a) has not filed financial statements or annual returns for any continuous period of three financial years; or

(b) has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more,

shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

Provided that where a person is appointed as a director of a company which is in default of clause (a) or clause (b), he shall not incur the disqualification for a period of six months from the date of his appointment.

However, in case of Government company this sub-section is not applicable.

3. A private company may by its articles provide for any disqualifications for appointment as a director in addition to those specified in sub-sections (1) and (2):

Provided that the disqualifications referred to in clauses (d), (e) and (g) of sub-section (1) shall continue to apply even if the appeal or petition has been filed against the order of conviction or disqualification.

MCA vide its notification dated 12th September 2017 published the list of directors associated with struck off companies and DISQUALIFIED all such Directors associated with such Companies which have not completed their annual filing for continuous period of three financial years, through the Registrar of Companies under Companies Act, 2013.

Vacation of Office

According to Section 167 of the Companies Act, 2013, the office of a director shall become vacant in case–

(a) he incurs any of the disqualifications specified in section 164; the office of the director shall become vacant in all the companies, other than the company which is in default under that sub-section;

(b) he absents himself from all the meetings of the Board of Directors held during a period of twelve months with or without seeking leave of absence of the Board;

(c) he acts in contravention of the provisions of section 184 relating to entering into contracts or arrangements in which he is directly or indirectly interested;

(d) he fails to disclose his interest in any contract or arrangement in which he is directly or indirectly interested, in contravention of the provisions of section 184;

(e) he becomes disqualified by an order of a court or the Tribunal;

(f) he is convicted by a court of any offence, whether involving moral turpitude or otherwise and sentenced in respect thereof to imprisonment for not less than six months.

Provided that the office shall not be vacated by the director in case of orders referred to in clauses (e) and (f)-

(i) for thirty days from the date of conviction or order of disqualification;

(ii) where an appeal or petition is preferred within thirty days as aforesaid against the conviction resulting in sentence or order, until expiry of seven days from the date on which such appeal or petition is disposed of; or

(iii) where any further appeal or petition is preferred against order or sentence within seven days, until such further appeal or petition is disposed of.

(g) he is removed in pursuance of the provisions of this Act;

(h) he, having been appointed a director by virtue of his holding any office or other employment in the holding, subsidiary or associate company, ceases to hold such office or other employment in that company.

Where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

A private company, which is not a subsidiary of a public company, may, by its articles, provide additional grounds for vacation of office of director.

On vacation of office of director, the company is required to file eForm DIR – 12 to the Registrar of Companies.

If a person, functions as a director even when he knows that the office of director held by him has become vacant on account of any of the disqualifications specified in sub-section (1), he shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

CASE LAW

In Re. G. Vasudevan vs. Union of India (Madras High Court) Date of Judgment: 02nd December, 2019

Section 167(1)(a) Companies Act not violative of Articles 14, and 19(1)(g) of the Constitution of India.

The issue raised was that the Section 167(1)(a) of the Companies Act 2013, as inserted vide the Companies (Amendment) Act 2017 as ultra vires the Articles 14, 19(1)(g) of the Constitution of India.

Section 167 of the Companies Act gives instances where the office of a Director shall become vacant. The proviso which is under challenge in the instant writ petition states that, when a company commits a default as stipulated in sub-section 2 of Section 164, then a Director of such defaulting company does not vacate the post in the company in which the default is committed but a Director of such a company has to vacate his seat as a Director in all other companies in which he is Director. The petitioner contends that proviso to Section 167(1)(a) of the Companies Act, leads to unequal treatment being met out to Directors of a defaulting company based on whether they are Directors in other companies or not. The petitioner claims that this leads to unfair treatment to those Directors who hold such posts in multiple companies.

The Court observed that the "purpose of the amendment was that if the post of Directorship is vacated under the provision (as it was) then, this post would remain vacant as these provisions would automatically apply to any individual subsequently appointed".

The Court has held that the proviso to Section 167(1)(a) must be interpreted in ordinary terms and would apply to the entirety of Section 164 including sub-section 2. The Court has further held that this proviso can be justified on two grounds. Firstly, it has been reiterated that the exclusion of Directors from vacating their posts in the defaulting company while doing so in all other companies where they hold Directorship has been done in order to prevent the anomalous situation wherein the post of Director in a company remains vacant in perpetuity owing to automatic application of Section 167(1)(a) to all newly appointed Directors. Secondly, the underlying object behind the proviso to Section 167(1)(a) is seen to be the same as that of Section 164(2) both of which exist in the interest of transparency and probity in governance, Owing to these justifications, the Court thus holds that the proviso to Section 167(1)(a) is neither manifestly arbitrary nor does it offend any of the fundamental rights guaranteed under Part III of the Constitution of India.

Resignation of Directors

According to section 168 –

1. A director may resign from its office by giving a notice with the reasons of resignation in writing to the company.
2. The Board shall on receipt of such a notice from a director shall take note of the same.
3. The company shall within 30 days from the date of receipt of notice of resignation from a director, intimate the registrar in Form DIR-12 and post the information on its website if any as provided in Rule 15 of the companies (Appointment and Qualification of Directors) Rules, 2014.
4. The board shall place the facts of such resignation by the director in the Report of Directors laid in immediately following general meeting by the company.
5. The Director may within 30 days from his resignation, forward to the registrar a copy of his resignation along with reasons for resignation with reasons provided therein in Form DIR-11 along with the fee provided. In case of Specified IFSC public and private company, a director may file Form DIR-11 to the Registrar.
6. The resignation shall be effective from the date on which the notice is received by the company or the date specified by the Director in the notice whichever is later.
7. When all the Directors resign at the same time under section 167, in such case the required number of directors are to be appointed by the promoter or in his absence, the Central Government. The Directors so appointed shall hold office till the Directors are appointed by the company in general meeting. The proviso to sub section (2) of section 168 of Companies Act, 2013 clarifies that the Director who shall be liable even after his resignation for the offences which occurred during his tenure.

The proviso to sub section (2) of section 168 of Companies Act, 2013 clarifies that the Director who shall be liable even after his resignation for the offences which occurred during his tenure.

In Re. Harish Jain Vs. Haveli Restaurant & Resorts limited & Ors. dated 26th February, 2020

The NCLAT dismissed the claims of appellant on the ground that he failed to prove his resignation letter is a forged document.

Removal of Directors

Under section 169 of the Act, a company may, by ordinary resolution remove a director before the expiry of the period of his office. The provisions of section 169 shall apply regardless of the way in which the director concerned was appointed and notwithstanding anything contained in the articles of the company or any agreement with the director concerned.

Removal of Director by Shareholders

According to Section 169, a company may, by ordinary resolution, remove a director, not being a director appointed by the Tribunal under section 242, before the expiry of the period of his office after giving him a reasonable opportunity of being heard.

An independent director re-appointed for second term under sub-section (10) of section 149 shall be removed by the company only by passing a special resolution and after giving him a reasonable opportunity of being heard.

The provision relating to removal shall not apply where the company has availed itself of the option to appoint not less than two – thirds of the total number of directors according to the principle of proportional representation.

Procedure for Removal of Director

The following procedure is required to be adopted for removal of a director:

1. A special notice from a member of the company proposing an ordinary resolution for removing the director is necessary.
2. Send forthwith a copy of the special notice to the director proposed to be removed.
3. Decision to call a general meeting through the Board resolution.
4. Issue notice of the general meeting in writing at least twenty-one clear days before the date of the meeting informing about the special notice and proposing the ordinary resolution for removal.
5. In the notice of the meeting, state the facts of the representation made by the director concerned and also send a copy of the representation to every member of the company to whom notice of the meeting is sent (whether before or after the receipt of the representations by the company).
6. If the representation is received too late and it could not be sent to the members, the director concerned may require that the representation shall be read out at the meeting. The director concerned has also the right of being heard at the meeting.
7. However, the National Company Law Tribunal on an application of the company or any other person who claims to be aggrieved, on having satisfied, may dispense with the procedure of sending a copy of representation and reading thereof at the meeting if it is being used to secure needless publicity for defamatory matter.

8. In case of listed company, send notice of the general meeting to the stock exchange(s) within 24 hours of the occurrence of the event where the company is listed [Refer regulation 30(6) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015].

9. Hold the general meeting and pass the proposed resolution by ordinary resolution.

10. In case of listed company, forward a copy of the proceedings of the meeting within 24 hours of the occurrence of the event to the stock exchange(s) where the company is listed.

11. The company has to file particulars of director in Form DIR – 12 with the Registrar of Companies within thirty days of the removal after paying the requisite fee electronically.

    For the purpose of filing Form DIR – 12, the following attachments are required:

    (a) Notice of resignation;

    (b) Evidence of Cessation;

    (c) Interest in other entities.

    Ensure that said Form is digitally signed by managing director or manager or secretary of the company and also certified by a Company Secretary or Chartered accountant or Cost accountant in Whole time practice by digitally signing it.

12. The particulars of the director and other aspects of the director have accordingly to be modified in the registers maintained under Sections 170 and 189.

13. Give a general public notice in newspaper regarding removal of the director if it is so warranted for the protection of the company and benefit of the general public.

Removal of Director by the National Company Law Tribunal

Where an application has been made to the National Company Law Tribunal under Section 241 of the Companies Act 2013 for prevention of oppression or mismanagement and the Tribunal has conducted its proceedings on the application, it has the power under Section 242(2)(h) of the Act, to remove any director.

In Re. S. Varadarajan and Anr. v. Udhayem Leasing and Investments Pvt. Ltd. [(2005) Vol. 125 CC 853]

It was held that "Any omission to serve a special notice on the directors sought to be removed, would constitute denial of their statutory right of reply and in the absence of such notice to the directors, any resolution for their removal would be vitiated by such omission". In *Giridhar Gopal Gupta and Ors. v. AAR Gee Board Mills P. Ltd. and Ors (2004) Vol. 60 CLA 182*, It was held that, "any removal of directors belonging to one of the two equal groups of the company and appointment of an additional director not in conformity with the procedure laid down in the Act, would result in setting aside such removal of directors, being bad in law".

LOANS TO DIRECTORS (SECTION 185)

(1) According to section 185(1), no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by,—

    (a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

    (b) any firm in which any such director or relative is a partner.

(2) A company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, subject to the condition that—

(a) A special resolution is passed by the company in general meeting:

Provided that the explanatory statement to the notice for the relevant general meeting shall disclose the full particulars of the loans given, or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security and any other relevant fact; and

(b) the loans are utilised by the borrowing company for its principal business activities.

For the purposes of this sub-section, the expression "any person in whom any of the director of the company is interested" means –

(a) any private company of which any such director is a director or member;

(b) any body corporate at a general meeting of which not less than twenty-five per cent. of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(c) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

(3) Nothing contained in sub-sections (1) and (2) shall apply to—

(a) the giving of any loan to a managing or whole-time director—

(i) as a part of the conditions of service extended by the company to all its employees; or

(ii) pursuant to any scheme approved by the members by a special resolution; or

(b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three years, five years or ten years Government security closest to the tenor of the loan; or

(c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or

(d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

Provided that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities.

(4) If any loan is advanced or a guarantee or security is given or provided or utilised in contravention of the provisions of this section,—

(i) the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees;

(ii) every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees; and

(iii) the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both.

Disclosures by a director of his interest

Section 184 (1) states that every director shall at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the disclosures already made, then at the first Board meeting held after such change, disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding, in such manner as may be prescribed in Rule 9 of Companies (Meetings of Board and its Powers) Rules, 2014.

Section 184(2) states that every director of a company who is in any way, whether directly or indirectly, concerned or interested in a contract or arrangement or proposed contract or arrangement entered into or to be entered into—

(a) with a body corporate in which such director or such director in association with any other director, holds more than two per cent. shareholding of that body corporate, or is a promoter, manager, chief executive officer of that body corporate; or

(b) with a firm or other entity in which, such director is a partner, owner or member, as the case may be, shall disclose the nature of his concern or interest at the meeting of the Board in which the contract or arrangement is discussed and shall not participate in such meeting.

Provided that where any director who is not so concerned or interested at the time of entering into such contract or arrangement, he shall, if he becomes concerned or interested after the contract or arrangement is entered into, disclose his concern or interest forthwith when he becomes concerned or interested or at the first meeting of the Board held after he becomes so concerned or interested.

Further as per section 184(3), a contract or arrangement entered into by the company without disclosure under sub-section (2) or with participation by a director who is concerned or interested in any way, directly or indirectly, in the contract or arrangement, shall be voidable at the option of the company.

It is also stated that, nothing in this section—

(a) shall be taken to prejudice the operation of any rule of law restricting a director of a company from having any concern or interest in any contract or arrangement with the company;

(b) shall apply to any contract or arrangement entered into or to be entered into between two companies or between one or more companies and one or more bodies corporate where any of the directors of the one company or body corporate or two or more of them together holds or hold not more than two per cent. of the paid-up share capital in the other company or the body corporate.

Penalty:

If a director of the company contravenes the provisions of sub-section (1) or sub-section (2) of Section 184, such director shall be liable to a penalty of one lakh rupees.

In case of private company - Section 184 (2) shall apply; with the exception that the interested director may participate in such meeting after disclosure of his interest and in case of Section 8 company - Section 184 (2) shall apply, only if the transaction with reference to section 188 on the basis of terms and conditions of the contract or arrangement exceeds one lakh rupees.

Further, in case of Specified IFSC Public Company - Sub-section (2) of section 184 shall apply with the exception that interested director may participate in such meeting provided the disclosure of his interest is made by the concerned director either prior or at the meeting.

Rule 9 of the Companies (Meetings of Board and its Powers) Rules, 2014

(1) Every director shall disclose his concern or interest in any company or companies or bodies corporate (including shareholding interest), firms or other association of individuals, by giving a notice in writing in Form MBP 1.

(2) It shall be the duty of the director giving notice of interest to cause it to be disclosed at the meeting held immediately after the date of the notice.

(3) All notices shall be kept at the registered office and such notices shall be preserved for a period of eight years from the end of the financial year to which it relates and shall be kept in the custody of the company secretary of the company or any other person authorised by the Board for the purpose.

DUTIES OF DIRECTORS [SECTION 166]

The duties of directors as contained in section 166 of the Companies Act, 2013 are described as follows:

1. **Duty to act as per the articles of the company**

   The director of a company shall act in accordance with the articles of the company.

2. **Duty to act in good faith**

   A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.

3. **Duty to exercise due care**

   A director of a company shall exercise his duties with due and reasonable care, skill and diligence and shall exercise independent judgment.

4. **Duty to avoid conflict of interest**

   A director of a company shall not involve in a situation in which he may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.

5. **Duty not to make any undue gain**

   A director of a company shall not achieve or attempt to achieve any undue gain or advantage either to himself or to his relatives, partners, or associates and if such director is found guilty of making any undue gain, he shall be liable to pay an amount equal to that gain to the company.

6. **Duty not to assign his office**

   A director of a company shall not assign his office and any assignment so made shall be void.

Punishment for contravention

If a director of the company contravenes the provisions of this section such director shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees.

REGISTER OF DIRECTORS AND KEY MANAGERIAL PERSONNEL AND THEIR SHAREHOLDING

Section 170 makes it obligatory for every company to maintain a register containing the prescribed particulars of all its directors and Key Managerial Personnel and their shareholding.

The provisions of section 170 read with Rule 17 and Rule 18 of the Companies (Appointment and Qualification of Directors) Rules, 2014 are as follows:

(i) Every company shall keep at its registered office a register containing such particulars of its directors and key managerial personnel as may be prescribed and which shall include details of securities held by each of them in the company or its holding, subsidiary, subsidiary of its holding companies or associate companies. [Section 170(1)]

(ii) A return containing such particulars and documents as may be prescribed, of the directors and the key managerial personnel shall be filed with the Registrar in e-form DIR-12 within 30 days from the appointment of every director and key managerial personnel, as the case may be, and within 30 days of any change taking place. [Section 170(2)]

In case of Government Company - Section 170 shall not apply to Government Company in which the entire share capital is held by the Central Government, or by any State Government or Governments or by the Central Government or by one or more State Governments (Notification dated 5th June, 2015).

In case of Specified IFSC Public Company and Specified IFSC Private Company - In section 170(2) as stated above, for the words "thirty days" at both places is read as "sixty days" (Notification Dated 4th January 2017).

In Re Welspun project Ltd, NCLT Ahmedabad bench T.P. NO. 149/621A/NCLT/AHM/2016, in this case the register of directors' shareholding of petitioner company did not disclose complete particulars as required under section 307 (170 of Companies Act, 2013) and this violation was continued for about 8 years. Petitioners admitted such violation and filed petition under section 621A (section 441 of the Companies Act, 2013) for compounding violation. The RoC informed the facts that no similar offence under section 307 was compounded during last three years by petitioners and company was not included in list of vanishing company. It was held that as there was no repetition of such violation, offence committed was to be compounded on payment of fine.

MEMBERS RIGHT TO INSPECT (SECTION 171)

(i) The register of directors and Key Managerial Personnel kept under section 170(1) shall be open for inspection during business hours and the members shall have the right to take extracts there from and copies thereof, on request and will be provided within 30 days free of cost. [Section 171(1)(a)]

(ii) Such register shall also be kept open for inspection at every annual general meeting of the company and shall be made accessible to any person attending the meeting. [Section 171(1)(b)]

(iii) If any inspection during business hours is refused, or if any copy required as above is not sent within thirty days from the date of receipt of such request, the Registrar shall on an application made to him order immediate inspection and supply of copies required there under. [Section 171(2)]

In case of Government Company - Section 171 shall not apply to Government Company in which the entire share capital is held by the Central Government, or by any State Government or Governments or by the Central Government or by one or more State Governments. Notification dated 5th June, 2015.

SPECIMEN RESOLUTION

1. Board Resolution for appointing a person as additional director of the company

"**RESOLVED THAT** pursuant to the provisions of Section 161 of the Companies Act, 2013 and other applicable provisions (including any modification or re-enactment thereof), if any, Mrs. ABC (DIN: _____), who has signified her consent to act as a director, be and is hereby appointed as an Additional Director of the Company to hold office with effect from _____ and shall hold office upto the date of the ensuing Annual General Meeting of the Company.

RESOLVED FURTHER THAT Mr. Z (Director) and/or Mr. Y (Director), of the Company be and are hereby authorized to do all acts, deeds, matters, and things as may be deemed necessary and to sign and execute all necessary documents, applications, and returns for the purpose of giving effect to the aforesaid resolution along with filing of necessary e-form(s) with the Registrar of Companies."

2. Board Resolution Accepting Director's Resignation

"RESOLVED THAT the resignation of Mr. XYZ (DIN: _____) from the directorship of the Company be and is hereby accepted with effect _____, as due to pre-occupations, Mr. XYZ would not be able to devote his time to the affairs of the Company.

RESOLVED FURTHER THAT the Board places on record their appreciation for the assistance and guidance provided by Mr. XYZ (DIN: _____) during his tenure as Director of the Company.

RESOLVED FURTHER THAT any directors of the Company be and is hereby authorized to do all such acts and deeds as may be deemed necessary to give effect to the above resolution."

3. Appointment of First Directors

"RESOLVED THAT the following persons, whose names are given as first directions of the company under the Article number..... of the Articles of Association of the company hereby constitute the board of directors of the and first directors of the company:

1. Mr/Mrs.....
2. Mr/Mrs.....
3. Mr/Mrs.....

RESOLVED FURTHER THAT Mr. ....., Director of the company be and is hereby authorized to make necessary entries in the Register of Directors and Register of Director's shareholding."

LESSON ROUND-UP

- To attain the objectives prescribed in Memorandum of Association of the company, company depends on Board of Directors. Directors of a company are its eyes, ears, brain, hands and other essential limbs.
- The concept of a Director Identification Number (DIN) has been introduced for the first time in the year 2006. It is an 8-digit unique identification number that has lifetime validity.
- A director to the Board may be appointed as; first director, resident director, woman director, independent director, alternate director, additional director, small shareholder director, nominee director and professional director.
- Every public company shall have at least 3 directors and every private company shall have at least 2 directors and every one person company shall have at least 1 director as per section 149.
- Section 164 lays down disqualifications of directors.
- Section 166 (6) of the Companies Act, 2013, prohibits assignment of office of director to any other person.
- Certain prescribed class or classes of companies is required to have at least one woman director.
- Every company including one person company shall have at least on director who stays in India for a period of not less than 182 days during the financial year.

- The members of a company may, by special resolution, specify any lesser number of companies in which a director of the company may act as director.
- A director may be removed from the office by giving a special notice.

GLOSSARY

DIN: Director Identification Number

IICA: The Indian Institute of Corporate Affairs

TEST YOURSELF

(*These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation*)

1. Explain the concept appointment of small shareholder directors?
2. Does a person intends to be an independent director need to get itself registered in databank?
3. How to apply for DIN ?
4. What are the qualifications of a director? When is a person disqualified for appointment as a director of the company?
5. Does every willing and eligible independent director needs to pass online proficiency test? What are the exceptions?
6. Mr. 'A' is to be appointed as independent director. Explain the law relating to number of directors.
7. Mr. 'A' an independent director of ABC ltd. Has Mr. B as alternate director. Mr. B is also the Vice President and Director of the company. Explain the nature of working and legal interpretation?
8. How can the directors be removed from the office before the expiry of their term?
9. Under what circumstances is a director deemed to have vacated the office of directorship?
10. Guru is the director of Superwell Trading Ltd. The name of the company was recently struck off from the register of companies by the Registrar. He does not hold directorship in any other company. Therefore, Guru applied to the Registrar for cancellation of his Directors Identification Number. His application was rejected by the Registrar. Is the action of the Registrar justified under the relevant provisions of the Companies Act, 2013?
    (a) No, Guru has applied for cancellation of DIN through valid E form, the ROC shall accept the E Form
    (b) No, Guru has applied for cancellation of DIN through valid E form, the ROC shall accept the E Form
    (c) Yes, Guru has applied for cancellation of DIN despite the fact that he was appointed director using his DIN, such DIN shall not be deactivated and DIR-5 cannot be filed, the action of the Registrar of Companies is correct
    (d) No, Guru has applied for cancellation of DIN through wrong E Form.

11. Independent directors (ID) of Apex global Ltd. a listed company decided to convene a meeting of IDs on their own. Non-Independent directors objected to and called it as illegal.

    Choose the correct answer:

    (a) Separate meeting of Independent Directors is not valid and Non- Independent Directors can challenge this as per section 149(8) read with Schedule IV of the Companies Act, 2013.

    (b) Separate meeting of Independent Directors is valid and Non- Independent Directors cannot challenge this as per section 149(8) read with Schedule IV of the Companies Act, 2013.

    (c) Separate meeting of Independent Directors is valid after the approval from audit committee.

    (d) Separate meeting of Independent Directors is valid after the seeking permission from Board and shareholders of the company.

12. Rajeev and his wife Surekha are the only two directors of Rajsur Pvt. Ltd. Rajeev went abroad for two months. Before going abroad, he registered a general power of attorney in favour of his son Ranbeer, aged 21 years, to execute all documents on his behalf as an individual as well as director of Rajsur Pvt. Ltd. Ranbeer signed a contract on behalf of Rajsur Pvt. Ltd. by exercising his power of attorney. Is this contract binding upon the company?

    (a) No, Section 166 (6) of the Companies Act 2013 prohibits assignment of office of director to any other person. Any assignment of office made by a director shall be void. Authorizing any person to sign a document as a director amounts to assignment of office of director.

    (b) Yes, Section 166 (6) of the Companies Act 2013 allows assignment of office of director to any other person in his absence for more than 45 days.

    (c) No, Section 170 of the Companies Act 2013 prohibits assignment of office of director to any other person. Any assignment of office made by a director shall be void. Authorizing any person to sign a document as a director amounts to assignment of office of director.

    (d) Yes, Section 170 of the Companies Act 2013 allows assignment of office of director to any other person in his absence for more than 30 days.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- The Companies Act, 2013
- The SEBI (LODR) Regulations, 2015

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==
- https://www.sebi.gov.in/sebiweb/home/HomeAction.do?doListing=yes&sid=1&ssid=3&smid=0

Board Composition and Powers of the Board

Lesson 15

KEY CONCEPTS

■ Board of Director ■ Vigil Mechanism ■ Committees ■ Board Composition ■ Office of Profit ■ Related Party ■ Arm's Length Transaction ■ Omnibus Approval ■ Free Reserves ■ Inter-Corporate Loan

Learning Objectives

To understand:

- Board Composition, its Power and Restrictions
- Role of Board, which is responsible for the company's overall commercial performance as well
- Aims and objectives of Different committees constituted by the Board of the Company along with essential for its effective functioning
- Overview of Inter-Corporate Loans Investments, Guarantees and Security
- Related Party Transactions

Lesson Outline

- Introduction
- Board Composition
- Board Committees
- Restriction and Powers of Board
- Overview on Inter-Corporate Loans and Investments by Company
- Investment of Company to be held in its Own Name
- Related Party Transactions
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 149, 165, 177 to 188)
- The Companies (Meetings of Board and its Powers) Rules, 2014
- SEBI (LODR) Regulations, 2015
- Secretarial Standards (SS-I & SS-2)

INTRODUCTION

At the core of the corporate governance practices is the Board of Directors which oversees how the management serves and protects the long term interests of all the stakeholders of the company. The institution of Board or directors was based on the premise that a group of trustworthy and respectable people should look after the interests of the large number of shareholders who are not directly involved in the management of the company.

The shareholders and investors repose confidence on the Board of Directors as their representatives for conducting and monitoring the affairs of the company. The position of Board of Directors is that of trust as the Board is entrusted with the responsibility to act in the best interests of the company. The Board is accountable to the shareholders for creating, protecting and enhancing wealth, ensuring optimum utilisation of resources of the company, and reporting to them on the performance in a timely and transparent manner. The Board is ultimately responsible for ensuring compliance of various applicable laws in the best interests of stakeholders.

The Board generally performs three major roles in a company –

- provide direction (i.e. set the strategic direction of the company);
- control (i.e. monitor the management);
- provide support and advice (advisory role).

The board should comprise of independent minded directors. It should include an appropriate combination of executive directors, independent directors and non-independent non-executive directors to prevent one individual or a small group of individuals from dominating the board's decision making. The board should be of a size and level of diversity commensurate with the sophistication and scale of the organization. Appropriate board committees may be formed to assist the board in the effective performance of its duties. Truly independent boards are vital for effective governance.

As former UK Financial Reporting Council Chairman, Sir Christopher Hogg has noted, "Good boards are pretty uncomfortable places and that's where they should be."

Section 2(10) of the Companies Act, 2013 defines that "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company.

In *Jatan Kanwar vs. Golcha Properties 1971 AIR 374*, it was held that the power of management of the company is vested in the Board of Directors as a result of the Companies Act as well as the Articles of Association of the company unless and until the general body by the policy of its Articles chooses to take them away, and substitute others more to its taste, the Board of Directors in its right continues to manage the affairs of the company. The decisions of the Board of Directors are to be taken by a majority.

BOARD COMPOSITION

Only Individuals as Directors- Section 149(1) of the Companies Act, 2013 provides that only an individual can become a director. As per clause (34) of Section 2 of the Act, "director" means a director appointed to the Board of a company. Therefore, an individual who is appointed to the Board of a company is a Director.

Thus, 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: Section 149(1) of the Companies Act, 2013 requires that Board needs to have a minimum of:

(i) 3 Directors in case of a public company;

(ii) 2 Directors in the case of a private company; and

(iii) 1 Director in the case of a One Person Company.

Regulation 17 of the SEBI (LODR) Regulations, 2015 prescribes that the board of directors of the top 1000 listed entities (with effect from April 1, 2019) and the top 2000 listed entities (with effect from April 1, 2020) shall comprise of not less than six directors.

Explanation: The top 1000 and 2000 entities shall be determined on the basis of market capitalisation as at the end of the immediate previous financial year.

Minimum number of Directors in case of Producer Companies

Section 378(o) provides that Every Producer Company shall have at least 5 and not more than 15 directors:

Provided that in the case of an inter-State co-operative society incorporated as a Producer Company, such company may have more than fifteen directors for a period of one year from the date of its incorporation as a Producer Company.

Further, the Members who sign the memorandum and the articles may designate therein the Board of Directors, not less than five, who shall govern the affairs of the Producer Company until the directors are elected in accordance with the provisions of section 378P. The election of directors shall be conducted within a period of ninety days of the registration of the Producer Company.

Furthermore, in case of an inter-State co-operative society which has been registered as a Producer Company under sub-section (4) of section 378J in which at least five directors [including the directors continuing in office under sub-section (1) of section 378N] hold office as such on the date of registration of such company, the provisions of this sub-section shall have effect as if for the words "ninety days", the words "three hundred and sixty-five days" had been substituted.

Maximum number of Directors

Section 149(1) of the Companies Act, 2013 permits a maximum of 15 directors on the Board. However, a company may appoint more than 15 directors after passing a special resolution.

Government and Section 8 Companies are allowed to appoint more than 15 directors without passing special resolution. The Central Government has by separate notifications exempted Government Companies and Section 8 companies from the provisions of section 149 (1) (b) and first proviso of Section 149(1). Notification dated 05th June, 2015 & 13th June, 2017.

CASE LAW

In Re The Registrar of Companies, West Bengal (Appellant) Vs. Karan Kishore Samtani (Respondent) Company Appeal (AT) No.13 of 2019,dated 24/06/2020, (The National Company Law Appellate Tribunal) (NCLAT)

Number of Directorships by a Director-Minimum Fine

The Respondent was the Director, for more than 20 Companies till 31.03.2015. The Respondent tendered his resignation as the Director of the Company M/s Fabius Properties Pvt. Ltd. The same was accepted by the Board of Directors of the Companies on 29.12.2015. However, the intimation of his resignation was sent to the Registrar of Companies *vide* Form DIR-12 on 10.02.2016.

The Respondent has violated the provisions under Section 165(1) read with Section 165(3) of the Companies Act, 2013 which is punishable under Section 165(6) of the Act, The NCLT, Kolkata bench has imposed compounding fees of Rs. 50,000/- which is less than minimum fees prescribed under Section 165(6) of the Companies Act, 2013.

The issue for consideration is, whether Tribunal can impose the compounding fees under Section 441 (1) of the Companies Act, 2013, less than minimum prescribed fine for the offence under Section 165 (1) read with Section 165(6) of the Companies Act, 2013.

The NCLAT held that the NCLT, Kolkata Bench has failed to notice the minimum fine prescribed under Sub-Section (6) of Section 165 of the Companies Act, 2013 which was applicable at relevant time.

The Respondent has contravened the provisions of 165(1) of the Companies Act, 2013 which is punishable under Sub-Section (6) of Section 165 of the Companies Act, 2013. Taking into consideration, the facts and circumstances of the case, NCLAT imposed minimum fine at the rate of five thousand rupees for every day for the period 01.04.2015 to 21.02.2016 i.e. 272 days. The NCLAT quantified the penalty amount to Rs. 13,60,000/-. The Respondent has already paid Rs. 50,000/- after adjustment, now he is liable to pay Rs. 13,10,000/-. Therefore, The Respondent is directed to pay such amount within a period of 60 days in National Company Law Tribunal, Kolkata.

Number of Directors falling below minimum

If strength of directors falls below statutory minimum prescribed in the Act or Articles, the decisions taken shall not be valid. If the Articles prescribe for a higher limit of quorum than the higher number will have to be complied with. If the number of directors is as per statutory minimum but less than that as per the articles than also the decision taken shall not be valid for want of quorum.

Board Composition in Listed Entities

Independence of the Board and its' composition with a balanced mix of executive and non-executive directors is prescribed under Regulation 17 of SEBI (LODR) Regulations, 2015, which stipulates that the composition of board of directors of the listed entity shall be as follows:

(i) Board of directors shall have an optimum combination of executive and non-executive directors with at least one woman director and not less than fifty per cent. of the board of directors shall comprise of non-executive directors;

(ii) Board of directors of the top 500 listed entities required to have at least one independent woman director by April 1, 2019 and the Board of directors of the top 1000 listed entities required to have at least one independent woman director by April 1, 2020;

Explanation: The top 500 and 1000 entities shall be determined on the basis of market capitalisation, as at the end of the immediate previous financial year.

(iii) Where the chairperson of the board of directors is a non-executive director, at least one-third of the board of directors shall comprise of independent directors and where the listed entity does not have a regular non-executive chairperson, at least half of the board of directors shall comprise of independent directors:

Provided that where the regular non-executive chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the level of board of director or at one level below the board of directors, at least half of the board of directors of the listed entity shall consist of independent directors.

Explanation.- For the purpose of this clause, the expression "related to any promoter" shall have the following meaning:

(i) if the promoter is a listed entity, its directors other than the independent directors, its employees or its nominees shall be deemed to be related to it;

(ii) if the promoter is an unlisted entity, its directors, its employees or its nominees shall be deemed to be related to it.

(iv) Where the listed company has outstanding SR equity shares, at least half of the board of directors shall comprise of independent directors.

(v) No listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years unless a special resolution is passed to that effect, in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such a person.

(***Cross Reference***: *For more details Student are advised to refer Lesson 10 of Capital Market & Securities Law)*

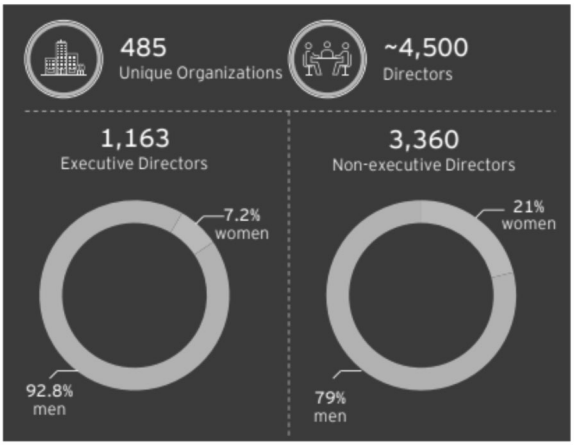
EY released its report on 'D*iversity in the Boardroom: Progress and the way forward*' highlighting its findings on the representation of women on Indian boards and emphasizing the actions organizations must take to increase gender diversity.

During 2013- 2022, India made significant and rapid progress in increasing women representation on boards from 6% in 2013 to 18% in 2022.

Executive versus Non-executive Directors: the great divide

In 2022, women account for 7.2% of executive positions on Indian Boards compared to 6% in 2017.

The growth of women in non-executive positions on Indian Boards paints a more encouraging picture as it has increased from 16% in 2017 to 21.4% in 2022.



95% companies

In 2022, Almost 95% companies out of NIFTY500 have one woman Board member compared to 69% in 2017

Traditionally, women representation on Indian Boards has been limited to leadership positions in Grievance and CSR committees; however, this is changing. Across NIFTY500, the Nomination and Remuneration Committee (NRC) and Audit Committee, customarily reserved for male Board members, had 13% and 12% women Board members respectively in 2017. In 2020, this had increased to 18% and 16%, respectively.

More than 40% of the companies have gone beyond the regulatory mandated limit and have appointed more than one women Board member. There is no doubt that Indian companies are making progress with respect to women representation on Boards; however, statistics highlight that there is still room for improvement as **less than 5% of companies have women as Chairpersons.**

Source: https://assets.ey.com/content/dam/ey-sites/ey-com/en_in/topics/women-fast-forward/2022/09/ey-dei-report.pdf

What is the difference between the term "Non Executive" and "Independent Director" of the Company?

Non-Executive Director of a company simply means a person not holding a position as an executive in the company. Such a director may or may not be an independent director.

An independent director on the other hand means a director, other than a managing director or a whole-time director or a nominee director and is one who fulfills the criteria laid down under Section 149 of the Companies Act 2013, in addition, to the criteria laid down under regulation 16(1)(b) of the SEBI (LODR) Regulations, 2015.

All non- executive directors need not be independent directors, but all independent directors are non-executive director.

Number of Directorships [Section 165]

Limit on Number of Directorships:

As per the provisions of section 165(1) of the Act, the maximum number of directorships shall be as under:

(i) Maximum directorships in aggregate (including alternate directorships) is 20 at the same time;

(ii) Maximum directorship in public companies is 10 companies. This includes directorship in private companies that are either holding or subsidiary company of a public company.

For reckoning the limit of Directorships of twenty companies, the Directorship in a dormant company shall not be included.

The members of a company may, however by passing a special resolution, specify any lesser number of companies in which a director of the company may act as a director.

Section 165 (3) provides that any person holding office as director in companies more than the limits as specified in sub-section (1), immediately before the commencement of this Act shall, within a period of one year from such commencement—

(a) choose not more than the specified limit of those companies, as companies in which he wishes to continue to hold the office of director;

(b) resign his office as director in the other remaining companies; and

(c) intimate the choice made by him under clause (a), to each of the companies in which he was holding the office of director before such commencement and to the Registrar having jurisdiction in respect of each such company.

Exceptions:

Section 165(1) that provides for maximum number of Directorship that a person can hold including alternate Directorship to be twenty companies - shall not be applicable to a section 8 company-Notification dated 05th June, 2015.

Personal liability of the directors to adhere to the limits

In case a person accepts an appointment as a director in violation of Section 165, he shall be liable to a penalty of two thousand rupees for each day after the first during which such violation continues, subject to a maximum of two lakh rupees.

It is the Director's personal liability to ensure compliance with the limits imposed on number of directorships.

Illustration- Mr. X is Director in 23 Companies as on 01.04.2014 i.e. the date on which Section 165 was notified. He has to choose 20 Companies out of 23 Companies in which he would like to continue that too before 31.03.2015 and intimate the registrar the resignation of three Companies.

Additional Requirements for Listed Companies

As per Regulation 17A of the SEBI (LODR) Regulations, 2015, the Directors of listed entities shall comply with the following conditions with respect to the maximum number of Directorships, including any alternate Directorships that can be held by them at any point of time -

1. A person shall not be a Director in more than eight listed entities with effect from April 1, 2019 and in not more than seven listed entities with effect from April 1, 2020.

   Provided that a person shall not serve as an Independent Director in more than seven listed entities.

2. Notwithstanding the above, any person who is serving as a Whole Time Director / Managing Director in any listed entity shall serve as an Independent Director in not more than three listed entities.

Explanation: For the purpose of this regulation, the count for the number of listed entities on which a person is a Director/ Independent Director shall be only those whose equity shares are listed on a stock exchange.

Question- Mr. A is a Director in the following Companies:

1. SSS Limited
2. PPP Private Limited
3. UUU Limited (A Subsidiary of SSS Limited)
4. HHH Private Limited (A Subsidiary of SSS Limited)
5. LLL Limited (A Dormant Company)
6. FFF Private Limited

In how many Companies, Mr. A can further be appointed as Director?

Answer- He is already a Director in following three Public Companies i.e. SSS Limited, UUU Limited and HHH Private Limited which is a deemed public Company by virtue of Section 165. LLL Limited is excluded from the number of directorship since it is a Dormant Company.

He is Director in two Private Companies namely PPP Private Limited and FFF Private Limited.

He is Director in total five Companies. He can further be appointed as Director in Fifteen Companies out of which not more than Seven shall be Public Companies.

Regulation 26 of SEBI (LODR) Regulations, 2015 requires that a director cannot be a member in more than ten committees or act as chairperson of more than five committees across all listed entities in which he/she is a director which shall be determined as follows:

(a) the limit of the committees on which a director may serve in all public limited companies, whether listed or not, shall be included and all other companies including private limited companies, foreign companies, 'high value debt listed entities' and companies under Section 8 of the Companies Act, 2013 shall be excluded;

(b) for the purpose of determination of limit, chairpersonship and membership of the audit committee and the Stakeholders' Relationship Committee alone shall be considered.

Registrar of Companies, West Bengal vs. Sabyasachi Bagchi on 24th June, 2020, NCLAT

Facts of the Case:

The Appellant Registrar Companies, West Bengal filed this Appeal under Section 421 of the Companies Act 2013 (in brief the Act) against the order dated 11.07.2018 passed by National Company Law Tribunal, Kolkata Bench, Kolkata.

Respondent Sabyasachi Bagchi was holding Directorship of 17 Companies on 01.04.2014 when section 165 (1) of the Act, came into force. However, he vacated directorship of three companies during the period of 01.04.2014 to 31.03.2015. After receipt of the notice from Appellant the Respondent has resigned from the Directorship of four Companies on 22.02.2016, thus, the Respondent has contravened the provisions of Section 165(1) of the Act, for a period of 01.04.2015 to 21.02.2016 i.e. 326 days.

The reply of show cause notice of Respondent found unsatisfactory, therefore, the Appellant filed a complaint under Section 165 (6) of the Act, against the Respondent before Chief Metropolitan Magistrate, Kolkata.

During the pendency of the Prosecution, Respondent filed an Application under Section 441(1) of the Act, before the National Company Law Tribunal, Kolkata for compounding the offence. The Appellant filed his report on compounding application before the Tribunal. After hearing the parties, Learned Tribunal allowed the Application subject to payment of compounding fees Rs. 25,000/- within 15 days from the date of order.

Being aggrieved with the order the Appellant filed this Appeal on 04.01.2019 along with Application for condonation of delay in filing the Appeal in NCLAT.

The Appellant submitted that the Respondent has accepted that he has contravened the provisions of 165 (1) of the Act, for a period of 01.04.2015 to 21.02.2016 i.e. 326 days. However, in the impugned order the period of default is shown 21 days only and Learned Tribunal has imposed compounding fees of Rs. 25,000/-. The Tribunal has ignored the provisions of sub-Section 6 of Section 165 of the Act, and directed to deposit compounding fees less than a minimum prescribed for the offence. The Tribunal has no jurisdiction to reduce the fine less than the minimum prescribed for the offence.

The issue for consideration is, whether Tribunal can impose the compounding fees under Section 441(1) of the Act, less than minimum prescribed for the offence under Section 165 (1) read with Section 165(6) ?

Judgment

In this case, the Respondent was conscious that after coming into force the provisions under Section 165(1) of the Act, he cannot hold Directorship in more than 20 companies and Directorship in more than 10 Public Companies, at the same time. As per the Section 165 (3) of the Act, till 31.03.2015 Respondent was required to resign from the Directorship of the Companies more than the limits specified in sub- Section 1 of Section 165 of the Act, within the specified period.

The Respondent has vacated the Directorship of three Companies. However, after receipt of the notice from the Appellant the Respondent has resigned from the Directorship of four Companies on 22.02.2016 and there is nothing on record to presume that the Respondent violated the provisions on a bonafide belief. The conduct of Respondent shows that he acted in conscious disregard of its obligation.

From the impugned order its manifest and clear that the Tribunal failed to notice the minimum fine prescribed under Sub-Section 6 of Section 165 of the Act, which was applicable at relevant time i.e. before the amendment. In view of the error apparent in the impugned order dated 11.07.2018 passed by the Tribunal, the order is set aside.

BOARD COMMITTEES

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. Committees enable better management of full board's time and allow in-depth scrutiny and focused attention.

However, the Board of Directors are ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure. The structure of a board and the planning of the board's work are key elements to effective governance. Establishing committees is one way of managing the work of the board, thereby strengthening the board's governance role. Boards should regularly review its own structure and performance and whether it has the right committee structure and an appropriate scheme of delegation from the board.

Functions of Board Committee

Committees often serve several different functions:

Governance: In large organizations participation of each and every director is not possible in decisions making of the organization as a whole, a committee is given the power to make decisions, spend money, or take actions. Some or all such powers may be limited or effectively unlimited. Members of the committee take decisions, keeping in view the interest of all stakeholders.

Coordination: Where there is a large board, it is common to have committees with more specialized functions for better coordination - for example, audit committee, finance committee, compensation committee, etc. wherein members meet regularly to discuss developments in their areas, review projects that cut across organizational boundaries, talk about future options, etc.

Research and recommendations: Committees are often formed to do research and make recommendations on a potential or planned project or change. For example, an organization considering a major capital investment might create a temporary working committee of several people to review options and make recommendations to the Board of Directors. Such committees are typically dissolved after giving recommendations.

With the increasing business complexities and time commitment of Board members, constituting committees has become inevitable for organization of any significant size. Committees keep the number of participants manageable; in larger groups, either many people do not get to speak or discussion gets quite lengthy.

Powers of the Board to form a Committee

- The Board of Directors of the Company derive powers from Article of Association of the Company [Table F (Limited by shares) & H (Limited by Guarantee and not having share capital)] under the Companies Act, 2013:
  - (i) The Board may, subject to the provisions of the Companies Act, 2013 delegate any of its powers to committees consisting of such member or members of its body as it thinks fit.
  - (ii) Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on it by the Board.
- Under Regulation 4 of the SEBI (LODR) Regulations, 2015, when committees of the board of directors are established, their mandate, composition and working procedures shall be well defined and disclosed by the board of directors.

Mandatory Board Committees

Mandatory Committees of the Board are prescribed under the Companies Act, 2013 (for certain class of companies) and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 for listed companies.

AUDIT COMMITTEE

Audit Committee is one of the main pillars of the Corporate Governance mechanism in any company. The main function of an Audit Committee is oversight of financial disclosures, reporting, internal and external audits, internal control, accounting, regulatory compliance and risk management. Its main aim is to strengthen the confidence of stakeholders in the company's financial statements and announcements, its internal control process and the risk management process.

The constitution of Audit Committee is mandated under the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Constitution of Audit Committee

Section 177(1) of the Companies Act, 2013 read with Rule 6 of the Companies (Meetings of the Board and its Powers) Rules, 2014, provides that the Board of Directors of following companies are required to constitute an Audit Committee of the Board-

(i) Every listed public company;

(ii) All public companies with a paid up share capital of 10 crore rupees or more; or

(iii) All public companies having turnover of 100 crore rupees or more; or

(iv) All public companies, having in aggregate, outstanding loans, debentures and deposits exceeding 50 crore rupees.

The paid up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account for the purposes of this rule.

The following classes of unlisted public companies shall not be covered for the above purpose:-

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under section 455 of the Act.

Composition of the Audit Committee

The audit committee need to consist of the following:

Category	*Provisions of Section 177 of the Companies Act, 2013*	*Provisions of Regulation 18 of SEBI (LODR) Regulations, 2015*
Number of Directors	Minimum 3 directors as members	Minimum 3 directors as members
Independent Directors	Of the total members, independent directors need to form majority except Section 8 Company	• At least two-thirds of the members of audit committee shall be independent directors and • In case of a listed entity having outstanding SR equity shares, the audit committee shall only comprise of independent directors

Chairperson	The Companies Act, 2013 does not prescribe that the Chairman of the Audit Committee shall be an independent Director	An Independent Director
Educational Qualification	Majority of members of Audit Committee including its chairperson must have ability to read and understand the financial statement	All members of audit committee need to be financially literate and at least one member shall have accounting or related financial management expertise
Presence in AGM/ GM	Not provided in the Act, however, SS-2 provides that either the Chairman of the Committee or any other Member of the Committee authorised by the Chairman of the Committee can attend the general meeting on his behalf	The chairperson of the audit committee shall be present at Annual general meeting to answer shareholder queries
Secretary of the Committee	Not provided	Company Secretary
Presence of other in the meeting of audit committee	The Audit Committee can call for comments of the auditors about internal control systems, the scope of audit, including the observations of the auditors and review of financial statement before their submission to the Board and may also discuss any related issues with the internal and statutory auditors and management of the company	The audit committee at its discretion shall invite the finance director or head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee: Provided that occasionally the audit committee may meet without the presence of any executives of the listed entity
Meeting of the Audit Committee	As per SS-1, Audit Committee shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board	At least four times in a year and not more than one hundred and twenty days shall elapse between two meetings
Quorum for the meeting	As per SS-1, unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum	Two members or one third of the members of the audit committee, whichever is greater, with at least two independent directors.

Power of Audit Committee	The Audit committee has authority to investigate into any matter in relation to the items specified under Section 177(4) of the Act or referred to it by the Board and for this purpose shall have power to obtain professional advice from external sources and have full access to information contained in the records of the company.	The audit committee shall have powers to investigate any activity within its terms of reference, seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

Functions/Role of the Audit Committee

Section 177(4) stipulates that, every Audit Committee shall act in accordance with the terms of reference specified in writing by the Board.

Terms of reference as prescribed by the Board shall *inter alia,* include, –

(a) The recommendation for appointment, remuneration and terms of appointment of auditors of the company;

> In case of Government Companies, in Clause (1) of sub-section (4) of section 177, for the words "recommendation for appointment, remuneration and terms of appointment" the words "recommendation for remuneration" shall be substituted – Exemption Notification dated 05th June, 2015.

(b) Review and monitor the auditor's independence and performance, and effectiveness of audit process;

(c) Examination of the financial statements and the auditors' report thereon;

(d) Approval or any subsequent modification of transactions of the company with related parties;

The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as prescribed under rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014.

(e) Scrutiny of inter-corporate loans and investments;

(f) Valuation of undertakings or assets of the company, wherever it is necessary;

(g) Evaluation of internal financial controls and risk management systems;

(h) Monitoring the end use of funds raised through public offers and related matters.

Section 177 is not applicable for Specified IFSC Public Company.

Omnibus approval of Related Party Transactions [Rule 6A of the Companies (Meetings of Board and its Powers) Rules, 2014].

(1) The Audit Committee must, after obtaining approval of the Board of Directors, specify the criteria for making omnibus approval for related party transactions proposed to be entered into by the company, which need to include the following conditions, namely:

(a) maximum value of the transactions, in aggregate, which can be allowed under the omnibus route in a year;

(b) the maximum value per transaction which can be allowed;

(c) extent and manner of disclosures to be made to the Audit Committee at the time of seeking omnibus approval;

(d) review, at such intervals as the Audit Committee may deem fit, related party transaction entered into by the company pursuant to each of the omnibus approval made;

(e) transactions which cannot be subject to the omnibus approval by the Audit Committee.

(2) The Audit Committee need to consider the following factors while specifying the criteria for making omnibus approval, namely: -

(a) repetitiveness of the transactions (in past or in future);

(b) justification for the need of omnibus approval.

(3) The Audit Committee shall satisfy itself on the need for omnibus approval for transactions of repetitive nature and that such approval is in the interest of the company.

(4) The omnibus approval shall contain or indicate the following: -

(a) name of the related parties;

(b) nature and duration of the transaction;

(c) maximum amount of transaction that can be entered into;

(d) the indicative base price or current contracted price and the formula for variation in the price, if any; and

(e) any other information relevant or important for the Audit Committee to take a decision on the proposed transaction:

Provided that where the need for related party transaction cannot be foreseen and aforesaid details are not available, audit committee may make omnibus approval for such transactions subject to their value not exceeding rupees one crore per transaction.

(5) Omnibus approval shall be valid for a period not exceeding one financial year and shall require fresh approval after the expiry of such financial year.

(6) Omnibus approval shall not be made for transactions in respect of selling or disposing of the undertaking of the company.

(7) Any other conditions as the Audit Committee may deem fit.

Approval of the Audit Committee to a related party transaction can be granted by passing a circular resolution. Elucidate.

Section 188(1) of the Companies Act, 2013 prohibits the Board from dealing with an item of business pertaining to a contract or arrangement with a related party through a circular resolution. However, the law is silent on dealing with any item of business by the Audit Committee through a circular resolution.

Here, the intention of the Legislature is required to be gathered from the language used; which means that attention should be paid to what has been said as also to what has not been said. As a consequence, though it cannot be added that the law imposes any restriction, the principle applicable on meetings of the Board would be applicable to the meetings of the Audit Committee too, while dealing with items of business on related party transactions.

As per the Secretarial Standard on Meetings of the Board of Directors (SS-1), the Audit Committee should discuss related party transactions which are not in the ordinary course of business or which are not on arm's length basis at its meetings and not through circulation. However, there is no bar on omnibus approval of limits being passed by a circular resolution by the Audit Committee.

Related party transactions other than Section 188- As per second proviso to clause (iv) of Section 177(4) in case of transaction, other than transactions referred to in section 188, where Audit Committee does not approve the transaction, the company needs to make its recommendations to the Board.

Transaction involving less than Rs. 1 Crore- As per third proviso to clause (iv) of Section 177(4) in case of related party transaction involving any amount not exceeding one crore rupees is entered into by a director or officer of the company without obtaining the approval of the Audit Committee and it is not ratified by the Audit Committee within three months from the date of the transaction, such transaction shall be voidable at the option of the Audit Committee and if the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it.

Transaction between Holding Company and Wholly Owned Subsidiary- As per fourth proviso to clause (iv) of Section 177(4), for any related party transaction other than section 188, between a holding company and its wholly owned subsidiary company the approval of audit committee is not required.

However, if such transaction is covered under section 188, between a holding company and its wholly owned subsidiary company or between a holding company and its other than wholly owned subsidiary company the approval of audit committee is must.

Rights of Auditors, KMP to be heard by the Audit Committee

The auditors of a company and the key managerial personnel shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report. However, they do not have the right to vote.

Disclosure in Board's Report (Section 177(8))

The composition of an Audit Committee must be disclosed by the company in the report of its Board of Directors in the year.

In case the Board does not accept any recommendation of the Audit Committee, the same shall be disclosed in the Board report along with the reasons thereof.

The Role of Audit Committee as prescribed under Part C of Schedule II of SEBI (LODR) Regulation, 2015

The role of Audit Committee under the Regulation 18 is wider than the Companies Act, 2013, which includes:

- Oversight of the listed entity's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible;
- Recommendation for appointment, remuneration and terms of appointment of auditors of the listed entity;
- Approval of payment to statutory auditors for any other services rendered by the statutory auditors;
- Reviewing, with the management, the annual financial statements and auditor's report thereon before submission to the Board for approval, with particular reference to:
  - (a) Matters required to be included in the Director's responsibility statement to be included in the Board's report in terms of clause (c) of sub-section (3) of Section 134 of the Companies Act, 2013;
  - (b) Changes, if any, in accounting policies and practices and reasons for the same;
  - (c) Major accounting entries involving estimates based on the exercise of judgment by management;
  - (d) Significant adjustments made in the financial statements arising out of audit findings;

(e) Compliance with listing and other legal requirements relating to financial statements;

(f) Disclosure of any related party transactions;

(g) Modified opinion(s) in the draft audit report;

- Reviewing, with the management, the quarterly financial statements before submission to the Board for approval;
- Reviewing, with the management, the statement of uses / application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document / prospectus / notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue or preferential issue or qualified institutions placement, and making appropriate recommendations to the Board to take up steps in this matter;
- Reviewing and monitoring the auditor's independence and performance, and effectiveness of audit process;
- Approval or any subsequent modification of transactions of the listed entity with related parties;
- Scrutiny of inter-corporate loans and investments;
- Valuation of undertakings or assets of the listed entity, wherever it is necessary;
- Evaluation of internal financial controls and risk management systems;
- Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;
- Reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;
- Discussion with internal auditors of any significant findings and follow up there on;
- Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board;
- Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern;
- To look into the reasons for substantial defaults in the payment to the depositors, debenture holders, shareholders (in case of non-payment of declared dividends) and creditors;
- To review the functioning of the whistle blower mechanism;
- Approval of appointment of chief financial officer after assessing the qualifications, experience and background, etc. of the candidate;
- Carrying out any other function as is mentioned in the terms of reference of the audit Committee.
- Reviewing the utilization of loans and/ or advances from/investment by the holding company in the subsidiary exceeding Rs.100 crore or 10% of the asset size of the subsidiary, whichever is lower including existing loans / advances / investments existing as on the date of coming into force of this provision.
- Consider and comment on rationale, cost-benefits and impact of schemes involving merger, demerger, amalgamation etc., on the listed entity and its shareholders.

The Audit Committee shall mandatorily review the following information:

- Management discussion and analysis of financial condition and results of operations;
- Management letters / letters of internal control weaknesses issued by the statutory auditors;
- Internal audit reports relating to internal control weaknesses; and
- The appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee.
- Statement of deviations:
  - Quarterly statement of deviation(s) including report of monitoring agency, if applicable, submitted to stock exchange(s) in terms of Regulation 32(1) of the SEBI (LODR) Regulations, 2015.
  - Annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/notice in terms of Regulation 32(7) of the SEBI (LODR) Regulations, 2015.

VIGIL MECHANISM [SECTION 177(9) TO 177(10)]

Section 177(9) of the Act read with Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for establishment of Vigil Mechanism for their directors and employees to report their genuine concerns or grievances as under:

(1) Every listed company;

(2) the companies which accept deposits from the public;

(3) the companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

The vigil mechanism set up as above, shall provide for adequate safeguards against victimisation of employees and Directors who use such mechanism and make provision for direct access to the Chairperson of the Audit Committee or the Director nominated to play the role of Audit Committee in appropriate or exceptional cases.

In case of repeated frivolous complaints being filed by a director or an employee, the audit committee or the director nominated to play the role of audit committee may take suitable action against the concerned director or employee including reprimand.

The companies which are required to constitute an Audit Committee shall oversee the vigil mechanism through the Committee and if any of the members of the Committee have a conflicted of interest in a given case, they should recuse themselves and the others on the Committee would deal with the matter on hand.

In case of other companies (not required to constitute Audit Committee), the Board of Directors shall nominate a Director to play the role of Audit Committee for the purpose of vigil mechanism to whom other Directors and employees may report their concerns.

The details of establishment of the Vigil Mechanism is required to be disclosed by the company on its website, if any, and in the Board's report.

It may be noted that while section 177(9) of the Act mandates to establish a vigil mechanism for directors and employees to report genuine concerns, in case of a listed company, such mechanism is available to all stakeholders.

Regulation 4(2)(d)(iv) of SEBI (LODR) Regulations, 2015 provides that the listed company shall devise an effective vigil mechanism/whistle blower policy enabling stakeholders, including individual employees and their representative bodies, to freely communicate their concerns about illegal or unethical practices.

Further, the Regulation 22 of the SEBI (LODR) Regulations, 2015 provides that the listed company shall formulate a vigil mechanism/ whistle blower policy for directors and employees to report genuine concerns and such mechanism shall provide for adequate safeguards against victimization of director(s) or employee(s) or any other person who avail the mechanism and also provide for direct access to the chairperson of the audit committee in appropriate or exceptional cases.

1) What does the term financially literate mean?

According to Explanation to Regulation 18(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, "financially literate" shall mean the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Given that one of the primary functions of Audit Committee is to review and ensure integrity of the financial statements of the Company, it is pertinent that the members of the Audit Committee are sufficiently capable of understanding the financial statements and its repercussions. Going by the definition it is clear that the members need not necessarily be financial or accounting professional. However it is important that the members understand the process of auditing and possess an in-depth understanding of financial statements.

2) What does the term 'have accounting or related financial management expertise' mean in Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015?

According to Explanation (2) of Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, a member shall be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

3) If a company intends to constitute its Audit Committee with 5 members, then how many such members should be independent?

Regulation 18 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires at least two-thirds of the members of the Audit Committee to be independent directors. Hence given 5 members, 3 members of the Audit Committee should be independent.

SECTION 178: NOMINATION AND REMUNERATION COMMITTEE

Constitution of Nomination and Remuneration Committee

The Nomination and Remuneration Committee helps the Board of Directors in the preparations relating to the election of members of the Board of Directors, and in handling matters within its scope of responsibility that relate to the conditions of employment and remuneration of senior management, and to management's and personnel's remuneration and incentive schemes. The responsibilities of the Nomination and Remuneration Committee are defined in Nomination and remuneration policy or terms of reference of the Nomination and Remuneration document.

The Board of Directors of following companies shall constitute Nomination and Remuneration Committee of the Board:

(a) Every listed Public Company; or

(b) The following class of companies –

(i) all public companies with a paid up share capital of ten crore rupees or more;

(ii) all public companies having turnover of one hundred crore rupees or more;

(iii) all public companies, having in aggregate, outstanding loans , debentures and deposits, exceeding fifty crore rupees.

The paid-up share capital or turnover or outstanding loans, debentures and deposits, as the case may be, as existing on the last date of latest audited financial statements shall be taken into account for the above purpose.

The following classes of unlisted public company shall not be covered for above purpose:-

(a) a joint venture;

(b) a wholly owned subsidiary; and

(c) a dormant company as defined under section 455 of the Act.

Exceptions:

- After exemption notification dated 05.06.2015 the provisions of Section 178 of the Act are not applicable to the Section 8 Companies.
- After exemption notification dated 04.01.2017 the provisions of Section 178 of the Act are not applicable to the Specified IFSC Public Companies.

Composition of Nomination and Remuneration Committee

Category	*Provisions of Section 178 of the Companies Act, 2013*	*Provisions of Regulation 19 of SEBI (LODR) Regulations, 2015*
Number of Directors	Minimum 3 or more non-executive directors as members. The chairperson of the company (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.	Minimum 3 non-executive directors as members. The chairperson of the listed entity (whether executive or non-executive) may be appointed as a member of the Nomination and Remuneration Committee but shall not chair such Committee.
Independent Directors	Of the total members, one-half shall be independent directors.	At least two-thirds of the members of the committee shall be independent directors.
Chairperson	Not Provided	An Independent Director.
Presence in AGM/ GM	The chairperson of nomination and remuneration committee or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.	The Chairperson of the nomination and remuneration committee may be present at the annual general meeting, to answer the shareholders' queries; however, it shall be up to the chairperson to decide who shall answer the queries.

Category	*Provisions of Section 178 of the Companies Act, 2013*	*Provisions of Regulation 19 of SEBI (LODR) Regulations, 2015*
Meeting of the Nomination and Remuneration Committee	As per SS-1, Nomination and Remuneration Committees shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.	At least once in a year.
Quorum for the meeting	As per SS-1, Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum.	Two members or one-third of the members of the committee, whichever is greater, including at least one independent director in attendance.

Functions of Nomination and Remuneration Committee

As per section 178(2) of the Act, the Committee shall identify the person qualified to become Directors and may be appointed in senior management, in accordance with the criteria laid down and recommend to the Board their appointment and removal and shall specify the manner for effective evaluation of performance of Board, its Committees and individual directors to be carried out either by the Board, by the Nomination and Remuneration Committee or by an independent external agency and review its implementation and compliance.

As per section 178(3) of the Act, the Committee shall formulate the criteria, for determining qualifications, positive attributes and independence of a Director and recommend to the Board the policy relating to remuneration for Directors, KMPs and other employees.

As per section 178(4) of the Act, while formulating its policy, the Nomination and Remuneration Committee shall ensure that:

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate the directors of the quality required to run the company successfully;

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals:

Such policy shall be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's report.

Exceptions:

In case of Government company - Sub-sections (2), (3) and (4) of Section 178, shall not apply except with regard to appointment of 'senior management' and other employees'. - Notification dated 5th June, 2015.

Functions of the Nomination and Remuneration committee as specified in Part D of the Schedule II of SEBI (LODR) Regulation, 2015:

1. Formulation of the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board of Directors a policy relating to, the remuneration of the directors, key managerial personnel and other employees;
2. For every appointment of an independent director, the Nomination and Remuneration Committee shall evaluate the balance of skills, knowledge and experience on the Board and on the basis of such evaluation, prepare a description of the role and capabilities required of an independent director. The person recommended to the Board for appointment as an independent director shall have the capabilities identified in such description.

   For the purpose of identifying suitable candidates, the Committee may:

   a. use the services of an external agencies, if required;

   b. consider candidates from a wide range of backgrounds, having due regard to diversity; and

   c. consider the time commitments of the candidates.
3. Formulation of criteria for evaluation of performance of Independent Directors and the Board of Directors;
4. Devising a policy on diversity of Board of Directors;
5. Identifying persons who are qualified to become Directors and who may be appointed in senior management in accordance with the criteria laid down, and recommend to the Board of Directors their appointment and removal;
6. Whether to extend or continue the term of appointment of the Independent Director, on the basis of the report of performance evaluation of Independent Directors;
7. Recommend to the Board, all remuneration, in whatever form, payable to senior management.

SECTION 178- STAKEHOLDERS RELATIONSHIP COMMITTEE

Constitution of Stakeholders Relationship Committee

Section 178(5) of the Companies Act, 2013 provides for constitution of the stakeholders relationship committee.

The Board of Directors of a company which consists of more than 1000 shareholders, debenture-holders, deposit- holders and any other security holders at any time during a financial year shall constitute a Stakeholders Relationship Committee.

Composition of Stakeholders Relationship Committee

Category	*Provisions of Section 178(5) of the Companies Act, 2013*	*Provisions of Regulation 20 of SEBI (LODR) Regulations, 2015*
Number of Directors	Stakeholders Relationship Committee shall consist of a chairperson and such other members as may be decided by the Board.	i) Minimum 3 directors as members with at least one being an independent director; ii) In case of a listed entity having outstanding SR equity shares, at least two thirds of the Stakeholders Relationship Committee shall comprise of independent directors.

Category	*Provisions of Section 178(5) of the Companies Act, 2013*	*Provisions of Regulation 20 of SEBI (LODR) Regulations, 2015*
Chairperson	Chairperson shall be a non-executive director	Chairperson shall be a non-executive director
Presence in AGM/GM	The Chairperson of Stakeholder's Relationship Committee or, in his absence, any other member of the committee authorised by him in this behalf shall attend the general meetings of the company.	The Chairperson of the Stakeholders Relationship Committee shall be present at the annual general meetings to answer queries of the security holders.
Meeting of the Stakeholder's Relationship Committee	As per SS-1, Committees shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.	At least once in a year.
Quorum for the meeting	As per SS-1, Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum.	Not specified.

Functions of Stakeholders Relationship Committee

The main function of the committee is to consider and resolve the grievances of security holders of the company. On similar terms Part D of the Schedule II of the SEBI (LODR) Regulations, 2015 provides the role of the committee which *inter-alia* include the following:

- Resolving the grievances of the security holders of the listed entity including complaints related to transfer/ transmission of shares, non-receipt of annual report, non-receipt of declared dividends, issue of new/ duplicate certificates, general meetings etc.
- Review of measures taken for effective exercise of voting rights by shareholders.
- Review of adherence to the service standards adopted by the listed entity in respect of various services being rendered by the Registrar & Share Transfer Agent.
- Review of the various measures and initiatives taken by the listed entity for reducing the quantum of unclaimed dividends and ensuring timely receipt of dividend warrants/annual reports/statutory notices by the shareholders of the company.

Penalty for Contravention of Section 177 and 178

Section 178(8) provides that in case of any contravention of the provisions of section 177 and section 178, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of one lakh rupee.

However, inability to resolve or consider any grievance by the Stakeholders Relationship Committee in good faith shall not constitute a contravention of this section.

Schedule IV under Section 149(7) of the Act contains the Code for Independent Directors. Under Sl. No. II (5) of the Code, Independent Directors are mandated to safeguard the interest of all stakeholders, especially the Minority Shareholders and balance the conflicting interests of the stakeholders.

RISK MANAGEMENT COMMITTEE

Constitution of Risk Management Committee

A Risk Management Committee fosters an integrated, enterprise-wide approach to identify and manage risk and provides an impetus toward improving the quality of risk reporting and monitoring, both for management and the Board.

The Companies Act, 2013 does not specifically contain any provisions with respect to constitution of a Risk Management Committee. However, It is to be noted that section 134(3)(n) of the Companies Act, 2013, provides that Board Report must contain a statement indicating the development and implementation of a Risk Management Policy for the company, including the identification of risks that may pose a threat to the existence of company.

Further section 177(4)(vii) of the Companies Act, 2013 state that the Audit Committee has an obligation to evaluate the company's internal financial controls and risk management systems.

Part II of Schedule IV of the Companies Act, 2013 requires, an Independent director of a company to bring an independent judgment to the board deliberations regarding the risk management systems of the company.

Composition of Risk Management Committee

Regulation 21 of the SEBI (LODR) Regulations, 2015 requires that the company through its Board of Directors shall constitute a Risk Management Committee.

Applicability

The provisions of this regulation shall be applicable to top 1000 listed entities, determined on the basis of market capitalization as at the end of the immediate preceding financial year and a 'high value debt listed entity'.

Composition of Risk Management Committee

- The Risk Management Committee shall have minimum 3 members with majority of them being members of the board of directors, including at least one independent director.
- In case of a listed entity having outstanding SR equity shares, at least two-thirds of the Risk Management Committee shall comprise of independent directors.
- The Chairperson of the Risk management committee shall be a member of the board of directors and senior executives of the listed entity may be members of the committee.

Meetings/Quorum

- The risk management committee shall meet at least twice in a year.
- The quorum for a meeting of the Risk Management Committee shall be either two members or one-third of the members of the committee, whichever is higher, including at least one member of the board of directors in attendance.
- The meetings of the risk management committee shall be conducted in such a manner that on a continuous basis not more than 180 days shall elapse between any two consecutive meetings.

Functions/Role of Risk Management Committee

The board of directors shall define the role and responsibility of the Risk Management Committee and may delegate monitoring and reviewing of the risk management plan to the committee and such other functions as it may deem fit, such function shall specifically cover cyber security.

The role and responsibilities of the Risk Management Committee shall mandatorily include the performance of functions specified in Part D of Schedule II of SEBI (LODR) Regulations, 2015.

The role of the committee shall, inter alia, include the following:

- To formulate a detailed risk management policy;
- To ensure that appropriate methodology, processes and systems are in place to monitor and evaluate risks associated with the business of the Company;
- To monitor and oversee implementation of the risk management policy, including evaluating the adequacy of risk management systems;
- To periodically review the risk management policy, at least once in two years, including by considering the changing industry dynamics and evolving complexity;
- To keep the board of directors informed about the nature and content of its discussions, recommendations and actions to be taken.

(**Cross Reference:** *For more details Students are advised to refer Lesson 10 of Capital Market & Securities Laws*.)

Powers of Risk Management Committee

The Risk Management Committee shall have powers to seek information from any employee, obtain outside legal or other professional advice and secure attendance of outsiders with relevant expertise, if it considers necessary.

CORPORATE SOCIAL RESPONSIBILITY COMMITTEE [SECTION 135]

Applicability of CSR Committee

- Every company having net worth of Rs.500 crore or more, or turnover of Rs.1000 crore or more or a net profit of Rs.5 Crore or more during the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board.
- Where the CSR obligation of the company does not exceed Rs.50 Lakhs, the requirement for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee provided under section 135 shall, in such cases, be discharged by the Board of Directors of such company.
- A company having any amount in its Unspent Corporate Social Responsibility Account as per Section 135(6) shall constitute a CSR Committee and comply with the provisions contained in sub-sections (2) to (6) of the said section. [*Second Proviso to Rule 3(1) of the Companies (CSR Policy) Rules, 2014*]

Composition of CSR Committee

- The CSR Committee shall consist of 3 or more Directors, out of which at least 1 Director shall be an Independent Director.
- Where a company is not required to appoint an Independent Director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more Directors.

Hence, a company which is not required to appoint an Independent Director, it shall have its CSR committee without such Director.

- A private company having only 2 directors on its Board shall constitute its CSR Committee with two such directors.
- With respect to a foreign company, the CSR Committee shall comprise of at least 2 persons of which one person shall be as specified under clause (d) of sub-section (1) of section 380 of the Companies Act, 2013 and another person shall be nominated by the foreign company.

Meetings/Quorum

- As per SS-1, the committee shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.
- A member of the Committee appointed by the Board or elected by the Committee as Chairman of the Committee, in accordance with the Act or any other law or the Articles, shall conduct the Meetings of the Committee. If no Chairman has been so elected or if the elected Chairman is unable to attend the Meeting, the Committee shall elect one of its members present to chair and conduct the Meeting of the Committee, unless otherwise provided in the Articles.
- Quorum of CSR Committee- Unless otherwise stipulated in the Act or the Articles or under any other law, the Quorum for Meetings of CSR Committee constituted by the Board shall be as specified by the Board. If no such Quorum is specified, the presence of all the members of such Committee is necessary to form the Quorum.

Functions of CSR Committee

- To formulate and recommend to the Board, a CSR Policy which shall indicate the activities to be undertaken by the company in areas or subjects as specified in Schedule VII of the Companies Act, 2013.
- To recommend the amount of expenditure to be incurred on the CSR activities.
- To monitor the Corporate Social Responsibility Policy of the company from time to time.
- Further the CSR rules provide that the CSR Committee shall formulate and recommend to the Board, an annual action plan in pursuance of its CSR policy, which shall include the following, namely:-

  (a) the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Companies Act, 2013;

  (b) the manner of execution of such projects or programmes as specified in sub-rule (1) of rule 4 of CSR Rules;

  (c) the modalities of utilisation of funds and implementation schedules for the projects or programmes;

  (d) monitoring and reporting mechanism for the projects or programmes; and

  (e) details of need and impact assessment, if any, for the projects undertaken by the company.

However, Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

Disclosures related to CSR Committee

- The Board of Directors of every company required to form a CSR Committee shall after taking into account the recommendations made by such Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as prescribed;
- The Board of Directors of the Company are mandatorily required to disclose the composition of the CSR Committee, and CSR Policy and Projects approved by the Board on their website, if any, for public access.

*(**Cross Reference**: For detailed discussion on CSR Provision, please refer Lesson 17-Corporate Social Responsibility-Concepts.)*

OTHER BOARD COMMITTEES

In addition to the Committees of the Board mandated by the Companies Act, 2013, viz., Audit Committee, Nomination and Remuneration Committee, Stakeholders Relationship Committee and the CSR Committee, Board of Directors may also constitute other Committees to oversee a specific objective or project. The nomenclature, composition and role of such Committees will vary, depending upon the specific objectives of the company.

A few examples of such Committees prevalent in the corporate sector in India and abroad are given below:

1. Corporate Governance Committee;
2. Science, Technology & Sustainability Committee;
3. Regulatory, Compliance & Government Affairs Committee;
4. Investment Committee;
5. Ethics Committee etc.

POWERS OF BOARD [SECTION 179]

Shareholders derive their powers from the MoA – therefore, the company has all the powers except those that are *ultra vires:*

- The Board has the general power to do everything that the company is empowered to do;
- Except for matters where the Companies Act, 2013 requires concurrence of general meeting;
- Or matters where shareholders have regulated the conduct of the directors;
- Or the articles confine the powers.

Powers to be exercised in Board Meeting

Section 179 of the Companies Act, 2013 empowers the Board to exercise all powers, and to do all such acts and things, as the company is authorised to exercise and do, except those powers which can only be exercised or done by the company in a general meeting. The powers of the board are however, subject to the provisions contained in that behalf in the Act, the memorandum and articles of association of the company or including regulations made by the company in general meeting.

However, no regulation made by the company in general meeting shall invalidate any prior act of the Board which would have been valid if that regulation had not been made.

In the case of *M/s K.K. Ahuja vs. V.K. Vora & Anr.* Under Negotiable Instrument Act, 1881, Supreme Court observed that a company though a legal entity can act only through its Board of Directors. The settled position is that a Managing Director is prima facie in charge of and responsible for the company's business and affairs and can be prosecuted for offences by the company. But insofar as other directors are concerned, they can be prosecuted only if they were in charge of and responsible for the conduct of the company's business.

The following [Section 179(3) read with Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014] powers of the Board of Directors shall be exercised **only by means of resolutions passed at meetings of the Board**, namely :-

(a) to make calls on shareholders in respect of money unpaid on their shares;

(b) to authorise buy-back of securities under section 68;

(c) to issue securities, including debentures, whether in or outside India;

(d) to borrow monies;

(e) to invest the funds of the company;

(f) to grant loans or give guarantee or provide security in respect of loans;

(g) to approve financial statement and the Board's report;

(h) to diversify the business of the company;

(i) to approve amalgamation, merger or reconstruction;

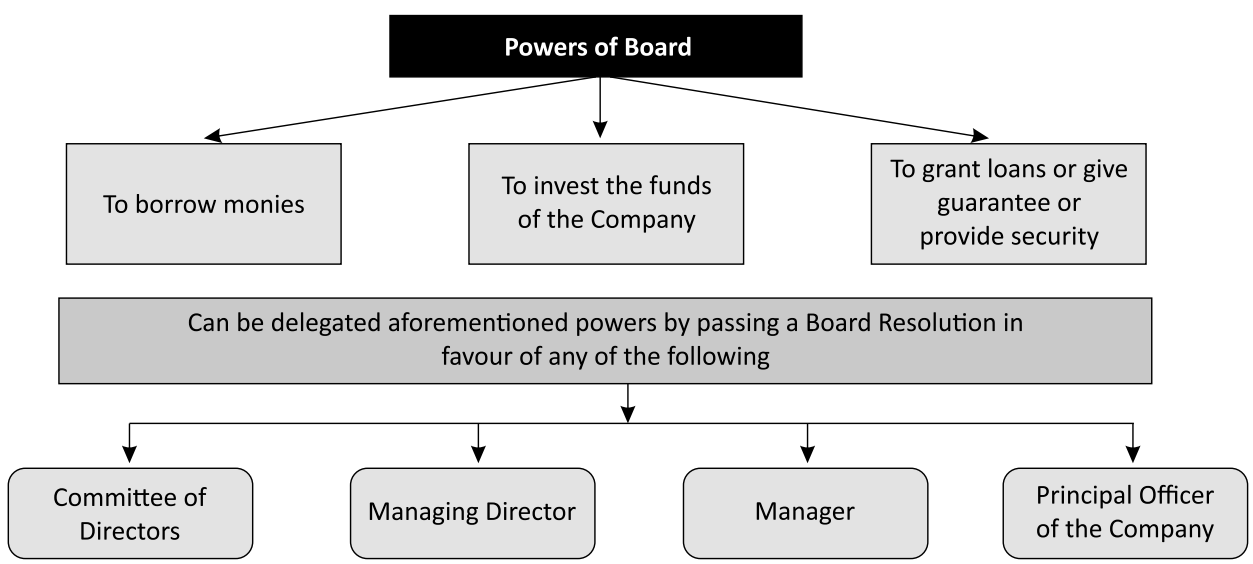
(j) to take over a company or acquire a controlling or substantial stake in another company;

(k) to make political contributions;

(l) to appoint or remove key managerial personnel (KMP);

(m) to appoint internal auditors and secretarial auditor.

Delegation of Powers of Board



First proviso to section 179(3) specifies that the following powers, on such conditions as it may specify can be delegated by the board to any committee of directors, the managing director, the manager or any other principal officer of the company or in the case of a branch office of the company, the principal officer of the branch office :-

- to borrow money;
- to invest the funds of the company;
- to grant loans or give guarantee or provide security in respect of loans.

The delegation of above powers can only be done by way of passing Resolution at the meeting of the board of directors and delegation cannot be made by way of passing Circular Resolution.

The acceptance by a banking company in the ordinary course of its business of deposits of money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of monies on deposit by a banking company with another banking company on such conditions as the Board may prescribe, shall not be deemed to be a borrowing of monies or, as the case may be, a making of loans by a banking company within the meaning of section 179 of the Companies Act, 2013.

Section 179(3)(d) of the Companies Act, 2013 shall not apply to borrowings by a banking company from other banking companies or from the Reserve Bank of India, the State Bank of India or any other banks established by or under any Act.

In respect of dealings between a company and its bankers, the exercise by the company of the power specified in Section 179(3)(d) of the Companies Act, 2013 shall mean the arrangement made by the company with its bankers for the borrowing of money by way of overdraft or cash credit or otherwise and not the actual day-to-day operation on overdraft, cash credit or other accounts by means of which the arrangement so made is actually availed of.

However, nothing in section 179 shall be deemed to affect the right of the company in general meeting to impose restrictions and conditions on the exercise by the Board of any of the powers specified in this section.

Exceptions

In case of Section 8 companies resolutions related to clauses (d), (e) and (f) of sub-section (3) of Section 179 of the Act i.e. borrow monies, to invest funds of the company and to grant loans or give guarantee or provide security in respect of loans by section 8 companies may be decided by the Board by circulation instead of at a meeting (*Exemption Notification dated- 5.6.2015*).

In case of Specified IFSC Public Company/Specified IFSC Private Company - In sub-section (3) of Section 179, after the second proviso, the following proviso shall be inserted, namely:-

"Provided also that in case of a Specified IFSC public company/ Specified IFSC Private Company, the Board can exercise powers by means of resolutions passed at the meetings of the Board or through resolutions passed by circulation"- *Notification Dated 4th January 2017*.

Restriction on Powers of Board [Section 180]

The Board can exercise following powers only with the consent of the company by **passing a special resolution**, namely –

(a) to sell, lease or otherwise dispose of the whole or substantially the whole of the undertaking of the company or where the company owns more than one undertaking, of the whole or substantially the whole of any of such undertakings.

Explanation to section 180(i)(a) defines the meaning of the expression "undertaking".

(i) "**Undertaking**" shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent. of the total income of the company during the previous financial year;

(ii) the expression "**substantially the whole of the undertaking**" in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

In case of *Madras Gymkhana Club Employee Union vs. Management of the Gymkhana*, the Hon'ble Supreme Court held that the business of the Company or undertaking of the company must be distinguished from the other properties belonging to the company. The meaning of undertaking was further defined to mean "any business or any work or project which one engages in or attempts as an enterprise similar to business or trade".

(b) to invest otherwise in trust securities the amount of compensation received by it as a result of any merger or amalgamation;

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium apart from temporary loans obtained from the company's bankers in the ordinary course of business;

The acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable 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.

Explanation – For the purposes of this clause, the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

(d) to remit, or give time for the repayment of, any debt due from a director.

The company cannot pass a blanket resolution in relation to borrowing money exceeding paid up share capital, free reserves and securities premium. It has to specify in the resolution the total amount up to which the money may be borrowed by the Board of Directors.

Nothing contained in clause (a) of sub-section (1) of Section 180 shall affect –

(a) the title of a buyer or other person who buys or takes on lease any property, investment or undertaking as is referred to in that clause, in good faith; or

(b) the sale or lease of any property of the company where the ordinary business of the company consists of, or comprises, such selling or leasing.

Condition may be imposed for resolution under Section 180

Any special resolution passed by the company consenting to the transaction as is referred to in clause (a) of sub- section (1) of Section 180 may stipulate such conditions as may be specified in such resolution, including conditions regarding the use, disposal or investment of the sale proceeds which may result from the transactions.

However, this sub-section shall not be deemed to authorise the company to effect any reduction in its capital except in accordance with the provisions contained in this Act.

It is prescribed that no debt incurred by the company in excess of the limit imposed by clause (c) of sub-section (1) of Section 180 is valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded, the Company shall be liable for the repayment of the same.

As per MCA Exemption Notification dated 05th June, 2015, Section 180 is exempted to Private Limited Companies.

Section 180 shall apply in case of a Specified IFSC public company, unless the articles of the company provides otherwise - *Notification Dated 4th January 2017.*

Illustration:

The following figures were extracted from the books of X Ltd (audited).

- Paid up share capital Rs.100 Lakh
- Reserve & Surplus General Reserve Rs.50 Lakh
- Security Premium Account Rs.25 Lakh
- Re-valuation Reserve Rs.25 Lakh
- Long Term Borrowings Rs.125 Lakh
- Short Term Borrowings (Cash Credit Loan) Rs.50 Lakh
- Temporary Loan for construction of Building Rs.25 Lakh

The Board of Directors further want to borrow a sum of Rs. 50 Lakh as Long Term Loan without obtaining the consent of the members in general meeting by special resolution. Advice the Board about the validity of this proposal. What will be your answer if it is a Private Limited company ?

As per section 180(1)(c), the board of directors of a company with the consent of the company by a special resolution shall borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital, free reserves and securities premium, apart from temporary loans obtained from the company's bankers in the ordinary course of business.

Temporary loans means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature.

In view of the above provision the eligible amount which can be borrowed by the Board is given below:

Paid up share capital	Rs. 100 Lakh
Reserve & Surplus General Reserve	Rs. 50 Lakh
Security Premium Account	Rs. 25 Lakh
Total	Rs. 175 Lakh

Re-valuation Reserve is not treated as free reserve as per Section 2(43).

The total borrowing of the company for the purpose of this sub section is –

Long Term Borrowings	Rs. 125 Lakh
Temporary Loan for construction of Building	Rs. 25 Lakh
Total	Rs. 150 Lakh

Short Term Borrowings (Cash Credit Loan) of Rs. 50 Lakhs is considered as temporary loan and loan for construction of building in not consider as temporary loan as per the explanation for temporary loan mentioned above.

Therefore, the company can borrow a further sum upto Rs. 25 Lakh without seeking the approval from the members. So, the board cannot borrow a sum of Rs. 50 Lakhs as Long Term Loan without obtaining the consent of the members in general meeting by special resolution.

In case of private company the provision of section 180 does not apply vide exemption notification dated 05th June, 2015, hence the board can borrow without approval from members in general meeting by passing special resolution.

Contributions to Charitable Funds [Section 181]

The Board of Directors of a company may contribute to bona fide charitable and other funds.

However, prior permission of company in its General Meeting is required if such contribution in case any amount the aggregate of which, in any financial year, exceeds 5% of its average net profits for the 3 immediately preceding financial years.

In the case of *Graphite India Ltd. and Anr. vs. Dalpat Rai Mehta and Anr.*, the Calcutta High Court observed that the word "contribution" has been defined inter-alia, as giving money or other aid for specified object.

In other words, a contribution is an aid or payment without any consideration.

Prohibitions and Restrictions Regarding Political Contributions [Section 182]

Section 182 of the Companies Act, 2013 prohibits certain companies to make political contribution as well as restricts some companies to make political contribution subject to the compliances of section 182. These are the Companies which are prohibited to make political contribution:

- A Government Company;
- A company which has been in existence for less than three financial years.

Other than above mentioned companies all companies can directly or indirectly make political contribution to any Political party subject to the following compliances:

- Every company shall pass a Board resolution at a meeting of the Board of Directors to authorise such political contribution, and such resolution shall, subject to the other provisions of this section, be deemed to be the justification in law for making such contribution authorised by it.
- Every company shall disclose in its profit and loss account the total amount contributed by it under this section during the financial year to which the account relates.
- The contribution shall be made by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.
- A company may make contribution through any instrument, issued pursuant to any scheme notified under any law for the time being in force, for contribution to the political parties.

"Political Party" means a political party registered under section 29A of the Representation of the People Act, 1951.

Without prejudice to the generality of the political party contribution, these are some transactions which shall be treated as Political party contribution:

(a) a donation or subscription or payment caused to be given by a company on its behalf or on its account to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or payment was given or made, can reasonably be regarded as likely to affect public support for a political party shall also be deemed to be contribution of the amount of such donation, subscription or payment to such person for a political purpose;

(b) the amount of expenditure incurred, directly or indirectly, by a company on an advertisement in any publication, being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like, shall also be deemed:

  (i) where such publication is by or on behalf of a political party, to be a contribution of such amount to such political party, and

  (ii) where such publication is not by or on behalf of, but for the advantage of a political party, to be a contribution for a political purpose.

In case of a contribution made by a company is in contravention of the provisions of Section 182, the Company and every officer in default shall be penalized in following manner:

Company	Fine which may extend to five times of the amount so contributed.
Every officer who is in default	Imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.

Power of Board and other Persons to make Contributions to National Defence Fund, etc. [Section 183]

The Board of Directors of any company or any person or authority exercising the powers of the Board of Directors of a company, or of the company in general meeting, may, notwithstanding anything contained in sections 180, 181 and section 182 or any other provision of this Act or in the memorandum, articles or any other instrument relating to the company, contribute such amount as it thinks fit to the National Defence Fund or any other Fund approved by the Central Government for the purpose of national defence.

The company is required to disclose in its profit and loss account the total amount or amounts contributed by it during the financial year to which the amount relates.

INTER CORPORATE LOANS, INVESTMENTS GUARANTEES AND SECURITY

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Act. However, the Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount. Thus, apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security can provide for a loan.

Provisions in respect of giving of loans, making investments, giving guarantee or providing security or acquiring securities of any other body corporate have been considerably modified by the Companies Act, 2013. As of

now, an overall limit of 60% of paid-up share capital plus free reserves and securities premium account or 100% of free reserves and securities premium account, whichever is more, has been fixed.

The Calcutta High Court in the case of *Saradindu Sekhar Banerjee vs. Lalit Mohan* has held that "Every loan is a debt but every debt is not a loan".

Let us understand some terminologies used in Section 186 of the Companies Act, 2013:

(1) Free Reserves

As per section 2(43) of the Companies Act, 2013 ('the Act') "free reserves" means such reserves which, as per the latest audited balance sheet of a company, are available for distribution as dividend:

Provided that –

(i) any amount representing unrealised gains, notional gains or revaluation of assets, whether shown as a reserve or otherwise, or

(ii) any change in carrying amount of an asset or of a liability recognised in equity, including surplus in profit and loss account on measurement of the asset or the liability at fair value, shall not be treated as free reserves.

(2) Paid-up share capital

As per Section 2(64) of the Act, "paid-up share capital" or "share capital paid-up" means such aggregate amount of money credited as paid-up as is equivalent to the amount received as paid up in respect of shares issued and also includes any amount credited as paid-up in respect of shares of the company, but does not include any other amount received in respect of such shares, by whatever name called;

The definition of paid-up share capital is exhaustive. Paid up share capital includes both equity and preference share capital.

(3) "Body Corporate" or "Corporation"

As per Section 2(11) of the Act, "body corporate" or "corporation" includes a company incorporated outside India, but does not include –

(i) a co-operative society registered under any law relating to co-operative societies; and

(i) any other body corporate (not being a company as defined in this Act), which the Central Government may, by notification, specify in this behalf.

(4) Difference between 'Advance' and 'Loans'

Section 2 of the Companies Act, 2013, does not define "loan". A loan is defined by the Oxford English Dictionary as a thing lent; something the use of which is allowed for a time, on the understanding that it shall be returned or an equivalent given, a sum of money lent on these conditions and usually with interest.

There is a difference between advance and loan. Loan is lending of money with absolute promise to repay whereas advances is to be adjusted against supply of goods and services. Genuine trade advances given to suppliers against orders for supply of goods will not be considered as loans and hence will be out of purview of Section 186. Similarly, advances given to employees against current month's salary will also not be in the nature of loans.

(5) Investments

The word 'Investments' in common parlance would include any property or right in which money or capital is invested. However, for the purpose of this study, the term 'Investments' is used in a limited sense to mean the investment of money in shares, stock, debentures, or other securities.

The power to invest the funds of the company is the prerogative of the Board of Directors. This power is derived by the Board under Section 179 of the Act. However, the Companies Act, 2013 contains provisions for restrictions on investments that a company can make and loans it can provide. Moreover, giving corporate guarantee or security is also as good as giving a loan, because the person to whom guarantee or security is given can decide to enforce the guarantee or security in certain conditions and in such a situation, the company will have to pay the amount.

Thus, apart from loan and investments, restrictions are also placed on the guarantees which the company can give or security it can provide for a loan. Provisions in respect of giving of loans, making investments, giving guarantee or providing security or acquiring securities of any other body corporate have been considerably modified by the Companies Act, 2013 by inserting Section 186.

LOAN AND INVESTMENT BY COMPANIES (SECTION 186)

Company to make investments through not more than two layers of investment companies - Section 186(1)

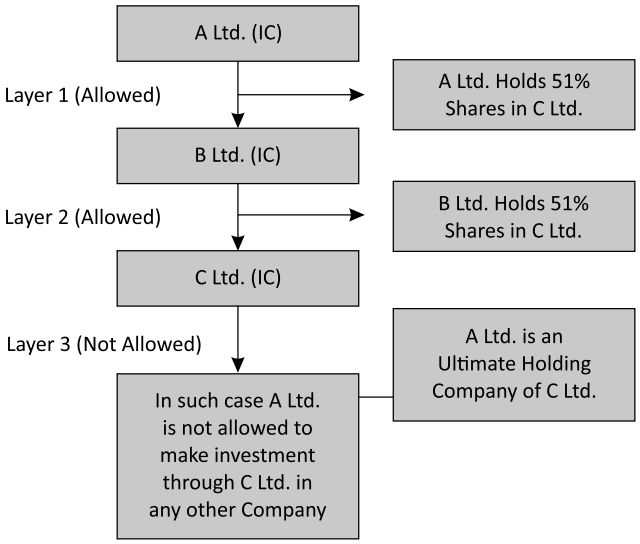
Section 186(1) restricts the power of a company from making an investment through not more than 2 layers of investment companies, unless otherwise prescribed, subject to exceptions provided in the proviso as follows:

(i) Acquisition of any other company incorporated in a country outside India, which has investment subsidiaries beyond two layers as per the laws of such country;

(ii) A subsidiary company from having any investment subsidiary for the purposes of meeting the requirements under any law or under any rule or regulation framed under any law for the time being in force.

'Layer' according to explanation (d) of Section 2(87) of the Companies Act, 2013 in relation to a holding Company means its subsidiary or subsidiaries.

"Investment Company" means a company whose principal business is the acquisition of shares, debentures or other securities and a company will be deemed to be principally engaged in the business of acquisition of shares, debentures or other securities, if its assets in the form of investment in shares, debentures or other securities constitute not less than fifty per cent. of its total assets, or if its income derived from investment business constitutes not less than fifty per cent. as a proportion of its gross income.



PROCEDURES INVOLVED IN MAKING LOAN GIVING GUARANTEE AND PROVIDING SECURITY

Section 186(2) stipulates that, no company shall directly or indirectly –

(a) give any loan to any person or other body corporate;

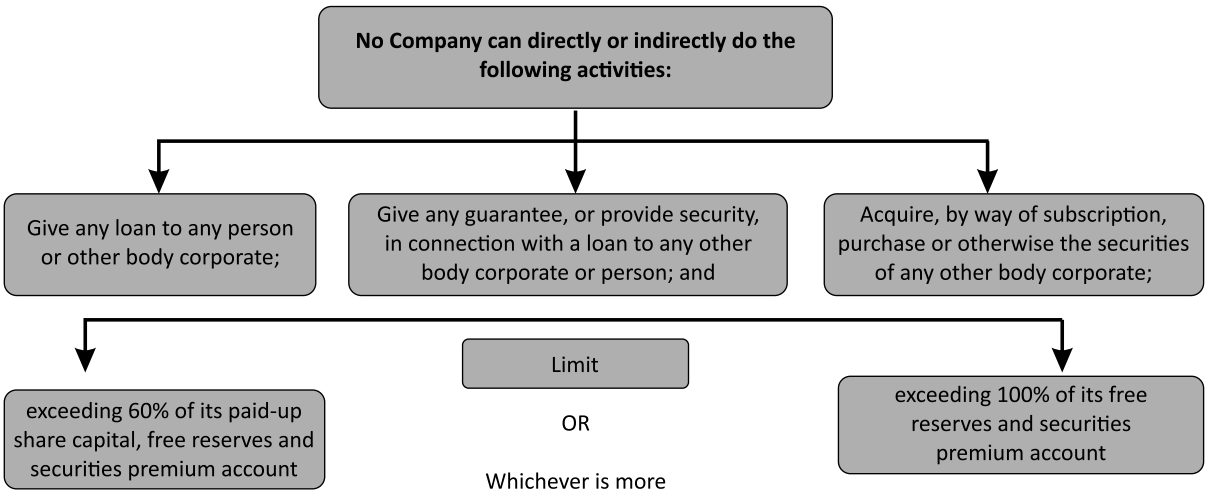
(b) give any guarantee, or provide security, in connection with a loan to any other body corporate or person; and

(c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

***Explanation.* –** For the purposes of this sub-section, the word "person" does not include any individual who is in the employment of the company.

Limits for Loans, Guarantees, Security and Investment - Section 186(2)



Loan/Investment to be made with the approval of all the Directors at the Board Meeting [Section 186(5)]

No loan or investment shall be made or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

Approval from Members [Section 186 (3)]

Though Section 186(2) makes restriction as above, Section 186(3) of the Act, empowers the company by stating that where the aggregate of the loans and investment so far made, the amount for which guarantee or security so far provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board, exceed the limits specified under sub-section (2) of Section 186 of the Act i.e. 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account whichever is more , investment or loan can be made or guarantee can be given or security can be provided only with the previous authorisation by a special resolution passed in a general meeting. [Section 186(3)]

Where a loan or guarantee is given or where a security has been provided by a company to its wholly owned subsidiary company or a joint venture company, or acquisition is made by a holding company, by way of subscription,

purchase or otherwise of, the securities of its wholly owned subsidiary company, the requirement of section 186(3) of the Act shall not apply i.e. prior special resolution is not required.

Rule 13 of the Companies (Meetings of Board and its Powers) Rules, 2014 prescribes that a resolution passed at a general meeting in terms of sub-section (3) of section 186 to give any loan or guarantee or investment or providing any security or the acquisition under sub-section (2) of section 186 shall specify the total amount up to which the Board of Directors are authorized to give such loan or guarantee, to provide such security or make such acquisition.

Further, the company shall disclose to the members in the financial statement the full particulars in accordance with the provisions of sub-section(4) of section 186.

As per Section 186(6) read with Rule 11 of the Companies (Meetings of Board and its Powers) Rules, 2014, no company, which is registered under section 12 of the Securities and Exchange Board of India Act, 1992 (SEBI Act) and covered under such class or classes of companies which is notified by the Central Government in consultation with the Securities and Exchange Board, shall take inter-corporate loan or deposits in excess of the limits specified under the regulations applicable to such company, pursuant to which it has obtained certificate of registration from the Securities and Exchange Board of India and such company shall furnish in its financial statement the details of such loan or deposits.

Section 12 of the SEBI Act, 1992 deals with the registration of stock brokers, sub-brokers, share transfer agents and various other market intermediaries.

Disclosure in Financial Statements [Section 186(4)]

The company shall disclose to the members in the financial statement the full particulars of the loans given, investment made or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security. Such disclosure has to be in the Board's Report also.

Prior Approval of Financial Institution [Section 186(5)]

The company has to obtain prior approval of the public financial institution concerned where any term loan is subsisting. Section 186(5) of the Act provides that no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

However, the prior approval of Public Financial Institution shall not be required where the aggregate of loans and investments so far made, the amounts for which guarantee or security so far provided to or in all other bodies corporate, along with the investments, loans, guarantee or security proposed to be made or given does not exceed the limit as specified in sub-section (2) of Section 186 of the Act and there is no default in repayment of loan installments or payment of interest thereon as per the terms and conditions of such loan to the public financial institution [Proviso Section 186(5)].

Illustration:

Metal Industries Ltd. passed a special resolution in the last general meeting to empower the Board of Directors to grant of loan to Subash Finance Ltd. in excess of the 60% of paid-up share capital, free reserves and securities premium account. However, the company auditor took a contrary view to the resolution passed stating that the resolution did not mention the loan amount that can be provided for. Besides, from the minutes of the Board Meeting in which such item was discussed had a dissenting vote by one of the directors of the company. Comment on the issued raised by the auditor.

In terms of sec 186 (2) of the Companies Act, 2013, no Company shall, directly or indirectly:

(a) give any loan to any person or other body corporate;

(b) give any guarantee, or provide security, in connection with a loan to any other body corporate or person; and (c) acquire, by way of subscription, purchase or otherwise the securities of any other body corporate;

exceeding 60% of its paid-up share capital, free reserves and securities premium account or 100% of its free reserves and securities premium account, whichever is more.

Where a loan and investment made, the amount for which guarantee or security provided to or in all other bodies corporate along with the investment, loan, guarantee or security proposed to be made or given by the Board exceeds the limits as specified above, no investment or loan shall be made or guarantee shall be given or security shall be provided unless previously authorized by a special resolution passed at a general meeting.

There is no requirement to mention the amount in such resolution however, all relevant details may be given in the resolution and explanatory statement as good corporate governance practice.

According to section 186(5), no investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.

Rate of Interest [Section 186(7)]

Loan given under this section shall carry the rate of interest not lower than the prevailing yield of one year, three year, five year or ten year Government Security closest to the tenor of the loan.

In case of section 8 companies, section 186 (7) of the Act, following proviso shall be applicable:-

Provided that nothing contained in this sub-section shall apply to a company in which twenty-six per cent. or more of the paid-up share capital is held by the Central Government or one or more State Governments or both, in respect of loans provided by such company for funding Industrial Research and Development projects in furtherance of its objects as stated in its memorandum of association." (Notification dated 13-06-2017)

Default subsists with respect to repayment of deposits [Section 186(8)]

No company, which is in default in repayment of any deposits accepted before or after the commencement of the Companies Act, 2013 or in payment of interest thereon, shall give any loan or give any guarantee, or provide any security or make an acquisition till such default is subsisting.

This prohibition will operate in respect of any default made under Section 73 to 76 of the Act and the Rules made thereunder and not only on the default of repayment of deposit or payment of interest thereon.

Register of Loans Made, Guarantees Given, Securities Provided and Investments Made [Section 186(9)]

Sub-section (9) of section 186 of the Act, provides that every company giving loan or giving a guarantee or providing security or making an acquisition under this section shall keep a register which shall contain such particulars and shall be maintained in manner prescribed under Rule 12 of the Companies (Meetings of Boards and its Powers) Rules, 2014.

Rule 12 states that every company giving loan or giving guarantee or providing security or making an acquisition of securities shall, from the date of its incorporation, maintain a register in **Form MBP 2** and enter therein separately, the particulars of loans and guarantees given, securities provided and acquisitions made as aforesaid. Further, the rule specifies that:

- The entries in the register shall be made chronologically in respect of each such transaction within seven days of making such loan or giving guarantee or providing security or making acquisition;
- The register shall be kept at the registered office of the company and shall be open to inspection at such office;
- The register shall be preserved permanently and shall be kept in the custody of the Company Secretary of the company or any other person authorised by the Board for the purpose;
- The entries in the register (either manual or electronic) shall be authenticated by the Company Secretary of the company or by any other person authorised by the Board for the purpose. The register can be maintained either manually or in electronic mode;
- The extracts from the register maintained may be furnished to any member of the company on payment of such fee as may be prescribed in the Articles of the company which shall not exceed ten rupees for each page.

NON APPLICABILITY OF SECTION 186

Exemptions

Sub-section (11) of section 186 of the Act, provides that nothing contained in section 186, except sub-section (1) of Section 186, shall apply –

(a) to any loan made, any guarantee given or any security provided or any investment made by a banking company, or an insurance company, or a housing finance company in the ordinary course of its business, or a company established with the object of and engaged in the business of financing industrial enterprises, or of providing infrastructural facilities;

- *the expression "business of financing industrial enterprises" shall include, with regard to a Non-Banking Financial Company registered with Reserve Bank of India, "business of giving of any loan to a person or providing any guaranty or security for due repayment of any loan availed by any person in the ordinary course of its business".*
- *the expression "infrastructure facilities" means the facilities specified in Schedule VI.*

(b) to any investment –

(i) made by an investment company;

(ii) made in shares allotted in pursuance of clause (a) of sub-section (1) of section 62 or in shares allotted in pursuance of rights issues made by a body corporate;

(iii) made, in respect of investment or lending activities, by a non-banking financial company registered under Chapter IIIB of the Reserve Bank of India Act, 1934 and whose principal business is acquisition of securities.

Exemption from Applicability of Section 186 to Government Company

In view of the Central Government's notification dated 5th June 2015 under Section 462 of the Companies Act, 2013, Section 186 shall not apply to:

(a) a Government company engaged in defence production;

(b) a Government company, other than a listed company, in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security or making any investment under the section.

Note: Except the government companies falling under the above mentioned conditions, all other companies are required to comply with the provisions of Section 186. In cases where there is no share capital, computation shall be based upon the free reserves of the company, if any.

Exemption from Applicability of Section 186 to Specified IFSC Companies

- In case of Specified IFSC Public Company/ Specified IFSC Private Company - In Sub-section (5) of section 186 after the proviso, the following proviso has been inserted –

  "Provided further that in case of a Specified IFSC public company/ Specified IFSC Private Company, the Board can exercise powers under this sub-section by means of resolutions passed at meetings of the Board of Directors or through resolutions passed by circulation." - *Notification Date 4th January, 2017.*

- In case of Specified IFSC Public Company/ Specified IFSC Private Company - In Sub-sections (2) and (3) of section 186 shall not apply if a company passes a resolution either at meeting of the Board of Directors or by circulation. - *Notification Date 4th January, 2017.*

- In case of Specified IFSC Public Company/Private Company - Sub-section (1) of section 186 shall not apply. -*Notification Date 4th January, 2017.*

Penalty for Contravention of Section 186

For Company:

If a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees; and

For Officers:

Every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees [Section 186(13)].

INVESTMENTS TO BE HELD IN COMPANY'S OWN NAME

According to Sub-section (1) of Section 187 of the Act, all investments made or held by a company in any property, security or other asset shall be made and held by it in its own name.

The requirement that the investment made by the company must be held in its own name is confined to only those investments which are made by it on its own behalf and not on behalf of someone else. In a case where the company is a trustee, the investment is supposed to be made on behalf of the beneficiaries of the trust and not on its own behalf. Therefore, the investments by the company as a trustee and held in the name of the beneficiaries is allowed.

As per proviso to section 187(1) of the Act, the company may hold any shares in its subsidiary company in the name of any nominee or nominees of the company, if it is necessary to do so, to ensure that the number of members of the subsidiary company is not reduced below the statutory limit.

Where the shares of a company were registered in the joint names of the company and one of its directors, it was held that the director was a nominee of the company for that purpose and could only act jointly as he had no rights of his own. [*Exchange Travel (Holdings) Ltd. Re, (1991) BCLC 728 (Ch D)*].

Exemptions from applicability of Section 187(1)

In terms of the provisions of Section 187(2), Section 187(1) of the Act, does not prevent a company:

(a) from depositing with the bank, being the bankers of the company, any shares or securities for the collection of any dividend or interest payable thereon; or

(b) from depositing with or transferring to, or holding in the name of, the State Bank of India or a scheduled bank, being the bankers of the company, shares or securities, in order to facilitate the transfer thereof.

However, if within a period of 6 months from the date on which the shares or securities are transferred by the company to, or are first held by the company in the name of, the State Bank of India or a scheduled bank as aforesaid, no transfer of such shares or securities takes place, the company shall, as soon as practicable, after the expiry of that period, have the shares or securities re-transferred to it from the State Bank of India or the scheduled bank or, as the case may be, again hold the shares or securities in its own name; or

(c) from depositing with, or transferring to, any person any shares or securities, by way of security for the re-payment of any loan advanced to the company or the performance of any obligation undertaken by it.

(d) from holding investments in the name of a depository when such investments are in the form of securities held by the company as a beneficial owner.

Thus, it is not necessary for the company to hold the shares or stocks or debentures in its own name if they are deposited with the bank as aforesaid. A resolution of the Board of directors in this behalf is sufficient. The bank is entitled to have the shares or debentures registered in its own name with the specific purpose of collecting dividend or interest from the company whose shares or debentures are deposited with the bank. The company holding the investment in the name of the bank is only required to enter into a separate agreement with the bank that the latter will collect dividend and interest and credit the company with the amounts so collected. It may be noted that the deposit of shares, stocks and debentures with the bank need not be by way of a pledge but may be made for the specific object of enabling the banker to act as agent of the company to collect dividend and interest.

REGISTER OF INVESTMENTS NOT HELD IN COMPANY'S OWN NAME

According to sub-section (3) of section 187 of the Act, where in pursuance of clause (d) of sub-section (2) of section 187, any shares or securities in which investments have been made by a company are not held by it in its own name, the company shall maintain a register which shall contain such particulars as prescribed under Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014 and such register shall be open to inspection by any member or debenture-holder of the company without any charge during business hours subject to such reasonable restrictions as the company may by its articles or in general meeting impose.

Rule 14 of the Companies (Meetings of Board and its Powers) Rules, 2014 states the following:

(1) Every company shall, from the date of its registration, maintain a register in **Form MBP-3** and enter therein, chronologically, the particulars of investments in shares or other securities beneficially held by the company but which are not held in its own name and the company shall also record the reasons for

not holding the investments in its own name and the relationship or contract under which the investment is held in the name of any other person.

(2) The company shall also record whether such investments are held in a third party's name for the time being or otherwise.

(3) The register shall be maintained at the registered office of the company.

(4) The register shall be preserved permanently and shall be kept in the custody of the company secretary of the company or if there is no company secretary, any director or any other officer authorised by the Board for the purpose.

(5) The entries in the register shall be authenticated by the company secretary of the company or by any other person authorised by the Board for the purpose.

Let us Remember

The company has to maintain register of loans, investments in Form MBP-2 and register of Investment beneficially held by the company but not held in the name of the company in Form MBP-3.

Punishment

According to section 187(4) of the Act, if a company is in default in complying with the provisions of this section, the company shall be liable to a penalty of five lakh rupees and every officer of the company who is in default shall be liable to a penalty of fifty thousand rupees.

RELATED PARTY TRANSACTIONS

Related party transactions mean contracts or arrangements between a company and its related parties with respect to transactions covered in Section 188 of the Companies Act, 2013 (Act). The expression 'contract or arrangement' has different connotations under the Act. While 'contract' envisages a written / formal binding document, 'arrangement' may be with or without a written document.

Under the Companies Act, 2013, the scope and coverage of related party transactions has been made more complex and intricate. Besides strict procedural compliances have been foisted.

Related Party

According to Section 2(76) of Companies Act 2013, **"related party",** with reference to a company, means—

(i) a director or his relative;

(ii) a key managerial personnel or his relative;

(iii) a firm, in which a director, manager or his relative is a partner;

(iv) a private company in which a director or manager or his relative is a member or director;

(v) a public company in which a director or manager is a director and holds along with his relatives, more than two per cent (2%) of its paid-up share capital;

(vi) any body corporate whose Board of Directors, Managing Director or Manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;

(vii) any person on whose advice, directions or instructions a director or manager is accustomed to act:

Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;

(viii) any body corporate which is –

- a holding, subsidiary or an associate company of such company ;
- a subsidiary of a holding company to which it is also a subsidiary; or
- an investing company or the venturer of the company.

Explanation. — For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

(According to Notification no. GSR 464(E), dated 05th June, 2015 in case of Private Companies Section 2(76) Sub- clause viii shall not apply with respect to section 188.)

(ix) such other person as may be prescribed.

According to Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014 for the purposes of sub-clause (ix) of clause (76) of section 2 of the Act, a director other than independent director or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.

List of relatives in terms of Section 2(77) of the Companies Act, 2013

Relative with reference to any person, means anyone who is related to another if-

(a) they are members of Hindu Undivided Family;

(b) they are husband and wife; or

(c) one person is related to other in accordance with Rule 4 of the Companies (Specification of Definitions Details) Rules, 2014.

A person shall be deemed to be the relative of another, if he or she is related to another in the following manner, namely-

(i) Father: the term "Father" includes step-father;

(ii) Mother: the term "Mother" includes the step-mother;

(iii) Son: the term "Son" includes the step-son;

(iv) Son's wife;

(v) Daughter;

(vi) Daughter's husband;

(vii) Brother: the term "Brother" includes the step-brother;

(viii) Sister: the term "Sister" includes the step-sister.

Nature of Related Party Transactions

The scope of dealing with Related Party Transactions has been widened under the Companies Act, 2013. Section 188 of the Act provides that except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as prescribed under Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014, no company shall enter into any contract or arrangement with a related party with respect to :

(i) sale, purchase or supply of any goods or materials;

(ii) selling or otherwise disposing of, or buying, property of any kind;

(iii) leasing of property of any kind;

(iv) availing or rendering of any services;

(v) appointment of any agent for purchase or sale of goods, materials, services or property;

(vi) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and

(vii) underwriting the subscription of any securities or derivatives thereof, of the company.

However, such approval by the Board of Directors will not be required for transactions entered in the ordinary course of business and on an arm's length basis. In other words, approval of the Board of Directors will only be required for related party transactions which are either not in the ordinary course of business or not on an arm's length basis.

The approval of the Board of Directors cannot be obtained by way of passing of resolution by circulation. The law specifically requires that resolution can be passed in a duly convened meeting of the Board of Directors and only thereafter contract or arrangement can be entered into.

'Ordinary course of business'- Black's Law Dictionary defines 'ordinary course of business' as the 'normal routine in managing the trade or business'.

In common parlance, 'ordinary course of business' would include transactions which are entered into in the normal course of the business pursuant to or for promoting or in furtherance of the company's business objectives, as per the charter documents of the company.

For example, in case of a manufacturing company, purchase and sale of goods, taking premises on lease/ rent, construction of factory, employing workers, etc. will be considered as ordinary course of business. To carry on a business, several activities are carried on by the company; all such activities will be considered to be in the ordinary course of business.

However, if a manufacturing company for the purpose of diversification, decides to acquire another company which is engaged in a completely unrelated business, this activity will not be considered to be in the ordinary course of business.

In the case of *M/s. Bharti Televentures Ltd. vs. Addl./Jt. Commissioner of Income Tax*, it was held that the Memorandum and Articles of Association is not conclusive for deciding whether an activity is in the ordinary course of business of the company. Frequency of the activity is sought to be highlighted. It should be a continuous activity carried out in a normal organized manner.

'Arm Length Transaction'- Explanation to sub-section (1) of Section 188 of the Act defines the term 'arm length transaction' means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

The phrase 'on an arm's length basis' is in fact 'at arm's length' or 'an arm's length relationship' which means avoiding intimacy or close contact. The phrase 'at arm's length' in relation to dealings between two parties is used to refer to dealings when neither party is controlled by the other.

In the case of *Iljin Automotive Private Limited vs. Asst. Commissioner of Income Tax*, the Court opined that "the determination of 'arm's length price' seeks answer to the question – What would have been the price if the transactions were between two unrelated parties, similarly placed as the related parties in so far as nature of product, and terms and conditions of the transactions are concerned?"

The Bangalore Bench of the Income Tax Appellate Tribunal in the case of *Filtrex Technologies Pvt. Ltd. vs. Asst. Commissioner of Income Tax,* held that acceptance of arm's length price declared by one party cannot preclude the Revenue from examining arm's length price in the hands of the other party to the same transaction.

Issue: Who determines that the transaction with related party is in the ordinary course of business? Is it the Board or the Audit Committee?

***View*:** The Companies Act, 2013 does not clearly lay down tests for determining whether a transaction is in the ordinary course of business.

The Memorandum of Association of the company should be referred to for ascertaining whether the activity is covered in the objects clause therein. This is not a conclusive test but will assist in determining whether a transaction is in the ordinary course of business or not. The Audit Committee may decide whether a particular transaction is in the ordinary course of business and such decision will be based on the policy on transactions with related parties, if any. The company's policy on transactions with related parties should specify the parameters to guide the Audit Committee on whether a transaction is in the ordinary course of business or not.

Apart from such a policy, a company may formulate guidelines approved by the Audit Committee and the Board of Directors on transactions with related parties. In such cases, the company can enter into transactions based on the approved guidelines and every transaction need not be placed before the Audit Committee for determining whether the same is in the ordinary course of business or not. In case the company does not have an Audit Committee, the decision as to whether a transaction is in the ordinary course of business or not will be taken by the Board.

Office or Place of Profit

As per Explanation to Sub-Section (i) of Section 188 the expression "office or place of profit" means any office or place where such office or place is held by:

(i) a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(ii) an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise.

For example, in case of a transaction with respect to remuneration of a director, it will be considered to be on an arm's length basis if the director gets remuneration in accordance with the provisions of Section 197 read with Schedule V of the Act.

In *Firestone Tyre & Rubber Co. vs. Synthetics & Chemicals Ltd.,* the Hon'ble Bombay High Court held that 'the object underlying Section 314 of the 1956 Act (corresponding to Section 188 of the Companies Act, 2013) is to prevent a director or his relative from holding any office or place of profit carrying a total monthly remuneration beyond the prescribed limits under the company and thereby put in his pocket, directly or indirectly, additional profit over and above the remuneration to which he is entitled as such director, without obtaining the requisite permission.'

Illustrations:

a) Mr. A is the managing director in AB Ltd., which is engaged in manufacturing medicines. Mr. A is a qualified software expert. AB Ltd. after following a due process of tendering engages the services of Mr. A in his capacity of a software expert and for which an amount of Rs 50 lakh is proposed to be paid. The next lowest quotation for the proposal is Rs 2 crore.

Ans. This is a transaction with a related party. This transaction will fall under the proviso to Section 197(4) of the Act. If the terms and conditions are comparable with those offered by other parties, the transaction will not be treated as an office or place of profit as covered under Section 188. (Price offered by Mr. A is certainly far lower than the next lowest quote but the other terms also need to be examined). However, approval of the Audit Committee will be necessary. Approval of the Nomination & Remuneration Committee as provided under Section 197of the Act will also be required.

b) Mr. X was appointed as the managing director in MNP Ltd. on 1st January 2020. MNP Ltd. is engaged in manufacturing automobiles. Mr. X holds a few patents in his name since July 2010 and he is requested by MNP Ltd. for a licence of 5 years of one of the patents for which an amount of Rs 50 lakh is proposed to be paid.

Ans. Although this transaction is with a related party, this transaction will be protected under the proviso to Section 197(4) of the Act. Section 188(1) of the Act will be attracted if the transaction is not on an arm's length basis. This transaction is in the same line of business as that of the company and obtaining a license of the patent will be in its ordinary course of business. However, approval of the Audit Committee will be necessary. Approval of the Nomination & Remuneration Committee as provided under Section 197 of the Act will also be required.

Information to the Board for Related Party Transactions

Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that a company shall enter into any contract or arrangement with a related party subject to the following conditions, namely:-

(1) The agenda of the Board meeting at which the resolution is proposed to be moved shall disclose-

(a) the name of the related party and nature of relationship;

(b) the nature, duration of the contract and particulars of the contract or arrangement;

(c) the material terms of the contract or arrangement including the value, if any;

(d) any advance paid or received for the contract or arrangement, if any;

(e) the manner of determining the pricing and other commercial terms, both included as part of contract and not considered as part of the contract;

(f) whether all factors relevant to the contract have been considered, if not, the details of factors not considered with the rationale for not considering those factors; and

(g) any other information relevant or important for the Board to take a decision on the proposed transaction.

(2) Where any director is interested in any contract or arrangement with a related party, such director shall not be present at the meeting during discussions on the subject matter of the resolution relating to such contract or arrangement.

Prior Approval of the Company by a Resolution

First Proviso to the Section 188 (1) of the Act provides that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions not exceeding such sums, as prescribed, shall be entered into except with the prior approval of the company by a resolution.

Rule 15 of the Companies (Meetings of board and its Powers) Rules, 2014 provides that except with the prior approval of the company by a resolution, a company shall not enter into a transaction or transactions, where the transaction or transactions to be entered into,-

(a) as contracts or arrangements with respect to clauses (a) to (e) of sub-section (1) of section 188, with criteria as mentioned below-

Particular	***Threshold***
(i) Sale, purchase or supply of any goods or materials, directly or through appointment of agent	Transaction value ≥ 10% of annual turnover
(ii) Selling or otherwise disposing of, or buying, property of any kind, directly or through appointment of agent	Transaction value ≥ 10% of net worth
(iii) Leasing of property of any kind	Transaction value ≥ 10% of annual turnover
(iv) Availing or rendering of any services, directly or through appointment of agent	Transaction value ≥ 10% of annual turnover
(v) Appointment to any office or place of profit in the company, its subsidiary company or associate company	Monthly remuneration > Rs. 2.50 lakh
(vi) Remuneration for underwriting the subscription of any securities or derivatives thereof	Transaction value > 1% of net worth

The limits specified in sub-clause (i) to (iv) above shall apply for transaction or transactions to be entered into either individually or taken together with the previous transactions during a financial year.

The turnover or net worth referred in the above sub-rules shall be computed on the basis of the audited financial statements of the preceding financial year.

Exceptions: The requirement of passing the resolution shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

In case of wholly owned subsidiary, if the resolution is passed by the holding company, it shall be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

Information to be provided: The explanatory statement to be annexed to the notice of a general meeting convened pursuant to section 101 shall contain the following particulars, namely:-

(a) name of the related party;

(b) name of the director or key managerial personnel who is related, if any;

(c) nature of relationship;

(d) nature, material terms, monetary value and particulars of the contract or arrangements;

(e) any other information relevant or important for the members to take a decision on the proposed resolution.

Issue: Will the requirement of passing a shareholder's resolution not be applicable for transactions entered into between a Holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed for approval before the shareholders at the general meeting of the Holding company?

View: Yes, the fifth proviso to Section 188(1) provides that the requirement of passing the resolution under the first proviso of section (1) of Section 188 shall not be applicable for transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

It is pertinent to observe that explanation (2) to Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides that in case of a wholly owned subsidiary, the resolution that is passed by the holding company would be sufficient for the purpose of entering into the transaction between the wholly owned subsidiary and the holding company.

This will mean that in case the fifth proviso to Section 188(1) is not available to a company as the accounts are not so consolidated, then as per explanation (2) to Rule 15 a resolution passed by the holding company will be sufficient.

Related Party not to Vote on Resolution

Second Proviso to Section 188 (1) of the Act provides that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party.

This shall not apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties.

The Ministry of Corporate Affairs, vide their Circular No. 30/2014 dated 17th July, 2014 has clarified that " the related party, if he is a member of the Company, shall not take part in the voting on Resolution – second proviso of Section 188 (1). It is clarified that 'related party 'referred to in the second proviso has to be construed with reference only to the contract or arrangement for which the said resolution is being passed.

Thus, the term 'related party' in the above context refers only to such related party as may be a related party in the context of the contract or arrangement for which the said resolution is being passed.

- **Exemption to Private Companies**: In case of private companies second proviso to Section 188(1) of the Act, shall not apply (*Notification No. GSR 464(E) dated 5th June, 2015*).
- **Exemption to Government Companies**: In case of Government companies First and Second Proviso to the section 188 (1) of the Act shall not apply to -

  (a) A Government company in respect of contracts or arrangements entered into by it with any other Government company or with Central Government or any State Government or any combination thereof;

  (b) A Government company, other than a listed company, in respect of contracts or arrangements other than those referred to in clause (a), in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before entering into such contract or arrangement.

  [*Notification No. GSR 463(E) dated 5-6-2015) further amended by (Notification No: G.S.R. 151(E) dated 02nd March, 2020*].

- **Exemptions to Specified IFSC Public Company :** Second proviso to sub section (1) of section 188 shall not apply, In case of Specified IFSC Public Company.

By virtue of MCA Notifications dated, 13th June, 2017, the exemption from applicability of the Second Proviso to Section 188 (1) of the Companies Act is available only to those private and Government companies who have not committed a default in filing of their financial statements under Section 137 or Section 92 of the Companies Act, 2013.

Disclosure in Board's Report

Section 188(2) of the Act, provides that every related party contracts or arrangements shall have to be disclosed in the Board's report and referred to shareholders along with the justification for entering into such type of transactions in the prescribed form i.e., **Form no. AOC-2** [pursuant to Section 134(3)(h) and Section 188(2)].

Form AOC-2 shall be signed by the persons who have signed the Board's Report.

Consequences of entering into Related Party Contracts or Arrangements by the Director or the Employee without the consent of the Board or Approval by Resolution:

- Section 188(3) of the Act, provides that where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting under Section 188(1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.
- Section 188(4) of the Act, states that it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.
- A person shall not be entitled to be appointed as a Director by virtue of Section 164(1)(g) of the Companies Act, 2013 upon such director being convicted of an offence dealing with related party transactions under Section 188 of the Act at any time during the last preceding five years.

Issue: *Will a transaction of payment of salary to an employee who is a relative of a Director, (where such payment is in the ordinary course of business and on arm's length) require disclosure as a related party transaction in the Board's Report?*

View: The same need not be disclosed as a related party transaction in Form AOC-2 in the Board's Report unless the same is material in the context of the company's business.

Issue: *Is it required that items falling in the ambit of the fourth proviso to Section 188(1) of the Act i.e. transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis, be mentioned in Form AOC-2?*

***View*:** Form AOC–2 uses the term 'material' and therefore if the transactions are material, the same will need disclosure. A transaction which is in the ordinary course of business and on arm's length basis but which is considered to be material will require disclosure in Form AOC–2. It is to be noted that approvals of the Board and the shareholders are not required if the transaction is in the ordinary course of business and on arm's length basis, but disclosure is required from the perspective of transparency.

Penalties for Non Compliance

Section 188(5) of the Act, prescribes penalty for any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section :

In case of listed company	Liable to penalty of Rs. 25 Lakhs
In case of any other company	Liable to penalty of Rs. 5 Lakhs

Cross Reference: For detailed discussion on Relate Party Transactions Provisions under SEBI(LODR)Regulations, 2015, please refer Lesson 10 of Capital Market & Securities Laws.

CASE STUDY

25/04/2022	***Securities and Exchange Board of India (Appellant) vs. R.T. Agro Private Limited & Ors. (Respondents)***	***Supreme Court***

Facts of the Case

The company R. T. Exports Limited proposed to enter into a transaction with one Neelkanth Realtors Private Limited for purchase of 40,000 sq. ft. of residential space. This proposal was treated as a related party transaction and was required to be approved by the shareholders of the Company. Accordingly, a special resolution was approved by R. T. Exports Limited on 15.07.2014. In terms of Section 188 of the Companies Act, 2013, the related parties abstained from voting on this special resolution. Thereafter, an Extra-Ordinary General Meeting was convened on 16.12.2016 for rescinding the resolution dated 15.07.2014 in which, the related parties also voted.

However, the appellant-SEBI took up the matter on a complaint and issued notice alleging violation of Regulation 23 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015. The Adjudicating Officer, ultimately, proceeded to penalise the present respondents with a cumulative sum of Rs. 35 lakhs for the alleged violation of the said Regulation 23.

Judgment

The Supreme Court observed that the Securities Appellate Tribunal has not approved this order passed by the Adjudicating Officer and has allowed the appeal filed by the present respondents while, inter alia, holding that the bar of voting as per Section 188 of the Companies Act, 2013 on related parties operated only at the time of entering into a contract or arrangement, i.e., when the resolution dated 15.07.2014 was passed; and therein the said related parties indeed abstained from voting. The Appellate Tribunal found no fault in the said parties voting in the recalling/rescinding of the said resolution.

It was held that the view, as taken by the Appellate Tribunal, in the given set of facts and circumstances of the present case, appears to be a plausible view of the matter. In fact, nothing of ill-intent on the part of the respondents has been established in the present case. The hyper-technical stance of the appellant could have only been, and has rightly been, disapproved on the given set of facts and circumstances. The appeal fails and is, therefore, dismissed.

LESSON ROUND-UP

- Every company shall have a Board of Directors consisting of individuals as directors and shall have—
  - (a) a minimum number of three directors in the case of a public company,
  - (b) two directors in the case of a private company, and
  - (c) one director in the case of a One Person Company.
- Every company shall have at least one director who stays in India for a total period of not less than one hundred and eighty-two days during the financial year.
- No person, shall hold office as a director, including any alternate directorship, in more than twenty companies at the same time.
- For reckoning the limit of directorships of twenty companies, the directorship in a dormant company shall not be included.
- The Audit Committee shall consist of a minimum of three directors with independent directors forming a majority.
- The vigil mechanism shall provide for adequate safeguards against victimisation of persons who use such mechanism and make provision for direct access to the chairperson of the Audit Committee in appropriate or exceptional cases.
- The Nomination and Remuneration Committee shall formulate the criteria for determining qualifications, positive attributes and independence of a director and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees.
- No investment shall be made or loan or guarantee or security given by the company unless the resolution sanctioning it is passed at a meeting of the Board with the consent of all the directors present at the meeting and the prior approval of the public financial institution concerned where any term loan is subsisting, is obtained.
- Approvals for making investments and loans would have to be taken in accordance with the specific provisions of the Companies Act. A blanket approval of the shareholders for the purpose would not suffice.
- No member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party. This shall not apply to a company in which ninety per cent. or more members, in number, are relatives of promoters or are related parties.
- The Audit Committee may make omnibus approval for related party transactions proposed to be entered into by the company subject to such conditions as may be prescribed.

GLOSSARY

Ordinary course of business: 'Part of doing regular business; the regular or customary condition or course of things; as things usually happen'.

Arm Length Transaction: A transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

Director: A director appointed to the Board of a company.

Financial Institution: Includes a scheduled bank, and any other financial institution defined or notified under the Reserve Bank of India Act, 1934.

TEST YOURSELF

(*These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).*

1. Raso Ltd. Is an unlisted public company having a paid-up capital of Rs. 50 Crore as on 31st March, 2022 and a turnover of Rs.200 Crore. The total number of directors are 15.

   (a) State the minimum number of independent directors that the company should appoint.

   (b) How many independent directors are to be appointed if Raso Ltd. is a listed company?

2. Lamco Engineers Ltd. has a paid-up capital of Rs.50 lakhs, Free Reserves of Rs.3 lakhs and Securities Premium of Rs.2 lakh. It has granted a loan of Rs.20 lakhs to Manza Traders Ltd. The Board of Directors is proposing the following transactions without securing approval of the members :

   (I) Sanctioning a loan of Rs.2 lakh to ASC Cement Ltd.; and

   (II) Sanctioning a loan of Rs.3 lakh to an employee of the company.

3. Mohit is a well-known banker and holds directorship in 22 companies as on 30th September, 2021. The companies include 10 public companies, 11 private companies (including XYZ Pvt. Ltd., a dormant company) and 1 company registered under section 8 of the Companies Act, 2013.

   Recently, on 20th December, 2021, ABC Ltd. in which Mohit is not a director acquired 100% shares in XYZ Pvt. Ltd. In this context, answer the following :

   (i) Whether the directorships held by Mohit as on 30th September, 2021 are valid ?

   (ii) Can Mohit continue to hold directorship in all 22 companies after acquisition made by ABC Ltd. ?

   (iii) Company Secretary of ABC Ltd. has proposed to restrict number of directorship of the directors in ABC Ltd. Whether the proposal given by the Company Secretary is tenable in light of the provisions of the Companies Act, 2013 ?

4. Sensa Ltd. intends to acquire shares in another company. How much amount can be invested by Sensa Ltd. without passing special resolution considering the facts mentioned below?

Particulars	***Amount (Crore)***
Paid-up Share Capital	Rs. 100
Free Reserves	Rs. 80
Securities Premium Account	Rs. 70
Investment in another company	Rs.50

5. If A Ltd. makes an investment in B Ltd. and further B Ltd. makes an investment in X, which is a Limited Liability Partnership. Whereas X, LLP holds shares of Y Ltd. Is there any violation of Section 186 of the Companies Act, 2013 ?

6. Dynamic Ltd. (paid-up share capital Rs. 25 Crore) proposes to enter into a contract with Sunil for the procurement of raw materials for an amount of Rs. 5 Crore during the financial year. Sunil is the step brother (father's second wife's son) of Anil, who is a director of Dynamic Ltd. Discuss the compliance requirements in respect of the above procurement contract.

7. The Board of Directors of ABC Ltd. has agreed in principle to grant loan of Rs. 6 crores to XYZ Ltd.: ABC Ltd. has provided the following information:

   Authorised Share Capital: Rs.15 crores Paid up Share Capital: Rs.10 crores

   Free Reserves: Rs.4 crores

   Securities Premium Account: Rs.1 crore

   ABC Ltd. has already given loan of Rs.3 crores to another company namely PQR Ltd. and has made investment of Rs.2 crores in the shares of other companies. What advice would you give to the Board of Directors of ABC Ltd. about the proposed loan to XYZ Ltd. in the light of provisions of the Companies Act, 2013 and the rules made thereunder?

8. Does the acceptance of deposits by a public limited company from its director attract compliance of any of the provisions of section 188?

9. Explaining the meaning of the term 'related party' in relation to a company under the provisions of the Companies Act, 2013, decide whether the following shall be treated as 'related party':

   - Kamal, a director of Deep Ltd. holds 170 shares in the company's paid-up share capital.
   - Fair Ltd. is an associate company of Mohan Ltd. Also explain whether a company can enter into a contract with a related party' for leasing of the company's property and also for sale of any goods produced by the company.

10. The AOA of XYZ Ltd. Provide that the maximum number of Directors in the Company shall be 10. Presently the maximum number of directors is 8. The Board of Directors of the said Company desires to increase the number to 16. Advise whether it can do so.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premier on Company Law
- Bare Act- The Companies Act, 2013
- Secretarial Standard-1
- Guidance Note on SS-1
- The SEBI(LODR) Regulations, 2015

OTHER REFERENCES (Including Websites/ Video Links)

- *http://ebook.mca.gov.in/Default.aspx?page=main*

Meetings of Board and its Committees

Lesson 16

KEY CONCEPTS

■ Meeting ■ Notice ■ Quorum ■ Agenda ■ Chairman ■ Circulation ■ Attendance ■ Leave of absence ■ Minutes

Learning Objectives

To understand:

- The legal provisions relating to meetings of the Board and committees along with procedural aspects
- Roles and responsibilities of the officers and directors thereunder
- Meaning and procedure of Board meeting through video or audio-visual means

Lesson Outline

- Introduction
- Frequency, Convening and Proceedings of Board and Committee meetings
- Agenda Management
- Meeting Management
- Resolution by circulation
- Types of Resolutions
- Duties of Company Secretary before, during and after Board/Committee Meeting
- Virtual Meetings: Technological Advancement in conduct of Board Committee
- Need and Scope of Secretarial Standards
- Secretarial Standard- 1
- Drafting of Notice, Agenda and Minutes of Board and Committee Meetings
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013(Sections 108, 173-175, 118)
- The Companies (Meetings of Board & Powers) Rules, 2014
- The Companies (Management and Administration) Rules, 2014
- The SEBI (LODR) Regulations, 2015
- SS-1- Secretarial Standard on Meetings of the Board of Directors

INTRODUCTION – BOARD AND COMMITTEE MEETINGS

Meaning of Board and Committee:

As per section 2(10) of the Companies Act, 2013, "Board of Directors" or "Board", in relation to a company, means the collective body of the directors of the company.

On the other hand, Board can set up committees with particular terms of reference when it needs assistance (for example a new project sub-committee) or when an issue requires more resources and attention (review of effect of legislative changes on organisational programs). They can be set up for a specific purpose or to deal with general issues such as 'development'. They can be established on a short-term or temporary basis, or they can be formed as a permanent body for ongoing work.

What is a Board Meeting?

"Meeting of Board" means a duly convened, held and conducted meeting of the Board or any Committee thereof.

The meetings play an important role in a corporate democracy. A Board Meeting is a formal meeting of the board of directors of an organization and invitees, wherever required, held at definite period of time and as and when needed to review performance, consider policy issues, address major problems and perform the legal business of the board. Directors of the Company have to exercise most of their powers or duties at periodical meetings of the Board or Committee of the Board. Therefore, Companies Act, 2013 and the rules framed thereunder contained detailed provisions relating to frequency, convening and conduct of the meeting.

Meetings of the Board are significant in the light of running of the company more efficiently and effectively. the Companies Act, 2013, mandates a company to hold minimal number of meetings of the Board for its proper functioning.

Board meetings are crucial for a company's development as these formal meetings are held to devise policies, drive the management, strategize and evaluate the expectations of the stakeholders.

Essentials for an effective board meeting are:

Meeting has a purpose;

Members of the board have been provided with adequate notice and appropriate materials in advance;

Meeting is chaired effectively;

It follow proper meeting procedures and respect the time of board members;

Availability clear supporting documents such as an agenda with detailed notes, minutes and other reports;

Agenda has separate section wherein progress of ongoing matters is covered from meeting to meeting till that matter gets closed. Agenda also has section of action taken reports on items of previous meeting;

To be documented with Minutes.

As per Guidance Note on SS -1, "A mere coincidental physical presence of all Directors at one place cannot constitute a board meeting."

MEETINGS OF BOARD AND ITS COMMITTEES

Meetings of the Board [Section 173]

Section 173 of the Act deals with Meetings of the Board and Section 174 deals with quorum. Further, as per Section 118(10) of the Act, every company shall observe secretarial standards with respect to General and Board meetings specified by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980, and approved by the Central Government. As such, it is important to refer to Secretarial Standard on Board Meetings (SS-1) along with provisions of the Companies Act, 2013 to ensure proper compliance to the statutory requirements regarding Board Meetings.

The Board of Directors of a company shall exercise certain powers on behalf of the company only by means of Resolutions passed at a Meeting of the Board and not by a Resolution passed by circulation. Further, certain powers of the Board shall be exercised by Resolutions passed at Meetings, with the consent of all the Directors present at the Meeting.

Frequency, Convening and Proceedings of the Meetings of the Board

Section 173 of the Act provides that the first board meeting should be held within thirty days of the date of incorporation. Thereafter, there shall be minimum number of four board meetings every year and not more than one hundred and twenty days shall intervene between two consecutive Board meetings.

The Board of directors of Equity Listed Company shall meet at least four times in a year, with a maximum time gap of one hundred and twenty days between any two meetings. [Regulation 17(2) of SEBI (LODR) Regulations, 2015]

Further, in this context Secretarial Standard on Board Meetings (SS-1) issued by ICSI clarifies that the company shall hold at least four Meetings of its Board in each Calendar Year with a maximum interval of one hundred and twenty days between any two consecutive Meetings.

Furthermore, SS-1 states that the company shall hold first meeting of its Board within thirty days of the date of incorporation. It shall be sufficient if subsequent Meetings are held with a maximum interval of one hundred and twenty days between any two consecutive Meetings.

Illustration:

If a company is incorporated on 15th June, the first Meeting should be held within thirty days i.e. latest by 14th July. If the meeting is held say on 10th July, then the next Meeting should be held within 120 days from 10th July.

In case of one person company (OPC), small company, dormant company and private company which is recognized as start- up***, at least one Board meeting should be conducted in each half of the calendar year*** and the gap between two meetings should not be less than ninety days. However, this provision would not apply to a one person company in which there is only one director on its Board.

The term "start-up" means a private company incorporated under the Act and recognised as start-up in accordance with the notification issued by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India.

Illustration:

In case a small company holds the first meeting of the Calendar Year 2024 on 1st June, 2024, it would be sufficient if it holds one more Meeting on any day before 31st December, 2024, but on or after 30th August 2024. If it holds the next Meeting on 30th July, 2024, it should hold at least one more Meeting on or after 30th August, 2024, but before 31st December, 2024.

Exemptions:

In case of Section 8 Company, after MCA exemptions Notification Dated 05.06.2015, the provisions of Section 173(1) shall apply only to the extent that the Board of Directors, of such companies shall hold at least one meeting within every six calendar months.

Specified IFSC Public & Private Company shall hold the first meeting of the Board of Directors within sixty days of its incorporation and thereafter hold at least one meeting of the Board of Directors in each half of a calendar year. (Notification Dated 04.01.2017).

The Act does not contain any provision conferring on the Directors the right to appoint a proxy to attend Board Meetings. A Director cannot appoint another person as his proxy to attend a Board Meeting since the right to appoint a proxy is not a common law right and can only be given by statute.

Aspects to be considered while fixing the Venue:

A Meeting may be held at the Registered Office of the company or at any other place, including a remote place. A Meeting may be held in India or abroad.

Notice of the Meeting shall clearly mention a venue, whether registered office or otherwise, to be the venue of the Meeting and all the recordings of the proceedings of the Meeting, if conducted through Electronic Mode, shall be deemed to be made at such place.

With respect to every Meeting conducted through Electronic Mode, the scheduled venue of the Meeting as set forth in the Notice convening the Meeting, shall be deemed to be the venue of the said Meeting and all recordings of the proceedings at the Meeting shall be deemed to be made at such place. [Rule 3(6) of the Companies (Meetings of Board and its Powers) Rules, 2014]

Board Meeting through Video Conferencing:

The board members can make their participation in meeting of the Board either in person or through video conferencing or other audio visual means, as may be prescribed, which are capable of recording and recognizing the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.

However, the Central Government may, by notification, specify such matters which shall not be dealt with in a meeting through video conferencing or other audio visual means.

CASE LAW

The New Delhi bench of NCLAT held in the case of *Achintya Kumar Barua alias Manju Baruah Vs. Ranjit Barthkur (2018)* that Order passed by Tribunal permitting director of company to attend board meeting through video-conferencing could not be interfered on apprehension that it would not be possible to ensure that no person other than concerned director was attending said meeting.

As Section 173 (2) gives right to a director to participate in the meeting through video-conferencing or other audio-visual means and it would be in the interest of the companies to comply with the provisions in public interest. The Tribunal took note of the fact that the company in this matter had all the necessary infrastructure available. The Tribunal came to the conclusion that the provisions of section 173 (2) of the 2013 Act are mandatory and the companies not be permitted to make any deviations therefrom.

Meetings of the Board – The SEBI (LODR) Regulations, 2015

Regulation 29: The listed entity shall give prior intimation of at least two working days in advance, excluding the date of the intimation and date of the meeting, to stock exchange about the meeting of the board of directors in which any of the following proposals is due to be considered:

(a) financial results, viz., quarterly, half yearly, or annual, as the case may be;

(b) proposal for buyback of securities;

(c) proposal for voluntary delisting by the listed entity from the stock exchange(s);

(d) Fund raising by way of issue of securities (excluding security receipts, securitized debt instruments or money market instruments regulated by the Reserve Bank of India), through further public offer, rights issue, American Depository Receipts/Global Depository Receipts/Foreign Currency Convertible Bonds, qualified institutions placement, debt issue, preferential issue or any other method and for determination of issue price;

Provided that intimation shall also be given in case of any annual general meeting or extraordinary general meeting or postal ballot that is proposed to be held for obtaining shareholder approval for further fund raising indicating type of issuance.

Provided further that intimation for determination of issue price in a qualified institutions placement is not required if such placement is done in accordance with the provisions of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

(e) Declaration/ recommendation of dividend, issue of convertible securities including convertible

debentures or of debentures carrying a right to subscribe to equity shares or the passing over of dividend;

(f) The proposal for declaration of bonus securities.

(g) any alteration in the form or nature of any of its securities that are listed on the stock exchange or in the rights or privileges of the holders thereof;

(h) any alteration in the date on which, the interest on debentures or bonds, or the redemption amount of redeemable shares or of debentures or bonds, shall be payable.

The intimation required under sub-regulation (1) shall mention the date of such meeting of board of directors.

Meetings of Committees

A board committee is a small working group identified by the board, consisting of board members, for the purpose of supporting the board's work. Committees are generally formed to perform some expertise work. Members of the committee are expected to have expertise in the specified field. Committees are usually formed as a means of improving board effectiveness and efficiency, in areas where more focused, specialized and technical discussions are required. These committees prepare the groundwork for decision-making and report at the subsequent board meeting. However, the Board of Directors are ultimately responsible for the acts of the committee. Board is responsible for defining the committee role and structure.

If authorized by articles, the directors have power to delegate their authority to a committee unless prohibited or limits prescribed in the Act. A company may adopt Regulations of Table F to Schedule I which reads as under:

Regulation 71 states:

(1) The Board may, subject to the provisions of the Act, delegate any of its powers to committees consisting of such member or a member of its body as it thinks fit;

(2) Any committee so formed shall, in the exercise of the powers so delegated, conform to any regulations that may be imposed on it by the Board.

For transacting business of the company, the committee meetings can be conducted in accordance with Regulations 72 to 75 of Table F to Schedule I of the Act or other corresponding provisions of the company's articles. These regulations read as under:

Regulation 72 provides:

(1) A committee may elect a chairperson of its meetings;

(2) If no such chairperson is elected, or if at any meeting the chairperson is not present within five minutes after the time appointed for holding the meeting, the members present may choose one of their members to be chairperson of the meeting.

Regulation 73 provides:

(1) A committee may meet and adjourn as it thinks fit;

(2) Questions arising at any meeting of a committee shall be determined by a majority of votes of the members present and in case of an equality of votes, the chairperson shall have a second or casting vote.

Regulation 74 provides:

All acts done in any meeting of the Board or of a committee thereof or by any person acting as a director, shall, notwithstanding that it may be afterwards discovered that there was some defect in the appointment of any one or more of such directors or of any person acting as aforesaid, or that they or any of them were disqualified, be

as valid as if every such director or such person had been duly appointed and was qualified to be a director.

Regulation 75 provides:

Save as otherwise expressly provided in the Act, a resolution in writing, signed by all the members of the Board or of a committee thereof, for the time being entitled to receive notice of a meeting of the Board or Committee, shall be as valid and effective as if it had been passed at a meeting of the Board or Committee, duly convened and held.

According to SS-1 (Secretarial Standard on Board Meetings) Committees shall meet as often as necessary subject to the minimum number and frequency prescribed by any law or any authority or as stipulated by the Board.

Frequency of Meetings of a Committee

Committees should meet as often as required and at least as often as stipulated by the Board while constituting the Committee. Guidelines, Rules and Regulations framed under the Act or by any statutory/regulatory authority may contain provisions for frequency of Meetings of a Committee and such stipulations should be followed.

Preparation of Notices for meetings of Board/Committees of Board

(1) Section 173 (3) requires that not less than seven days' notice in writing shall be given to every director at the registered address (whether in India or outside India) as available with the company and such notice shall be sent by hand delivery or by post or by electronic means.

Provided that a meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting.

Provided further that in case of absence of independent directors from such a meeting of the Board, decisions taken at such a meeting shall be circulated to all the directors and shall be final only on ratification thereof by at least one independent director, if any.

(2) SS-1 provides exhaustive guide for the meetings of Board/committees. Accordingly, it provides that Notice convening a Meeting shall be given at least seven days before the date of the Meeting, unless the Articles prescribe a longer period.

In case the company sends the Notice by speed post or by registered post, an additional two days shall be added for the service of Notice.

Notice of an adjourned Meeting shall be given to all Directors including those who did not attend the Meeting on the originally convened date and unless the date of adjourned Meeting is decided at the Meeting, Notice thereof shall also be given not less than seven days before the Meeting.

As per Guidance Note on SS-1, the date of notice need not be excluded but the date of meeting is to be excluded while computing the period of seven days.

(3) Notice in writing of every Meeting shall be given to every Director by hand or by speed post or by registered post or by facsimile or by e-mail or by any other electronic means. It will not be given by ordinary post.

Notice cannot be given by ordinary post since proof of delivery or acknowledgement is not available. Notice should also be given to Directors who have gone abroad or who usually reside abroad and who do not have an address in India.

(4) The notice shall contain contact number or e-mail address (es) of the chairman or the company secretary or any other person authorised by the Board, to whom the Director shall confirm in this regard. . In the absence of an advance communication or confirmation from the Director as above, it shall be assumed that he will attend the Meeting physically

(5) The Notice shall be sent to the postal address or e-mail address, registered by the Director with the company or in the absence of such details or any change thereto, any of such addresses appearing in the Director Identification Number (DIN) registration of the Director. Where a Director specifies a particular means of delivery of Notice, the Notice shall be given to him by such means. However, in case of a Meeting conducted at a shorter Notice, the company may choose an expedient mode of sending Notice.

Illustration:

The Articles of Association of XYZ Ltd. provides that all Notices of the Meetings of the Board and Committees thereof shall be sent to all the members of the Board/Committees by e-mail or through speed post or registered post with acknowledgment. Accordingly, the company is sending Notices through speed post to all Directors.

However Mr. A, Independent Director on the Board of XYZ Ltd. requested the company to send all such Notices to him through courier at his office.

Since Mr. A has specified a particular means of delivery of Notice, the company should send Notice of the Meetings through such means to him.

(6) Proof of sending Notice and its delivery shall be maintained by the company for such period as decided by the Board, which shall not be less than three years from the date of the Meeting.

(7) Notice shall be issued by the Company Secretary or where there is no Company Secretary, any Director or any other person authorised by the Board for the purpose.The Notice shall specify the serial number, day, date, time and full address of the venue of the Meeting. Where approval by means of a Resolution is required, the draft of such Resolution shall be either set out in the note or placed at the Meeting.

(8) The Notice shall inform the Directors about the option available to them to participate through Electronic Mode and provide them all the necessary information.

(9) The Notice of a Meeting shall be given even if Meetings are held on pre-determined dates or at pre-determined intervals.

If notice of meeting is not given to one of its directors, meeting of board of directors is invalid and resolution passed at such meeting are inoperative. *Parmeshwari Prasad Gupta v. Union of India [1974] 44 Comp Cas 1 (SC)*

Board meeting to transact urgent business, the Notice, Agenda and Notes on Agenda may be given at shorter period of time than stated above, subject to following conditions:

(a) If the company is required to have independent director:

- Presence of at least one Independent director is required.
- In case of absence of independent director, decision taken at such meeting shall be circulated to all the directors, and shall be final only on ratification thereof by at least one Independent director.

(b) If the company does not require appointing independent director, meeting can be called up at a shorter notice without any conditions to be complied with.

As per SS-1, in case the company does not have an Independent Director, the decisions shall be final only on ratification thereof by a majority of the Directors of the company, unless such decisions were approved at the Meeting itself by a majority of Directors of the company. The fact that the meeting is being held at a shorter notice shall be stated in the notice.

Illustration:

1) If the Meeting is proposed to be held on 14th November, the last date for giving the Notice would be 7th November.
2) In case Notice is being sent by facsimile or by e-mail or by any other electronic means to the Directors, Notice should be sent latest by 7th November.
3) In case any of the Director does not have an e-mail id and therefore the Notice is being sent to him solely by post, Notice should be sent to all Directors latest by 5th November.

CASE LAW

Sanjiv Kothari v. Vasant Kumar Chordia (2005) 66 CLA 45 (CLB)

Notice of meeting sent to a Director contrary to the mode specified by him cannot be a conclusive proof of service of notice.

AGENDA MANAGEMENT

As per SS-1, the Agenda, setting out the business to be transacted at the Meeting, and Notes on Agenda shall be given to the Directors at least seven days before the date of the Meeting, unless the Articles prescribe a longer period.

What is an Agenda?

The list of items of business to be transacted at a Meeting is known as the "Agenda". The Agenda draws attention to the relevant matters where deliberation is required. The Notes on Agenda explain each item of the Agenda in an endeavor to provide an understanding of points for discussion by the Board.

The Agenda should be accompanied or followed by Notes thereon explaining the proposal in brief, in easily understandable language and setting out the points for decision of the Board.

Agenda and Notes on Agenda shall be sent to all Directors by hand or by speed post or by registered post or by e-mail or by any other electronic means. These shall be sent to the postal address or e-mail address or any other electronic address registered by the Director with the company or in the absence of such details or any change thereto, to any of such addresses appearing in the Director Identification Number (DIN) registration of the Directors.

The Articles of the company may prescribe a longer period for sending the Agenda and Notes thereto, in which case the Articles should be complied with. However, the period of seven days cannot be reduced by the company in its Articles.

In case the company sends the Agenda and Notes on Agenda by speed post or by registered post, an additional two days shall be added for the service of Agenda and Notes on Agenda.

Where a Director specifies a particular means of delivery of Agenda and Notes on Agenda, these papers shall

be sent to him by such means. However, in case of a Meeting conducted at a shorter Notice, the company may choose an expedient mode of sending Agenda and Notes on Agenda.

Proof of sending Agenda and Notes on Agenda and their delivery shall be maintained by the company for such period as decided by the Board, which shall not be less than three years from the date of the Meeting.

The Notice, Agenda and Notes on Agenda shall be sent to the Original Director also at the address registered with the company, even if these have been sent to the Alternate Director. However, the mode of sending Notice, Agenda and Notes on Agenda to the original director shall be decided by the company.

Notes on items of business which are in the nature of Unpublished Price Sensitive Information may be given at a shorter period of time than stated above, with the consent of a majority of the Directors, which shall include at least one Independent Director, if any.

Where the company has Independent Director(s) and, if none of the Independent Directors consents to the giving of Notes on items of Agenda which are in the nature of Unpublished Price Sensitive Information (UPSI) at a shorter Notice, the said Notes should not be given at shorter Notice-*Guidance Note on SS-1.*

For this purpose, "Unpublished Price Sensitive Information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available, which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following: –

(i) financial results;

(ii) dividends;

(iii) change in capital structure;

(iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions; and

(v) changes in key managerial personnel.

General consent for giving Notes on items of Agenda which are in the nature of Unpublished Price Sensitive Information at a shorter Notice may be taken in the first Meeting of the Board held in each financial year and also whenever there is any change in Directors. Where general consent as above has not been taken, the requisite consent shall be taken before the concerned items are taken up for consideration at the Meeting. The fact of consent having been taken shall be recorded in the Minutes.

Consent to circulate Agenda items which are in the nature of UPSI at a shorter Notice from the new Directors appointed during a financial year may be obtained on an individual basis-Guidance Note on SS-1.

Illustration:

1) Assume there are 9 Directors and 5 have given their general consent at the beginning of the financial year to give Notes on items of Agenda which are in the nature of UPSI at shorter Notice. If 1 new Director is appointed, consent from the new Director to circulate Agenda items which are in the nature of UPSI at a shorter Notice may be obtained individually. If this Director gives his consent, no fresh consent from the Board would be needed. In case, this Director dissents or does not give his consent, fresh consent should be taken from the Board.

2) Assume there are 9 Directors and 5 have given their general consent at the beginning of the financial year to give Notes on items of Agenda which are in the nature of UPSI at shorter Notice. If, out of these 5 who consented, 2 resign, it means that out of the remaining 7 Directors only 3 have given their consent. In such case, fresh consent is required.

Supplementary Notes on any of the Agenda items may be circulated at or prior to the Meeting but shall be taken up with the permission of the Chairman and with the consent of a majority of the Directors present in the Meeting, which shall include at least one Independent Director, if any.

Each item of business requiring approval at the Meeting shall be supported by a note setting out the details of the proposal, relevant material facts that enable the Directors to understand the meaning, scope and implications of the proposal and the nature of concern or interest, if any, of any Director in the proposal, which the Director had earlier disclosed.

Each item of business to be taken up at the Meeting shall be serially numbered.

Any item not included in the Agenda may be taken up for consideration with the permission of the Chairman and with the consent of a majority of the Directors present in the Meeting.

Office copies of Notices, Agenda, Notes on Agenda and other related papers shall be preserved in good order in physical or in electronic form for as long as they remain current or for eight financial years, whichever is later and may be destroyed thereafter with the approval of the Board.

Office copies of Notices, Agenda, Notes on Agenda and other related papers of the transferor company, as handed over to the transferee company, shall be preserved in good order in physical or electronic form for as long as they remain current or for eight financial years, whichever is later and may be destroyed thereafter with the approval of the Board and permission of the Central Government, where applicable.

Where approval by means of a Resolution is required, the draft of such Resolution shall be either set out in the note or placed at the Meeting. However, any other decision taken at the Meeting may also be recorded in the Minutes in the form of Resolution. Resolutions drafted and circulated to Directors in advance, along with the Agenda saves time at the Meeting, clarifies the subject matter, facilitates discussion, simplifies preparation of Minutes of the Meeting and enables issuance of certified copies of Resolution, wherever required, after the Meeting and before the Minutes thereof are finalized.

Illustration:

Company XYZ Ltd. has 9 Directors out of which 6 Directors are present at the Meeting. An item not included in the Agenda is proposed to be taken up at a Meeting. Following are the scenarios and their effect:

1. Consent for taking up such item is obtained from only 3 Directors present in the Meeting, including the Chairman.

   Effect:

   Such item should not be taken up at the Meeting as majority of Directors present at the Meeting have not given their consent.

2. Consent for taking up such item is obtained from 4 Directors present at the Meeting, including the Chairman.

   Effect:

   Such item should be taken up as majority of Directors present at the Meeting have given their consent.

3. Consent for taking up such item is obtained from 4 Directors out of 6 Directors present at the Meeting, including the Chairman. However, out of 6 Directors only 4 approved the decision. Majority of Directors of the company is 5 Directors.

Effect:

Such item should be taken up, as majority of Directors present at the Meeting have given their consent. The decision should be final only on ratification by majority of Directors of the Company, which is 5 Directors. The said decision approved by 4 Directors at the Meeting should be circulated to all the Directors along with relevant supporting documents, specifically highlighting the requirement of ratification by majority of Directors of the Company.

Any item not included in the Agenda and Notes thereon may either be circulated to the Directors before the Meeting or tabled at the Meeting, but can only be taken up with the requisite consent.

Sample of Important Agenda Items for Board Meeting

Agenda Items of Board Meeting

Item No.	***Particulars***	***Frequency***
1.	To grant leave of absence, if any.	Every meeting
2.	Appointment of Chairperson of the Meeting.	Every meeting.
3.	To take note of minutes of last Board/ Committee Meeting held in a financial year.	Every meeting.
4.	To take note of Disclosure of Interest by Directors pursuant to section 184(1).	Disclosure to be given at first meeting : (i) after appointment in which an individual participates as a director; (ii) in every Financial Year; (iii) Whenever there is any change in the disclosures already made, then at the first Board meeting held after such change.
5.	To take note of entries made in register of contracts pursuant to section 189.	Every meeting. In case of no entry, mention that.
6.	To take note of Declaration given by Independent Director to meets the criteria of Independence under section149 (7) of the Companies Act, 2013.	Disclosure to be given at first meeting : a. After appointment as Independent Director; b. In every financial year; or c. After change in circumstances.
7.	Matters arising out of previous minutes.	All matters that are continuing or require update in next meeting should be clubbed in this agenda and updates given in every notes on agenda till further reporting is not required.

Item No.	*Particulars*	*Frequency*
8.	Report on investments, borrowings, corporate guarantees, sale of assets, sources & application of funds etc.	Event based.
9.	• To consider and approve policy (Name of the Policy). • Alternative agenda when any policy needs some change due to many factors. • To consider amendment in the policy (Name of the Policy).	On adoption of new policy. Whenever any amendment becomes necessary.
10.	To take note of statement containing investor complaints under regulation 13(3) of the SEBI (LODR) Regulations, 2015.	On quarterly basis, placed before the board of directors of the listed entity.
11.	To take note of Compliance Report on corporate governance under regulation 27(2) of SEBI (LODR) Regulations, 2015.	Review periodically.
12.	Appointment of Secretarial Auditor of the Company for the financial year_____ (if applicable).	Concerned meeting.
13.	Appointment of Internal Auditor of the Company for the financial year (if applicable).	Concerned meeting.
14.	To Approve & consider Audited Financial Statements for the year ended.....	Concerned meeting.
15.	To Take note of Statutory Auditors Report on the Financial Statements of the Company for the year ended 31st March.....	Concerned meeting.
16.	Related Party Transactions.	Omnibus approvals, related party transactions, report on related party transactions during the quarter.
17.	Progress Report.	In case of any ongoing projects, a detailed progress report.
18.	Any other item(s) with the permission of Chair.	As and when required.

Illustrative List of Agenda Items for Board Meeting as per SS 1 in addition to those prescribed under Companies Act:

General Business Items:

1. Noting Minutes of Meetings of Audit Committee and other Committees.

2. Considering the Compliance Certificate to ensure compliance with the provisions of all the laws applicable to the company.
3. Specifying list of laws applicable specifically to the company.
4. The Board is required to take note of the specific list of laws applicable to the company. For example, Banking Regulation Act, 1949 in case of banking companies.
5. Appointment of Secretarial Auditors and Internal Auditors.

Specific Items:

1. Approving remuneration of Managing Director, Whole-time Director and Manager.
2. Making political contributions.
3. According sanction for transactions with Related Party which are not in the ordinary course of business or which are not on arm's length basis.
4. Appointment or Removal of Key Managerial Personnel.
5. Approving purchase and sale of material tangible/intangible assets not in the normal course of business.

MEETING MANAGEMENT

Convening a Meeting

Any Director of a company may, at any time, summon a Meeting of the Board, and the Company Secretary or where there is no Company Secretary, any person authorised by the Board in this behalf, on the requisition of a Director, shall convene a Meeting of the Board, in consultation with the Chairman or in his absence, the Managing Director or in his absence, the Whole-time Director, where there is any, unless otherwise provided in the Articles.

Directors may participate in the meeting either in person or through video conferencing or other audio visual means as prescribed, which are capable of recording and recognising the participation of the directors and of the recording and storing the proceedings of such meetings along with date and time.

A Meeting may be convened on any day as per the Gregorian calendar, including on a public holiday, unless the Articles provide otherwise.

Being a matter of good practice and as far as possible, the companies should avoid holding of Board Meeting on a National Holiday, as the presence of the employees of the company would be needed for smooth conduct of any such Meeting.

Penalty

Every officer of the company who is duty bound to give notice under Section 173 of the Companies Act, 2013 and who fails to do so shall be liable to a penalty of twenty five thousand rupees.

CASE LAW

Belfin Spa (A Company incorporated Under the laws of Italy) & Ors. (Appellants) v. Cima Shyam Springs Private Limited & Ors. (Respondents) (dated: 10th June, 2019)

NCLAT held that decisions taken in the Board Meetings, EOGMs and AGM discussed in this Judgment regarding which there was no Notice or short notice to the Appellants, are not binding on the Appellants.

Quorum for Board Meetings: Section 174

"Quorum" means the minimum number of Directors whose presence is necessary for holding of a Meeting.

One third of total strength or two directors, whichever is higher, shall be the quorum for a Board meeting. For the purpose of determining the quorum, the participation by a director through Video Conferencing or other audio visual means shall also be counted, unless he is to be excluded for any item of business under any provisions of the Act or the rules - Section 174(1).

Section 174 is not applicable to One Person Company in which there is only one director.

Illustration:

For instance, if there are 12 directors and 10 of them are interested, remaining 2 directors would not have normally constituted quorum since four directors is the requisite quorum, but, in such event, remaining 2 disinterested directors would constitute quorum.

If at any time the number of interested directors exceeds or is equal to two-thirds of the total strength of the Board of directors, the number of directors who are not interested and present at the meeting, being not less than two shall be the quorum during such time.

Companies Act lays down only minimum number of directors to form a quorum, company by its articles can provide for a higher number of quorum - *Amrit Kaur Puri* v. *Kapurthala Flour, Oil & General Mills Co (P) Ltd.* [1984] 56 Comp Cas 194 (P & H)

Where due to removal or resignation or for some other reason, the number of directors is reduced below the quorum, then the continuing directors may act for the purpose of increasing the number of directors to that fixed for the quorum, or of summoning a general meeting of the company and for no other purpose.

CASE LAW

Where with resignation of one director, number of Directors fell below minimum number of two, subsequent Board meeting convened and conducted by said director by his withdrawal of resignation was patently illegal and consequently, further appointments of directors in such meetings were also illegal and cannot be established. [Held by High Court of Andhra Pradesh in case of *Smt. Dr. Renuka Datla* v. *Biological E Ltd.* in the year 2015]

The meeting shall be adjourned due to want of quorum, unless the articles of the company otherwise provide, the meeting shall be held on the same day at the same time and same place in the next week or if that day is a National Holiday, on the next succeeding day, which is not a national holiday, at the same time and place.

Sub–section (4) of Section 174 of the Act prohibits holding of Board Meetings adjourned for want of Quorum on National Holidays. However, law is not specifically prohibiting the original meeting to be held on a National Holiday.

If the Board meeting is adjourned for want of quorum and at the adjourned Board meeting also no quorum is present, meeting stands cancelled. Adjourned Board meetings are continuation of the original board meeting. Hence, maximum permissible interval period of 120 days shall be counted from the date of original meeting.

According to SS-1, the Chairman may, unless dissented to or objected by the majority of Directors present at a Meeting at which a Quorum is present, adjourn the Meeting for any reason, at any stage of the Meeting.

Adjournment of a Meeting otherwise than for want of Quorum may be necessitated for paucity of time to complete the Agenda or for any other reason viz. curfew, earthquakes or other events of force majeure etc.

Quorum shall be present not only at the time of commencement of the Meeting but also while transacting business.

A Director shall neither be reckoned for Quorum nor shall be entitled to participate in respect of an item of business in which he is interested. However, in case of a private company, a Director shall be reckoned for Quorum and entitled to participate in respect of such item after disclosure of his interest.

Additionally, for listed entities the quorum for every meeting of the board of directors of the top 2000 listed entities shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

(The words "top 1000 listed entities with effect from April 1, 2019 and of the" omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f. 31.12.2024. The words "with effect from April 1, 2020" omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f. 31.12.2024.)

The participation of the directors by video conferencing or by other audio-visual means shall also be counted for the purposes of such quorum.

As per SS-1 Directors participating through Electronic Mode in a Meeting shall be counted for the purpose of Quorum, unless they are to be excluded for any items of business under the provisions of the Act or any other law except for restricted items in which Quorum shall be ascertained on the basis of physical presence of Directors.

(Omitted by the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2024 w.e.f.31.12.2024.)

Exemptions:

In case of section 8 company, either eight members or twenty-five per cent, of its total strength whichever is less" shall form a quorum. However, the quorum shall not be less than two members. Notification dated 5th June, 2015.

In case of Specified IFSC Public Company and Specified IFSC Private Company - Sub-section (3) of section 174 shall apply with the exception that interested director may participate in such meeting provided the disclosure of his interest is made by the concerned director either prior or at the meeting. - Notification Dated 4th January, 2017.

In case of Private Company - Sub-Section (3) of Section 174 shall apply with the exception that the interested director may also be counted towards quorum in such meeting after disclosure of his interest pursuant to section 184." - Notification Dated 13th June, 2017.

To Sum Up Quorum for Board meeting

Requirement:

- Quorum for Board Meeting = 1/3rd of its Total strength or two directors, whichever is higher;
- A Director participating through video conferencing/audio visual modes will also be counted for quorum;
- Any fraction of a member will be rounded off as one;
- Total strength shall not include directors whose places are vacant.

Illustrations:

1. A Meeting is convened on 8th August at 4:00 p.m. at the Registered Office of the company. On that day, the required Quorum is not present. In the absence of any provisions to the contrary in the Articles, the Meeting is automatically adjourned to the same day in the next week, i.e. 15th August, at the same time and place. However, since 15th August is a National Holiday, the adjourned Meeting should be held on 16th August.
2. In ABC Ltd., there are total 12 directors. The quorum for the meeting will be 4 director i.e. 1/3rd of its total strength.
3. In NHS Limited, there are 12 directors and 10 directors are interested as they hold more than 2% shareholding of that body corporate. In a meeting 2 non-interested directors are present. The quorum of the meeting shall be 2 non-interested directors during such time.

Meetings of Committees

SS-1 lists hierarchy of stipulations for the quorum of a Committee constituted by the Board that are as following: —

a. First in hierarchy is the quorum that has been stipulated in the Act, or mentioned in the Articles or is stipulated under any other law;

b. If no such stipulation exists, the quorum shall be as specified by the board;

c. If the board has also not specified the quorum for the committee, presence of all the members of the committee shall be necessary to form the quorum.

Attendance Registers

Attendance register is a formal evidence of the presence of the persons signing such register. Maintenance of attendance register is a good secretarial practice which helps in keeping proper record of the attendance in the Meeting, enables cross-verification and also protects the interest of individual Directors and the invitees. It contains the signatures of the Directors who are present and other invitees also.

The attendance register is also contemplated under the Model Articles which state that "Every Director present at any Meeting of the Board or of a Committee thereof shall sign his name in a book to be kept for that purpose [Regulation 65 of Table F of Schedule I to the Act].

SS-1 provides that every company shall maintain separate attendance registers for the meetings of the Board and meetings of the committee. The pages of the respective attendance registers shall be serially numbered. If an attendance register is maintained in loose leaf form, it shall be bound periodically, at least once in every three years. The attendance register shall be maintained at the Registered Office of the company or such other place as may be approved by the Board. The attendance register may be taken to any place where a Meeting of the Board or Committee is held. The attendance register is open for inspection by the Directors. Even after a person ceases to be a Director, he shall be entitled to inspect the attendance register of the Meetings held during the period of his Directorship.

The attendance register shall contain the following particulars: serial number and date of the Meeting; in case of a Committee Meeting name of the Committee; place of the Meeting; time of the Meeting; names and signatures of the Directors, the Company Secretary and also of persons attending the Meeting by invitation and their mode of presence, if participating through Electronic Mode.

The attendance register shall be deemed to have been signed by the Directors participating through Electronic Mode, if their attendance is recorded in the attendance register and authenticated by the Company Secretary or where there is no Company Secretary, by the Chairman or by any other Director present at the Meeting, if so authorised by the Chairman and the fact of such participation is also recorded in the Minutes.

CASE LAW

In the absence of copy of the Notice convening the Board Meeting and the log book meant to record signatures of Directors attending the Meeting of the Board of Directors and any other proof to show that a Meeting was held, a Meeting of the Board of Directors cannot be accepted to be held *[Dale & Carrington Investment (P) Ltd. v. P. K. Prathapan and Others (2004) Supp (7) SCR 334].*

The attendance register shall be preserved for a period of at least eight financial years from the date of last entry made therein and may be destroyed thereafter with the approval of the Board. It shall be in the custody of the Company Secretary.

Where there is no Company Secretary, the attendance register shall be in the custody of any other person authorised by the Board for this purpose.

The period of eight financial years should be counted from the end of the financial year to which the last entry in the register pertains to.

In case of equity listed companies, such records should be preserved as per the policy approved by the Board for preservation of documents.

Illustration:

In case the attendance register contains the attendance record of a Meeting held on 5th May, 2010 as the first entry and 18th March, 2015 as the last entry, the attendance register should be preserved at least up to 31st March, 2023 i.e. for eight financial years from 31st March, 2015 since the last entry therein is 18th March, 2015.

Leave of Absence

Leave of absence shall be granted to a Director only when a request for such leave has been communicated to the Company Secretary or to the Chairman or to any other person authorised by the Board to issue Notice of the Meeting.

The office of a director shall become vacant in case the director absents himself from all the meetings of the Board held during a period of twelve months with or without seeking leave of absence of the Board.

Illustration:

Suppose, the Board Meetings of a company were held on 28th March, 2020, 25th June, 2020, 20th September, 2020, 30th December, 2020 and 27th March, 2021. Director X attended the Meeting on 28th March, 2020 and did not attend any Meetings thereafter.

In such a case, the count for Meetings of the Board held during a period of twelve months for the purpose of reckoning his vacation of office should commence from 25th June, 2020. Thus, if he does not attend any of the Meetings held upto end June 2021, he should vacate the office.

Chairman of the meeting of the Board/Committee

"Chairman" means the Chairman of the Board or its Committee, as the case may be, or the Chairman appointed or elected for a Meeting.

The Chairman of the Company shall be the chairman of the Board. If the company does not have a Chairman, the Directors may elect one of themselves to be the chairman of the Board.

Appointment of Chairman

For a Meeting to be properly constituted, the Chairman of the Board or a validly elected person should be in the chair. The Act does not provide for appointment of a Chairman of the Meeting but the Model Articles provide that the Board may elect a Chairman of its Meetings and determine the period for which he is to hold office [Regulation 70 (i) of Table F of Schedule I to the Act].

While appointing such person, the Board may stipulate a time period for the person to continue as Chairman of the Board. At the end of such period, the Board may either re-appoint the person or appoint any other Director as Chairman of the Board.

In case of committee meeting, a member of the committee appointed by the Board or elected by the Committee as chairman of the Committee, in accordance with the Act or any other law or the Articles, shall conduct the meetings of the committee. If no Chairman has been so elected or if the elected chairman is unable to attend the meeting, the Committee shall elect one of its members present to chair and conduct the meeting of the committee, unless otherwise provided in the articles.

The Chairman of the Board shall conduct the Meetings of the Board. If no such Chairman is elected or if the Chairman is unable to attend the Meeting, the Directors present at the Meeting shall elect one of themselves to chair and conduct the Meeting, unless otherwise provided in the Articles.

If the Chairman is interested in an item of business, he shall entrust the conduct of the proceedings in respect of such item to any Non-Interested Director, with the consent of the majority of Directors present, and resume the chair after that item of business has been transacted. However, in case of a private company, the Chairman may continue to chair, be reckoned for quorum and entitled to participate in respect of such item after disclosure of his interest.

Minutes

"Minutes" means a formal written record, in physical or electronic form, of the proceedings of a Meeting.

They are the official recording of the proceedings of the Meeting and the business transacted – evidence before Court.

Section 118 provides that every company shall prepare, sign and keep minutes of proceedings of every meeting of Board of Directors or of every committee of the Board within thirty days of the conclusion of every such meeting concerned in books kept for that purpose with their pages consecutively numbered.

In case of meeting of Board of Directors or of a committee of Board, the minutes shall contain:

(a) Name of the directors present at the meeting; and

(b) In the case of each resolution passed at the meeting, the names of dissenting director or a director who has not concurred the resolution.

The Chairman shall exercise his absolute discretion in respect of inclusion or non-inclusion of the matters which is regarded as defamatory of any person, irrelevant or immaterial to the proceedings; or detrimental to company's interest in the minutes. Minutes kept shall be evidence of the proceedings recorded in a meeting.

SS-1 contain detailed procedure regarding recording, contents, finalization, entry and signing of minutes which should be ensured.

Every company shall keep Minutes of all Board and Committee Meetings in a Minutes Book. Minutes kept in accordance with the provisions of the Act evidence the proceedings recorded therein. Minutes help in understanding the deliberations and decisions taken at the Meeting.

CASE LAW

In the case of ***Teleone Online Venture Private Limited*** ,ROC of Delhi & Haryana observed from the e-form AOC-4 filed on MCA portal for the Financial Year ended 31.03.2018 that the notice of Annual General Meeting and Board Report for the concerned years has not been numbered correctly, which amounts to violation of SS-1 and SS-2 of the Companies Act, 2013 and imposed penalty for non -compliance of the provisions under section 118 (11) of the Act, for violation of Secretarial Standard (SS-1) and (SS-2).

Maintenance of Minutes

- Minutes shall be recorded in books maintained for that purpose. A distinct Minutes Book shall be maintained for Meetings of the Board and each of its Committees. Company may maintain its Minutes in physical or in electronic form. The pages of the Minutes Books shall be consecutively numbered.
- Minutes may be maintained in electronic form in such manner as prescribed under the Act and as may be decided by the Board. Minutes in electronic form shall be maintained with Timestamp.

  "Timestamp" means the current time of an event that is recorded by a Secured Computer System and is used to describe the time that is printed to a file or other location to help keep track of when data is added, removed, sent or received.
- Minutes shall not be pasted or attached to the Minutes Book, or tampered with in any manner. Minutes Books, if maintained in loose-leaf form, shall be bound periodically depending on the size and volume and coinciding with one or more financial years of the company.
- Minutes Books shall be kept at the Registered Office of the company or at such other place as may be approved by the Board. [Rule 25(1)(f) of the Companies (Management and Administration) Rules, 2014]

Contents of Minutes

General Contents

a) Minutes shall state, at the beginning the serial number and type of the Meeting, name of the company, day, date, venue and time of commencement of the Meeting;

Every Meeting of the Board should be serially numbered for ease of reference.

While numbering serially, the company may choose to follow its existing system of numbering, if any, or any new system of numbering, which should be distinct and enable ease of reference and/or cross reference.

Illustrations

(i) Serially numbering on Calendar Year basis as follows: "1/2015", "2/2015", "3/2015" and so on.... In the next year, numbering would be "1/2016", "2/2016", "3/2016" and so on.

(ii) Serially numbering on financial year basis as follows: "1/2015-16", "2/2015-16", "3/2015-16" and so on....or 1/15-16, 2/15-16, 3/15-16 and so on.....

(iii) Continuous serially numbering across years: 120th Meeting, 121st Meeting, 122nd Meeting and so on .....

Here, a company may choose to either count and give continuous numbering from its incorporation or give continuous numbering from Meetings held on or after 1st July, 2015, this being the date from which SS-1 became effective.

Note: Serial number of the original Meeting and the adjourned Meeting should be the same. For eg: In case the serial number of the original Meeting is 12th Meeting, the serial number of the adjourned Meeting should be 12th Meeting (Adjourned).

b) Minutes shall record the names of the Directors present physically or through Electronic Mode, the Company Secretary who is in attendance at the Meeting and Invitees, if any, including Invitees for specific items;

c) Minutes shall contain a record of all appointments made at the Meeting.

Specific Contents

Minutes shall *inter-alia* contain:

a) The name(s) of Directors present and their mode of attendance, if through Electronic Mode;

b) In case of a Director participating through Electronic Mode, his particulars, the location from where he participated and wherever required, his consent to sign the statutory registers placed at the Meeting;

c) The name of Company Secretary who is in attendance and Invitees, if any, for specific items and mode of their attendance if through Electronic Mode;

d) Record of election, if any, of the Chairman of the Meeting;

e) Record of presence of Quorum;

f) The names of Directors who sought and were granted leave of absence;

g) Noting of the Minutes of the preceding Meeting;

h) Noting the Minutes of the Meetings of the Committees formed by the Board;

i) The text of the Resolution(s) passed by circulation since the last Meeting, including dissent or abstention, if any;

j) The fact that an Interested Director did not participate in the discussions and did not vote on item of business in which he was interested and in case of a related party transaction such director was not present in the meeting during discussions and voting on such item;

k) The views of the Directors particularly the Independent Director, if specifically insisted upon by such Directors, provided these, in the opinion of the Chairman, are not defamatory of any person, not irrelevant or immaterial to the proceedings or not detrimental to the interests of the company;

l) If any Director has participated only for a part of the Meeting, the Agenda items in which he did not participate;

m) The fact of the dissent and the name of the Director who dissented from the Resolution or abstained from voting thereon;

n) Ratification by Independent Director or majority of Directors, as the case may be, in case of Meetings held at a shorter Notice;

o) Consideration of any item other than those included in the Agenda with the consent of majority of the Directors present at the Meeting and ratification of the decision taken in respect of such item by a majority of Directors of the company;

p) The time of commencement and conclusion of the Meeting.

In respect of meeting adjourned for want of quorum, a statement to that effect by the chairperson or in his absence, by any other director present at the meeting shall be recorded in the minutes.

Apart from the Resolution or the decision, Minutes shall mention the brief background of all proposals and summarise the deliberations thereof. In case of major decisions, the rationale thereof shall also be mentioned.

Recording of Minutes

- Minutes shall contain a fair and correct summary of the proceedings of the Meeting.
- Minutes shall be written in clear, concise and plain language.
- Wherever the decision of the Board is based on any unsigned documents including reports or notes or presentations tabled or presented at the Meeting, which were not part of the Notes on Agenda and are referred to in the Minutes, shall be identified by initialling of such documents by the Company Secretary or the Chairman.
- Where any earlier Resolution(s) or decision is superseded or modified, Minutes shall contain a specific reference to such earlier Resolution(s) or decision or state that the Resolution is in supersession of allearlier Resolutions passed in that regard.
- Minutes of the preceding Meeting shall be noted at a Meeting of the Board held immediately following the date of entry of such Minutes in the Minutes Book.

Illustrations:

1) A Board Meeting was held on 1st July 2020 and the next Board Meeting is scheduled to be held on 25th July, 2020.If the minutes of the first Board Meeting are entered in the minutes books before the date of next Board Meeting i.e. 25th July, 2020, the same should be placed for noting thereat. If the minutes are yet to be entered in the minutes books, the same should be placed at the subsequent Board Meeting following the entry of minutes in the minutes books.

2) In case, the Meeting of a Committee is held on 1st July and the Meeting of the Board is held on 20th July, Minutes of the Meeting of the Committee should be entered in the Minutes Book on or before 30th July.

   Say, the Minutes of this Meeting of the Committee are entered in the Minutes Book on 28th July. In such a case, the Minutes of such Meeting should be noted at the Meeting of the Board held immediately following 28th July.

   If the Minutes of this Meeting of the Committee are entered in the Minutes Book on 15th July, the Minutes of such Meeting should be noted at the Meeting of the Board held immediately following 15th July, i.e. on 20th July.

3) If the Meeting is held and concluded on 1st September, 2020, the Minutes should be circulated latest by 15th September, 2020 and the receipt of the same by the Directors thereafter would be in compliance.

Finalization of Minutes

- Within fifteen days from the date of the conclusion of the Meeting of the Board or the Committee, the draft Minutes thereof shall be circulated by hand or by speed post or by registered post or by courier

or by e-mail or by any other recognised electronic means to all the members of the Board or the Committee, as on the date of the Meeting, for their comments.

- The Directors, whether present at the Meeting or not, shall communicate their comments, if any, in writing on the draft Minutes within seven days from the date of circulation thereof, so that the Minutes are finalised and entered in the Minutes Book within the specified time limit of thirty days.
- If any Director communicates his comments after the expiry of the said period of seven days, the Chairman, if so authorised by the Board, shall have the discretion to consider such comments.
- In the event a Director does not comment on the draft Minutes, the draft Minutes shall be deemed to have been approved by such Director. A Director, who ceases to be a Director after a Meeting of the Board is entitled to receive the draft Minutes of that particular Meeting and to offer comments thereon, irrespective of whether he attended such Meeting or not.
- Minutes shall be entered in the Minutes Book within thirty days from the date of conclusion of the Meeting.
- The date of entry of the Minutes in the Minutes Book shall be recorded by the Company Secretary.
- Minutes, once entered in the Minutes Book, shall not be altered. Any alteration in the Minutes as entered shall be made only by way of express approval of the Board at its subsequent Meeting at which the Minutes are noted by the Board and the fact of such alteration shall be recorded in the Minutes of such subsequent Meeting.

Signing and Dating of Minutes

- Minutes of the Meeting of the Board shall be signed and dated by the Chairman of the Meeting or by the Chairman of the next Meeting. Minutes, once signed by the Chairman, shall not be altered.
- Minutes of the previous Meeting may be signed either by the Chairman of such Meeting at any time before the next Meeting is held or by the Chairman of the next Meeting at the next Meeting.
- The Chairman shall initial each page of the Minutes, sign the last page and append to such signature the date on which and the place where he has signed the Minutes.
- If the Minutes are maintained in electronic form, the Chairman shall sign the Minutes digitally.
- Within fifteen days of signing of the Minutes, a copy of the said signed Minutes, certified by the Company Secretary or where there is no Company Secretary, by any Director authorised by the Board, shall be circulated to all the Directors, as on the date of the Meeting and appointed thereafter, except to those Directors who have waived their right to receive the same either in writing or such waiver is recorded in the Minutes.
- Proof of sending signed Minutes and its delivery shall be maintained by the company for such period as decided by the Board, which shall not be less than three years from the date of the Meeting.

Inspection and Extracts of Minutes

- The Minutes of Meetings of the Board and any Committee thereof can be inspected by the Directors. Extracts of the Minutes shall be given only after the Minutes have been duly entered in the Minutes Book. However, certified copies of any Resolution passed at a Meeting may be issued even earlier, if the text of that Resolution had been placed at the Meeting.
- A Director is entitled to inspect and receive, a copy of the Minutes of a Meeting held before the period of his Directorship. A Director is entitled to inspect and receive a copy of the signed Minutes of a Meeting held during the period of his Directorship, even if he ceases to be a Director.

- The Company Secretary in Practice appointed by the company, the Secretarial Auditor, the Statutory Auditor, the Cost Auditor or the Internal Auditor of the company can inspect the Minutes as he may consider necessary for the performance of his duties.
- Inspection of Minutes Book may be provided in physical or in electronic form.
- While providing inspection of Minutes Book, the Company Secretary or the official of the company authorised by the Company Secretary to facilitate inspection shall take all precautions to ensure that the Minutes Book is not mutilated or in any way tampered with by the person inspecting.
- A Member of the company is not entitled to inspect the Minutes of Meetings of the Board.

Preservation of Minutes

- The minutes books of the Board and committee meetings shall be preserved permanently and kept in the custody of the company secretary of the company or any director duly authorized by the Board.
- Where, under a scheme of arrangement, a company has been merged or amalgamated with another company, Minutes of all Meetings of the transferor company, as handed over to the transferee company, shall be preserved permanently by the transferee company, notwithstanding that the transferor company might have been dissolved.

Penalty

- If any default is made in complying with the provisions of Section 118 of the Companies Act, 2013 in respect of any meeting, the company shall be liable to a penalty of twenty-five thousand rupees and every officer of the company who is in default shall be liable to a penalty of five thousand rupees.
- If a person is found guilty of tampering with the minutes of the proceedings of meeting, he shall be punishable with imprisonment for a term which may extend to two years and with fine which shall not be less than twenty-five thousand rupees but which may extend to one lakh rupees.

TYPES OF RESOLUTIONS

Board Resolution:

A board resolution is a recorded form of decisions made by the Board of Directors during a board meeting. It is maintained along with the Board meeting minutes. The Board resolution is a formal written motion, which is used to track company's significant decisions.

The Board of Directors of a company shall exercise certain powers on behalf of the company only by means of Resolutions passed at a Meeting of the Board and not by a Resolution passed by circulation, such as:

- To make calls on shareholders in respect of money unpaid on their shares;
- To authorise buy-back of securities;
- To issue securities, including debentures, whether in or outside India;
- To borrow monies;
- To invest the funds of the company;
- To approve financial statement and the Board's report;
- To diversify the business of the company;
- To grant loans or give guarantee or provide security in respect.

Unanimous Resolution:

Unanimous consent board resolution is a form of voting used by boards to take decisions on certain matters. A unanimous resolution is the agreement of all of the directors on the agenda who are present at a duly convened meeting of Board of Directors i.e.100% of the directors present in the meeting will required to be in favour of the particular matter for it to pass. The terms of the company's constitution documents, shareholders agreement or the Companies Act, 2013 determines what type of resolution required to be passed in particular case.

Certain powers of the Board shall be exercised by Resolutions passed at Meetings, with the consent of all the Directors present at the Meeting. A list of powers of the Board to be exercised by Unanimous Consent is as under:

- Power to appoint or employ a person as its Managing Director under Section 203 of the Act if he is the Managing Director or Manager of one and not more than one other company;
- Power to invest or to give loans or guarantee or security under Section 186(5) of the Act.
- Power to remove trustees for the depositors after issue of circular or advertisement and before expiry of his term [Rule 7(4) of the Companies (Acceptance of Deposits) Rules, 2014]

Resolution by Circulation:

The Act requires certain business to be approved only at Meetings of the Board. However, other business that requires urgent decisions can be approved by means of Resolutions passed by circulation. Resolutions passed by circulation are deemed to be passed at a duly convened Meeting of the Board and have equal authority. The detailed version of resolution by circulation is discussed in below paragraphs.

RESOLUTION BY CIRCULATION

Passing of Resolution by Circulation: Section 175

A company may pass the resolutions through circulation. No resolution shall be deemed to have been duly passed by the Board or by a committee thereof by circulation, unless the resolution has been circulated in draft form, together with the necessary papers, if any, to all the directors or members of committee at their address registered with the company in India by hand delivery or by speed post or by courier or through electronic means which may include e-mail or fax.

The said resolution must be passed by majority of directors or members entitled to vote. Where not less than one-third of the total number of directors of the company for the time being require that any resolution under circulation must be decided at a meeting, the chairperson shall put the resolution to be decided at a meeting of the Board.

The resolution passed through circulation be noted at a subsequent meeting and made part of the minutes of such meeting.

Matters covered by section 179(3) and rule 8 of the Companies (Meetings of Board and its powers) Rules, 2014 are required to be passed at a meeting of Board and cannot be passed by circulation.

Further SS-1, requires that each item of business proposed to be passed by way of resolution by circulation shall be explained by a note setting out details of the proposal, relevant material facts that enable the directors to understand the meaning, scope and implications of the proposal, the nature of concern of interest, if any, of any director in the proposal, which the director had earlier disclosed and the draft of the resolution proposed. The note shall also indicate how a Director shall signify assent or dissent to the Resolution proposed and the date by which the Director shall respond.

Each resolution shall be separately explained. The decision of the directors shall be sought for each resolution separately.

A single note containing more than one Resolution may be circulated but the note should enable the signifying of the decision by a Director on each Resolution separately.

Not more than seven days from the date of circulation of the draft of the resolution shall be given to the directors to respond and the last date shall be computed accordingly. An additional two days shall be added for the service of the draft Resolution, in case the same has been sent by the company by speed post or by registered post or by courier.

Passing of resolution by circulation shall be considered valid as if it had been passed at a duly convened meeting of the Board. This shall not dispense with the requirement for the Board to meet at the specified frequency.

The Resolution is passed when it is approved by a majority of the Directors entitled to vote on the Resolution, unless not less than one-third of the total number of Directors for the time being require the Resolution under circulation to be decided at a Meeting.

The Resolution, if passed, shall be deemed to have been passed on the earlier of:

(a) the last date specified for signifying assent or dissent by the Directors, or

(b) the date on which assent has been received from the required majority, provided that on that date the number of Directors, who have not yet responded on the resolution under circulation, along with the Directors who have expressed their desire that the resolution under circulation be decided at a Meeting of the Board, shall not be one third or more of the total number of Directors; and shall be effective from that date, if no other effective date is specified in such Resolution.

Procedure for Passing Resolution by Circulation as stated in Secretarial Standards issued by ICSI

1	**Authority for passing resolution by circulation (6.1.1)** **Following persons have authority to decide whether the item to be discussed through a resolution by circulation:** ● The Chairman of the Board or in his absence, ● The Managing Director or in his absence, ● Any Director other than an Interested Director.
2	**Requirement of majority of 1/3rd of directors for circulation of a resolution (6.1.2)** In case the 1/3rd (i.e. not less than one-third) of the total number of Directors for the time being require that the resolution under circulation should be decided at a Board Meeting, then the Chairman shall put the resolution for consideration at a meeting of the Board, instead of circulation of the same. **Calculation of the 1/3rd Number:** While calculating such 1/3rd number, the interested directors shall not be excluded for the purpose of determining the total number of directors.
3	**Procedure (6.2)** (i) A resolution proposed to be passed by circulation shall be sent in draft, together with the necessary papers, individually to all the Directors including Interested Directors on the same day. (ii) The draft of the resolution to be passed and the necessary papers shall be circulated amongst the Directors by hand, or by speed post or by registered post or by courier, or by e-mail or by any other recognized electronic means.

	(iii) The draft of the resolution and the necessary papers shall be sent to the postal address or e-mail address registered by the Director with the company or in the absence of such details or any change thereto, any of the addresses appearing in the Director Identification Number (DIN) registration of the Director. (iv) Proof of sending and delivery of the draft of the resolution and the necessary papers shall be maintained by the company for such period as decided by the Board, which shall not be less than three years from the date of the circulation of such resolution. (v) Each business proposed to be passed by way of resolution by circulation shall be explained by a note setting out the details of the proposal, relevant material facts that will enable the Directors to understand the meaning, scope and implications of the proposal, the nature of concern or interest, if any, of any Director in the proposal, which the Director had earlier disclosed and the draft of the resolution proposed. (vi) The note shall also indicate how a Director shall signify assent or dissent to the resolution proposed and the date by which the Director shall respond. (vii) Each resolution shall be separately explained. (viii) The decision of the Directors shall be sought for each resolution separately. (ix) Not more than (7) seven days from the date of circulation of the draft of the resolution shall be given to the Directors to respond and the last date shall be computed accordingly. (x) An additional two days shall be added for the service of the draft resolution, in case the same has been sent by the company by speed post or by registered post or by courier.
4	**Approval (6.3)** The Resolution is passed when it is approved by a majority of the Directors entitled to vote on the Resolution, unless not less than one-third of the total number of Directors for the time being require the Resolution under circulation to be decided at a Meeting.
5	**Recording (6.4)** Resolutions passed by circulation shall be noted at the subsequent meeting of the Board and the text thereof with dissent or abstention, if any, shall be recorded in the minutes of such meeting
6	**Validity (6.5)** Passing of resolution by circulation shall be considered valid as if it had been passed at a duly convened meeting of the Board. This shall not dispense with the requirement for the Board to meet at the specified frequency.

In case the Director does not respond on or before the last date specified for signifying assent or dissent, it shall be presumed that the Director has abstained from voting. Resolutions passed by circulation shall be noted at a subsequent Meeting of the Board and the text thereof with dissent or abstention, if any, shall be recorded in the Minutes of such Meeting.

Meeting of Independent Directors

The MCA vide Notification dated 5th July, 2017 has clarified that where a company is required to appoint Independent Directors under the Act, such Independent Directors shall hold at least one Meeting in a financial year without attendance of Non-Independent Directors.

The independent directors of the company shall hold at least one meeting in a financial year without the

attendance of non-independent directors and members of management; [Clause VII(1) of Schedule IV to the Act].

A Meeting of Independent Directors is not a Meeting of the Board or of a Committee of the Board. Therefore, provisions of SS-1 shall not be applicable to such Meetings. A record of the proceedings of such a Meeting may be kept. The Company Secretary, wherever appointed, shall facilitate convening and holding of such meeting, if so desired by the Independent Directors.

DUTIES OF COMPANY SECRETARY BEFORE, DURING AND AFTER BOARD /COMMITTEE MEETINGS

The Company Secretaries plays major role to ensure smooth running of board meetings. Therefore, this involves activities before, during and after meetings. The secretary is responsible for preparing minutes of the meetings, maintaining records, administration, flow of information/communication, etc.

A. Duties of Company Secretary before the meeting

1. The Secretary or any other person so authorised shall give not less than seven days' notice of the meeting in writing to every director at his address registered with the company and such notice shall be sent by hand delivery or by post or by electronic means [Section 173(3)].
2. Meeting of the Board may be called at shorter notice to transact urgent business subject to the condition that at least one independent director, if any, shall be present at the meeting.
3. According to Regulation 67 (ii) of Table-F of Schedule-I of the Act, a director may, and the manager or secretary on the requisition of a director shall, at any time, summon a meeting of the Board.
4. In case of first board meeting, the notice must also mention that it is the first Board Meeting.
5. It is not obligatory to give agenda in the notice, but it is a good secretarial practice to enclose the agenda to the notice of the meeting. However as per SS-1, the Agenda, setting out the business to be transacted at the Meeting, and Notes on Agenda shall be given to the Directors at least seven days before the date of the Meeting, unless the Articles prescribe a longer period.
6. Contact and request all the directors to attend the meeting and arrange the facilities required by them in this regard, like conveyance, stay arrangements, location of venue etc.
7. At least half an hour before the meeting, the persons responsible for the conducting the meeting should place the folders containing Agenda, notes to Agenda, statement of expenses incurred/to be incurred, Business Plan etc. for ready reference of all directors to enable them to deliberate and discuss on each item of the agenda in detail.
8. Before holding the meeting, welcome the directors and obtain their signatures on the Attendance Register.

B. Duties of Company Secretary at the meeting

1. If quorum, as required under Section 174, is present, declare the meeting in order and inform the names of the directors who sought leave of absence from attending the meeting. The Quorum of a company shall be one third of the total strength of the Board or two directors whichever is higher.

   The quorum for every meeting of the board of directors of the top 2000 listed entities shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

   Explanation – For removal of doubts, it is clarified that the participation of the directors by video conferencing or by other audio-visual means shall also be counted for the purposes of such quorum.

2. In case of section 8 companies, the quorum of co. shall be either eight members or 25% of its total strength whichever is less. Provided that the quorum shall not be less than two members.
3. As per SS-1, the Chairman of the company shall be the Chairman of the Board. If the company does not have a Chairman, the Directors may elect one of themselves to be the Chairman of the Board. The directors who are present at the meeting may elect one of them as the Chairman of the meeting and request him to take the Chair.
4. Help the Chairman to conduct the meeting as per the agenda.
5. If any director wants to place any other item for the discussion at the meeting, then such item may be taken up with the permission of the Chairman.
6. Every director shall disclose his concern or interest in any company or companies or bodies corporate, firms or other association of individuals, by giving notice in writing in From MBP-1.
7. Decide the date, time and place of the next Board meeting.

C. Duties of Company Secretary after the meeting

1. After the meeting is over, prepare draft minutes of the meeting complying with the requirements of SS- 1; get it reviewed by the chairman of the meeting and/or the Managing Director of the company.
2. Send copy of draft minutes of the meeting to each of the directors of the company for information and comments as per requirements of SS-1.
3. Contact and collect draft minutes from each of the directors with their comments. After that, in consultation with the Chairman/Managing Director finalise the minutes and enter them into the Minutes Book. All pages should be consecutively numbered.

   Such final minutes may be signed and dated by the Chairman of the meeting or by the Chairman of the succeeding meeting. All pages of the minutes are to be initialed and the last page of the minutes.
4. Minutes is to be signed and dated by the Chairman.
5. Ensure that the minutes are entered within 30 days of the conclusion of meeting.
6. A copy of the signed Minutes certified by the Company Secretary or where there is no Company Secretary, by any Director authorised by the Board shall be circulated to all Directors within fifteen days after these are signed.

It is a good practice to collate all documents for each meeting in chronological order such as Copy of Notice, Agenda, Notes on agenda, Minutes copies of minutes and all documents placed before the meeting, copies of draft minutes sent, copies of minutes received with comments and copy of minutes as signed by Chairperson, all having initials of Company Secretary / Chairperson as the case may be for securing their finality. Attach documentary proof of dispatch of Notice, Agenda, draft minutes and final minutes with respective items for record, easy access as well as for any future inspection by the regulator. These may also be kept in physical form or electronically.

VIRTUAL MEETINGS : TECHNOLOGICAL ADVANCEMENT IN CONDUCT OF BOARD COMMITTEE

Meaning of Virtual Meetings:

A meeting held totally by means of either Video conferencing or other audio-visual means is known as Virtual Meeting. A Virtual meeting is when people around the world, regardless of their location, use video, audio, and

text to link up online. Virtual meetings allow people to share information and data in real-time without being physically located together.

In virtual meeting there is no physical presence of participants and there is no designated venue for the purpose of meetings. Participants located at different places participate in the meeting either by teleconference or video conference or combination of them at predetermined time.

Virtual meetings are becoming an increasingly common aspect at corporate world. When it comes to professional communication and the way business are done, for most companies, virtual meetings is the fact of life. Companies today operate across multiple time zones from different countries and continents. Employees, Board Members, stakeholders and investors are not from any particular region, city or country; in fact they are spread wide and far. By using Virtual technology, it is possible to replace physical meetings which require the presence of people at the designated place and time.

With rapid change in technology and wide spread of internet and audio and video combination, which is readily available, affordable and reliable, many companies and organizations are adopting and favoring virtual meetings. The use of audio and video conferences, webinars and web meetings via computers, telephones or other devices is more frequent. The potential gains are in terms of reduced travel costs, time saving, efficiency improvements, and less environmental impact in terms of savings on fuel and transport.

Virtual Meetings are held at a distance in real time basis with the help of digital technology. The meetings are mainly–

1. Audio- and/or video based, such as audio conferencing, video conferencing, and on-line meetings or webinars, often they are supported by other forms like chat, white boards, document sharing, etc.
2. Audio conferencing means conference calls with three or more participants, either by connecting the different participants by using a conference phone, or both.
3. Video conferencing, a technology now a day commonly used in board meetings.

Brief Requirements for Virtual Meeting

The brief requirements of virtual meetings are given below:

- Meeting rooms;
- Software, which can be either purchased or can be provided by vendor for a fee on yearly rental basis;
- Hardware equipment like Monitor or LED screen, Webcams;
- High quality mike system;
- Projectors;
- Document scanners;
- Leased Lines;
- High speed wireless internet;
- Recording & Storage Equipment for recording the proceeding and Proper storage for future reference as many be required under law;
- Have trial run before the meeting to ensure all the systems are working properly;
- Ensure that the proper arrangements are made in the Meeting room.

A virtual meeting room is a unique identifier that allows a meeting organizer to invite attendees from disparate geographical locations to collaborate in real time over the Internet. A virtual meeting room is also known as a virtual meeting space.

Virtual Board Meetings

Present day Directors who are professional have busy schedules which makes it difficult for them to attend board meetings of the companies in which they are directors especially for those who are living and working in different cities and countries. Teleconferencing, videoconferencing, and meeting online benefit boards and directors to enable them to attend the meetings from any location. Virtual meetings help the directors to participate in meetings whereever they are despite their busy schedule and make valuable contributions by their participation. Virtual attendance can also make board participation more attractive and appealing especially for independent directors as they are not expected to attend every meeting of each company in person and it is not practically possible as they sit on many boards of company which are located in different cities and countries. Further, due to statutory requirements, most of the board meetings of the companies especially listed entities are held around the same time, making it more difficult for the Independent professional directors to be physically present and participate in the meetings. By holding virtual meetings, Boards, with members around the country and globe, will benefit from wider participation and reduced travel and reimbursement costs; and it would be very convenient for the directors to attend through virtual media from their respective location.

The use of technology can present its own challenges, viz., directors' reluctance, lack of technical proficiency, lack of access to data and material, confidentiality etc. However, modern tools like board portals and board management software helps them in solving some of the concerns.

Section 173 of Companies Act, 2013 read with Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 and Secretarial Standards on Board meetings (SS-1) provides a much wanted platform for holding Virtual Board Meetings.

SS-1 defines "Electronic Mode" in relation to Meetings means Meetings through video conferencing or other audio-visual means. "Video conferencing or other audio visual means" means audio-visual electronic communication facility employed which enables all the persons participating in a Meeting to communicate concurrently with each other without an intermediary and to participate effectively in the Meeting.

"**Secured Computer System"** means computer hardware, software, and procedure that –

(a) are reasonably secure from unauthorized access and misuse;

(b) provide a reasonable level of reliability and correct operation;

(c) are reasonably suited to performing the intended functions; and

(d) adhere to generally accepted security procedures.

"**Timestamp**" means the current time of an event that is recorded by a Secured Computer System and is used to describe the time that is printed to a file or other location to help keep track of when data is added, removed, sent or received. In simple language, Time Stamp means a digital record of the time of occurrence of a particular event.

SS-1 provisions related to Virtual Board Meeting in detail are as under:

Para 1.2.3 provides that any Director may participate through Electronic Mode in a Meeting unless the Act or any other law specifically prohibits such participation through Electronic Mode in respect of any item of business.

Earlier restriction was levied on Directors to participate through Electronic Mode in the discussion on certain restricted items prescribed under Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014.

However, the MCA vide Notification dated June 15, 2021 has omitted Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014 which was related to the matters not to be dealt with in a meeting through video conferencing or other audio-visual means.

Accordingly, with the said amendment, now the following previously restricted matters can be considered in a Board Meeting held through video conferencing or other audio-visual means, namely: -

i. the approval of the annual financial statements;

ii. the approval of the Board's report;

iii. the approval of the prospectus;

iv. the Audit Committee Meetings for consideration of financial statement including consolidated financial statement if any, to be approved by the board under section 134 (1) of the Companies Act, 2013; and

v. the approval of the matter relating to amalgamation, merger, demerger, acquisition and takeover.

Para 1.3.1 provides that notice in writing of every Meeting shall be given to every Director by hand or by speed post or by registered post or by facsimile or by e-mail or by any other electronic means.

The Notice shall be sent to the postal address or e-mail address, registered by the Director with the company or in the absence of such details or any change thereto, any of such addresses appearing in the Director Identification Number (DIN) registration of the Director.

Even if the notice is sent by e-mail or by any electronic means to the email id provided by the Director, then such notice sent through electronic platform shall be constituted as valid notice served on the director.

Para 1.3.4 provides that the Notice shall inform the Directors about the option available to them to participate through Electronic Mode and provide them all the necessary information.

If a Director intends to participate through Electronic Mode, he shall give sufficient prior intimation to the Chairman or the Company Secretary to enable them to make suitable arrangements in this behalf.

The Director may intimate his intention of participation through Electronic Mode at the beginning of the Calendar Year also, which shall be valid for such Calendar Year. Though such declaration shall not debar him from participation in the meeting in person, in such case a sufficient intimation of attending in person is required to be sent to the company.

The Notice shall also contain the contact number or e-mail address(es) of the Chairman or the Company Secretary or any other person authorized by the Board, to whom the Director shall confirm in this regard. In the absence of an advance communication or confirmation from the Director as above, it shall be assumed that he will attend the Meeting physically.

Every notice served on the director shall clearly specify that proper arrangements have been made for video conferencing and the director has option of participating in the meeting through such means. The Director should be sent the link through which he can log in and attend the meeting. The Director should inform the Chairman or the Secretary of the Company his option regarding participating the meeting through Electronic mode.

Para 3.3 provides that the directors participating through Electronic Mode in a Meeting shall be counted for the purpose of Quorum, except for restricted items in which Quorum shall be ascertained on the basis of physical presence of Directors.

The chairperson shall ensure that the required quorum is present throughout the meeting.

All the Directors may participate in a Meeting through Electronic Mode. In such a case, at least one person, who may either be the Chairman or the Company Secretary or in the absence of the Company Secretary, any other

person duly authorised in this behalf by the Chairman, should be physically present at the scheduled venue of the Meeting given in the Notice to enable proper recording, to safeguard the integrity of the Meeting and to fulfil other requirements of law in this regard.

Venue of the Virtual meeting

With respect to every meeting conducted through video conferencing or other audio-visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

Procedures for Convening and Conducting Board's Meetings through Video or Audio Visual Means (Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014):

Directors may participate in the meeting either in person or through video conferencing or other audio-visual means. Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 provides for the requirements and procedure for convening and conducting Board meetings through video conferencing or other audio-visual means:

1. Every Company shall make necessary arrangements to avoid failure of video or audio-visual connection.
2. The Chairperson of the meeting and the company secretary, if any, shall take due and reasonable care:
   (a) to safeguard the integrity of the meeting by ensuring sufficient security and identification procedures;
   (b) to ensure availability of proper video conferencing or other audio visual equipment or facilities for providing transmission of the communications for effective participation of the directors and other authorised participants at the Board meeting;
   (c) to record proceedings and prepare the minutes of the meeting;
   (d) to store for safekeeping and marking the tape recording(s) or other electronic recording mechanism as part of the records of the company at least before the time of completion of audit of that particular year.
   (e) to ensure that no person other than the concerned director are attending or have access to the proceedings of the meeting through video conferencing mode or other audio visual means; and
   (f) to ensure that participants attending the meeting through audio visual means are able to hear and see the other participants clearly during the course of the meeting:

   Provided that the persons, who are differently abled, may make request to the Board to allow a person to accompany him.
3. (a) The notices of the meeting shall be sent to all the directors in accordance with the provisions of sub section (3) of section 173 of the Companies Act, 2013.
   (b) The notice of the meeting shall inform the directors regarding the option available to them to participate through video conferencing mode or other audio-visual means, and shall provide all the necessary information to enable the directors to participate through video conferencing mode or other audio- visual means.
   (c) A director intending to participate through video conferencing mode or audio-visual means shall communicate his intention to the Chairman or the Company Secretary of the company.

(d) If the director intends to participate through video conferencing or other audio-visual means, he shall give prior intimation to that effect sufficiently in advance so that company is able to make suitable arrangement in this behalf.

(e) Any director who intends to participate in the meeting through electronic mode may intimate about such participation at the beginning of the calendar year and such declaration shall be valid or one year:

However, such declaration shall not debar him from participation in the meeting in person in which case he shall intimate the company sufficiently in advance of his intention to participate in person.

> In Re *Rupak Gupta v. U.P Hotels Ltd (NCLT-New Delhi, CA NO. 8/C-II/2016,* it was held that the Directors are entitled to attend board meeting via video conferencing even if intimation as provided under rule 3 of Companies (Meetings of Board and its Powers) Rules, 2014 at beginning of calendar year is not given.

(f) In the absence of any such intimation from the director, it shall be assumed that the director will attend the meeting in person.

4. At the commencement of the meeting, a roll call shall be taken by the Chairperson when every director participating through video conferencing or other audio-visual means shall state, for the record, the following namely:

(a) name;

(b) the location from where he is participating;

(c) that he has received the agenda and all the relevant material for the meeting; and

(d) that no one other than the concerned director is attending or having access to the proceedings of the meeting at the location mentioned in (b) above.

5. (a) After the roll call, the Chairperson or the Secretary shall inform the Board about the names of persons other than the directors who are present for the said meeting at the request or with the permission of the Chairperson and confirm that the required quorum is complete.

Explanation: It is clarified that a director participating in a meeting through video conferencing or other audio-visual means shall be counted for the purpose of quorum, unless he is to be excluded for any items of business under any provisions of the Act or the Rules.

(b) The Chairperson shall ensure that the required quorum is present throughout the meeting.

6. With respect to every meeting conducted through video conferencing or other audio-visual means authorised under these rules, the scheduled venue of the meeting as set forth in the notice convening the meeting, shall be deemed to be the place of the said meeting and all recordings of the proceedings at the meeting shall be deemed to be made at such place.

7. The statutory registers which are required to be placed in the Board meeting as per the provisions of the Act shall be placed at the scheduled venue of the meeting and where such registers are required to be signed by the directors, the same shall be deemed to have been signed by the directors participating through electronic mode if they have given their consent to this effect and it is so recorded in the minutes of the meeting.

8. (a) Every participant shall identify himself for the record before speaking on any item of business on the agenda.

(b) If a statement of a director in the meeting through video conferencing or other audio-visual means

is interrupted or garbled, the Chairperson or Company Secretary shall request for a repeat or reiteration by the director.

9. If a motion is objected to and there is a need to put it to vote, the Chairperson shall call the roll and note the vote of each director who shall identify himself while casting his vote.

10. From the commencement of the meeting until the conclusion of such meeting, no person other than the Chairperson, Directors, Company Secretary and any other person whose presence is required by the Board shall be allowed access to the place where any director is attending the meeting either physically or through video conferencing without the permission of the Board.

11. (a) At the end of discussion on each agenda item, the Chairperson of the meeting shall announce the summary of the decision taken on such item along with names of the directors, if any, dissented from the decision taken by majority and the draft minutes so recorded shall be preserved by the company till the confirmation of the draft minutes in accordance with sub-rule (12).

(b) The minutes shall disclose the particulars of the directors who attended the meeting through video conferencing or other audio-visual means.

12. (a) The draft minutes of the meeting shall be circulated among all the directors within fifteen days of the meeting either in writing or in electronic mode as may be decided by the Board.

(b) Every director who attended the meeting, whether personally or through video conferencing or other audio-visual means, shall confirm or give his comments in writing, about the accuracy of recording of the proceedings of that particular meeting in the draft minutes, within seven days or some reasonable time as decided by the Board, after receipt of the draft minutes failing which his approval shall be presumed.

(c) After completion of the meeting, the minutes shall be entered in the minute book as specified under section 118 of the Act and signed by the Chairperson.

Explanation - For the purposes of this rule, 'video conferencing or other audio-visual means' means audio-visual electronic communication facility employed which enables all the persons participating in a meeting to communicate concurrently with each other without an intermediary and to participate effectively in the meeting.

Summarized procedure of Video conferencing:

- Roll call by chairperson;
- Directors to introduce themselves at each and every time they speak on matters;
- Presence will be counted for quorum;
- No unauthorized access;
- Differently abled Director may have person accompanying them;
- Directors to repeat if there is any disturbances;
- Chairperson to announce summary at the end of the Meeting;
- Minutes of the meeting to contain the names of Directors who participated through Video conference.

NEED AND SCOPE OF SECRETARIAL STANDARDS

The Institute of Company Secretaries of India (ICSI), recognizing the need for integration, harmonization and Standardization of diverse secretarial practices prevalent in the corporate sector, has constituted the Secretarial Standards Board (SSB) in the year 2000 with the objective of formulating Secretarial Standards. The purpose of constituting this Board was for long-term benefits for the growth and enhanced visibility of the profession and setting up international benchmarks in Secretarial Standards.

Need of Secretarial Standards:

Companies follow diverse secretarial practices and, therefore, there is a need to integrate, harmonise and standardise such practices so as to promote uniformity and consistency. The SSB formulates Secretarial Standards taking into consideration the applicable laws, usages, business environment, practical applicability and the best secretarial practices prevalent. Secretarial Standards are developed;

- in a transparent manner;
- after extensive deliberations, analysis, research; and
- after taking views of corporate, regulators and the public at large.

Scope of Secretarial Standards:

The Secretarial Standards do not seek to substitute or supplant any existing laws or the rules and regulations framed thereunder but, in fact, seek to supplement such laws, rules and regulations. Secretarial Standards are issued in conformity with the provisions of the applicable laws. However, if, due to subsequent changes in the law, a particular Standard or any part thereof becomes inconsistent with such law, the provisions of the said law shall prevail.

Compliance with Secretarial Standards:

Section 118(10) of the Companies Act, 2013 requires every company to observe the secretarial standards with respect to Board Meetings and General Meetings specified by the Institute of Company Secretaries of India (ICSI) and approved as such by the Central Government.

Secretarial Standard on Meetings of the Board of Directors (SS-1) and Secretarial Standard on General Meetings (SS-2) issued by the Institute of Company Secretaries of India (ICSI) and approved by the Central Government are applicable to all companies w.e.f 1st October, 2017 (except One Person Company where there is one director and class or classes of companies which may get exempted through notification of the Central Government).

The adoption of the Secretarial Standards by the corporate sector will have substantial value addition to the quality of Secretarial practices followed making them comparable with the best in the world.

The Company Secretary in employment as well as in practice are entrusted to ensure the compliance of applicable Secretarial Standards.

Besides the above 2 Secretarial Standards, the ICSI has issued the various other Secretarial Standards for recommendatory observance in order to promote the standardized practices in other areas:

- SS-3: Secretarial Standard on Dividend
- SS-4: Secretarial Standard on Report of the Board of Directors.

SECRETARIAL STANDARDS 1 : SECRETARIAL STANDARD ON MEETINGS OF THE BOARD OF DIRECTORS

This Standard prescribes a set of principles for convening and conducting Meetings of the Board of Directors and matters related thereto.

Scope of SS- 1:

In terms of sub-section (10) of Section 118 of the Act, every company is required to observe SS-1. SS-1 is thus applicable to the Meetings of the Board of all companies incorporated under the Act, including private and small companies, except One Person Companies (OPC) having only one Director on its Board and such other class or classes of companies which are exempted by the Central Government through Notification.

MCA Notification No. G.S.R. 466(E) dated 5th June, 2015 exempted companies licensed under Section 8 of the Companies Act, 2013 from the applicability of Section 118 of the Act, as a whole except that Minutes of Meetings of such a company may be recorded within thirty days of the conclusion of every Meeting where the Articles of Association provide for confirmation of Minutes by circulation. As such, SS-1 is not applicable to companies licensed under Section 8 of the Companies Act, 2013 or corresponding provisions of any previous enactment thereof. Such companies may voluntarily comply with SS-1.

However, Section 8 companies need to comply with the applicable provisions of the Act relating to Board Meetings.

Further, MCA vide its Notifications No. G.S.R. 584(E) dated 13th June, 2017 modified the above cited Notification dated 5th June, 2015 to place a restriction that such exemptions shall be applicable to a Section 8 company which has not committed a default in filing its Financial Statements or Annual Return with the Registrar of Companies.

In addition, by virtue of MCA Exemption Notifications No. G.S.R. 08(E) & G.S.R. 9(E), dated 4th January, 2017, following class of companies are exempted from the applicability of Section 118(10) of the Companies Act, 2013 i.e. the compliance of Secretarial Standards:

1. **Specified IFSC public company:** An unlisted public company which is licensed to operate by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 read with the Special Economic Zones Rules, 2006.
2. **Specified IFSC private company**: A private company which is licensed to operate by the Reserve Bank of India or the Securities and Exchange Board of India or the Insurance Regulatory and Development Authority of India from the International Financial Services Centre located in an approved multi services Special Economic Zone set-up under the Special Economic Zones Act, 2005 read with the Special Economic Zones Rules, 2006.

Applicability to companies governed under Special Acts:

SS-1 is also applicable to Banking Companies, Insurance Companies, Companies engaged in generation or supply of electricity, and Companies governed by any Special Acts, if incorporated under the Act. However, if the provisions of these Special Acts such as the Banking Regulation Act, 1949, the Insurance Act, 1938, etc. applicable to these companies are inconsistent with SS-1, then the provisions of such Special Acts shall prevail.

The principles enunciated in this Standard for Meetings of the Board of Directors are also applicable to Meetings of Committee(s) of the Board, unless otherwise stated herein or stipulated by any other applicable Guidelines, Rules or Regulations.

Applicability to Meetings of the Committees:

SS-1 is also applicable to the Meetings of Committee(s) of the Board constituted in compliance with the requirements of the Act. At present, the Act provides for the constitution of following committees of the Board:

(a) Audit Committee

(b) Nomination and Remuneration Committee

(c) Corporate Social Responsibility (CSR) Committee

(d) Stakeholders Relationship Committee

In case any other committee of the Board is constituted voluntarily or pursuant to any other statute or regulations

etc., the company may comply with SS-1 with respect to meetings of such committee(s) as a good governance practice. This Standard is in conformity with the provisions of the Act. However, if, due to subsequent changes in the Act, a particular Standard or any part thereof becomes inconsistent with the Act, the provisions of the Act shall prevail.

SPECIMEN NOTICE AND MINUTES

Specimen Notice of the Board/Committee Meeting

Notice of the ..... (insert sequence number of the meeting) Board Meeting of ..... Pvt. Ltd. / Ltd. having its registered office at .....

To,

Mr./ Ms. (Director Name)
..... (Address)

Dear Sir/Madam,

Notice is hereby given that ..... (insert sequence number of the meeting) meeting of the members of the Board of Directors / (Name of the Committee) of the Board of Directors of the Company will be held on ..... (day of the week), the ..... (Date) day of ..... (Month), ... (year) at ..... (time) at .....(address of the venue of the meeting).

The Agenda of the business to be transacted at the meeting, along with detailed notes thereon and requisite annexures is enclosed herewith. You are requested to make it convenient to attend the meeting.

Directors may attend the meeting in person or through Video Conferencing / Other Audio Video Means (VC/ OAVM). A Director desirous of attending the meeting through VC/ OAVM should inform well in time so as to make suitable arrangements accordingly.

For ..... `(Name of the Company) Place:

Sd/- Date:

(Name) (Designation)

Enclosure: Agenda of the business to be transacted at the meeting

Sample Minutes of the Board Meeting

Minutes of the ..... Meeting of the Board of Directors of ..... (Company Name) held on ..... (Day), ... (Date, Month and Year), at ..... (Venue) from ..... (Time of Commencement)

PRESENT:

A.B. .....Chairman

C.D. .....Directors

E.F. .....Directors

I.J. .....Directors

K.L. .....Managing Director

IN ATTENDANCE

X .....Secretary

INVITEES

Y .....Chief Financial Officer

1. Chairman for the Meeting

Mr/Ms... was elected as the Chairman for the Meeting.

2. Leave of absence

Leave of absence from attending the Meeting was granted to Mr. M.N. and Mr. O.P. who expressed their inability to attend the Meeting owing to their preoccupation.

3. Quorum

The business before the Meeting was taken up after having established that the requisite quorum was present.

4. Minutes of the previous Board Meeting

The Minutes of the ..... Meeting of the Board of Directors of the company held on ....., as circulated, were noted by the Board and signed by the Chairman.

5. Minutes of the Committee Meetings

The Minutes of the ..... Meeting of the ..... Committee held on ....., as circulated, were noted by the Board.

6. Resolution passed by circulation since the last Meeting.

The following Resolution was passed by circulation on ..... (date of passing of the Resolution) in terms of the provisions of Section 175 of the Companies Act, 2013.

"RESOLVED THAT.....
....."

Mr. ..... , Director dissented on the Resolution.

7. Action Taken Report

The following action taken was noted by the Board:

Item No.	Item	Action Taken
———	———	———

8. Register of Contracts

The Register of Contracts in which Directors are interested under Section 189 of the Companies Act, 2013 and the Rules thereunder was signed by all the Directors present.

9. Notices of Disclosure of Interest of Directors

(a) The following Notices received from the Directors of the company, notifying their interest in other bodies corporate pursuant to the provisions of Section 184 of the Companies Act, 2013, were read and recorded:

Name of the Director	*Nature of Interest*	*Date of Notice*

(b) A Notice dated received from Mr. I.J. pursuant to the provisions of Section 170 of the Companies Act, 2013, disclosing his shareholding and the shareholding of Mrs. I.J. in the company was read and recorded.

10. Share Transfers

Reference was made to Mr. .....'s note dated on the subject, as circulated.

The Share Transfer Register of the company was also placed before the Meeting. The Board, after discussion, passed the following Resolution:

"RESOLVED THAT *Share Transfers Nos ..... to ..... (both inclusive) consisting of Equity shares of the company, be approved and the names of the transferees be entered in the Register of Members.*

RESOLVED FURTHER THAT *Mr. X, Secretary, be and is hereby authorised to take necessary action with regard to the aforesaid transfer of shares approved by the Board."*

11. Interim Dividend

Reference was made to Mr. .....'s note dated on the subject, as circulated. The payment of Interim Dividend for the year ending was considered on the basis of the unaudited Financial Statements of the company for the period from ..... to, as annexed to the note under reference. The Directors opined that there were adequate profits to permit payment of Interim Dividend.

The Board, after discussion, passed the following Resolution:

"**RESOLVED THAT** an Interim Dividend of Rupee one per equity share absorbing Rs. 10,00,000, be paid on the ..... (date), out of the profits of the company for the year ending, on 10,00,000 equity shares, to those equity shareholders whose names appear in the Register of Members of the company on the ..... of , and that the transfer books and the Register of Members be closed from the ..... of ..... to the ..... of ....., both days inclusive, for the purpose of payment of such dividend."

12. Opening of a Bank Account for payment of Interim Dividend

Reference was made to Mr. ..... note dated on the subject, as circulated. The Board passed the following resolution for opening a bank account for the purpose of payment of Interim Dividend :-

"RESOLVED THAT a Bank Account be opened in the name and style of '..... Limited - Interim Dividend' (Bank Account) with the ..... for payment of Interim Dividend for the financial year .....

RESOLVED FURTHER THAT the said Bank be and is hereby authorised to honour cheques / bank advices etc. drawn, accepted or made on behalf of the company and to act on any instruction(s) so given concerning the said Account by any two of the following signatories:-

.....

RESOLVED FURTHER THAT the said Bank be and is hereby authorised to change the name and style of the Bank Account to '..... Limited - Unpaid Interim Dividend .....' on and from .....

RESOLVED FURTHER THAT the authorised signatories be and are hereby authorised, in the manner stated above, to give instructions to the said Bank to close the Bank Account on disbursement of the Interim Dividend.

RESOLVED FURTHER THAT the authorised signatories be and are hereby authorised, in the manner stated above, to sign and execute such documents, letters etc., as may be required by the said Bank."

13. Conclusion of the Meeting

There being no other business, the Meeting concluded at (Time) with a vote of thanks to the Chair.

Date ....

Place ..... Chairman

LESSON ROUND-UP

- There shall be minimum of four Board meetings every year and not more one hundred and twenty days shall intervene between two consecutive Board meetings.
- Director can participate in the Board meeting physically or through video conferencing or other audio visual mode as may be prescribed.
- Notice of not less than seven days in writing is required to call a board meeting and notice of meeting to all directors shall be given, whether he is in India or outside India by hand delivery or by post or by electronic means.
- One third of total strength or two directors, whichever is higher, shall be the quorum for a Board meeting. The participation of director at Board meeting through video conferencing or by other electronic means shall be counted for the purpose of Quorum.
- Section 173 provides the participation through video conferencing or other audio visual means, subject to the system being capable of recording and recognizing the participation of the directors and of recording and storing the proceedings of such meetings along with date and time.
- The Chairman may adjourn a Meeting with the consent of the Members and shall adjourn a Meeting if so decided by the Members. The Meeting may, however, be adjourned at any time. It may be adjourned after some items of business have been transacted and the remaining items can be transacted at the adjourned Meeting.
- A company may pass the resolutions through circulation. The Resolution is passed when it is approved by a majority of the Directors entitled to vote on the Resolution, unless not less than one-third of the total number of Directors for the time being require the Resolution under circulation to be decided at a Meeting.
- SS-1 provides exhaustive guide for conduct of meetings of Board/committees. Company Secretary should perform his duties before, during and after the meetings of Board/Committees in accordance with the requirements of SS-1.
- Secretarial Standards are developed in a transparent manner after extensive deliberations, analysis, research and after considering the views of corporates, regulators and the public at large.
- A virtual meeting is when people around the world, regardless of their location, use video, audio, and text to link up online.
- The Section 173 of Companies Act, 2013 read with Rule 3 of the Companies (Meetings of Board and its Powers) Rules, 2014 and Secretarial Standards on Board meetings (SS-1) provides a platform for holding virtual Board Meetings.
- The Director may intimate his intention of participation through Electronic Mode at the beginning of the Calendar Year also, which shall be valid for such Calendar Year.
- As per SS-1 Directors participating through Electronic Mode in a Meeting shall be counted for the purpose of Quorum, except for restricted items in which Quorum shall be ascertained on the basis of physical presence of Directors.
- The chairperson shall ensure that the required quorum is present throughout the meeting.

GLOSSARY

One person Company: "One Person Company" means a company which has only one person as a member [Section 2(65)]

Small Company: "Small company" means a company, other than a public company,–

(I) paid-up share capital of which does not exceed four crore rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(II) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed forty crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to –

(A) a holding company or a subsidiary company;

(B) a company registered under section 8; or

(C) a company or body corporate governed by any special Act; [Section 2(85)].

Adjournment: Adjournment means to defer or suspend the meeting to a future time, either at an appointed date or indefinitely or as decided by the members present at the scheduled meeting.

Roll Call: A roll call is nothing but identifying and confirming the attendance of the director participating through Electronic Mode.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. State the procedure for holding meeting of the Board of directors.
2. What is the agenda for the meeting of the Board of directors?
3. Draft a notice of the Board Meeting.
4. Explain the duties of a Company Secretary before the Board Meeting?
5. Short Notes on:
   (a) Quorum
   (b) Resolution by circulation
   (c) Minutes
   (d) Attendance Register
6. ONS Ltd., an unlisted public company, has six directors on the Board with a quorum of 3 directors physically present for any board meeting. The Company convened a board meeting to approve the annual financial statements in which two out of the six directors participated through video conferencing. The financial statements were approved with the consent of the four directors physically present. Can the financial statements be taken to be validly approved ?
7. ABC ltd. Wants to hold meeting through electronic mode. As a Company Secretary, detail the procedure to the Board.
8. What is the need and scope of Secretarial Standard?

9. On receipt of the notice and agenda notes from Saturn Ltd., Harpreet , Director has requested for participation through video conferencing on the scheduled date of the meeting. As a Company Secretary, what should be your advice to the Chairperson of the company?

   (a) It is not mandatory under the Companies Act, 2013 for company to allow participation of directors in a meeting through video conferencing

   (b) Section 173(2) of the Companies Act, 2013 allow participation of directors in a meeting through video conferencing, unless the Companies Act, 2013 or any other law specifically prohibits such participation through Electronic Mode in respect of any item of business.

   (c) Section 177 of the Companies Act, 2013 allow participation of directors in a meeting through video conferencing, unless the Companies Act, 2013 or any other law specifically prohibits such participation through Electronic Mode in respect of any item of business.

   (d) None of these.

10. Mr. Raja Ram is the Chairman of the Risk Management Committee of Pioneer Guru Ltd. A meeting of this Committee of Directors has been scheduled to be held on 5th December, 2021 at 3.00 p.m. At 3.10 p.m. though the requisite quorum is present, Mr. Raja Ram is not present. Can the meeting be still held or requires to be adjourned?

   (a) The members present may elect any one among them to act as the Chairman of the meeting and hold the meeting.

   (b) The meeting shall stand adjourned for the next week same time & same place.

   (c) The members present shall wait for the chairman instructions.

   (d) The members present shall wait for the chairman instructions till 30 minutes, then adjourn the meeting.

11. M/s Aman Enterprises Ltd. has 9 directors in its board. On 19th August, 2021 the company called for its board meeting where 2 directors were present in person and 1 director has joined through video confrencing. Whether the meeting has requisite quorum as per Company Law provisions?

   (a) No, as only 2 directors were present in person. The requirement of quorum is not fulfilled.

   (b) Quorum requirement is fulfilled.

   (c) Atlease 4 directors should be present to have necessary quorum.

   (d) Atleast one third of directors must present in person to constitute requisite quorum.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premiere on Company Law
- Bare Act- The Companies Act, 2013
- ICSI Guidance Note on SS-1
- ICSI Secretarial Standard-1
- The Law and Practice Relating to Company Meetings, Third Edition by CS Ramaswami Kalidas, FCS, MBA—Bloomsbury Publishing India Pvt. Ltd

OTHER REFERENCES (Including Websites/Video Links)
• https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ== • https://www.sebi.gov.in/web/?file=/sebi_data/attachdocs/feb-2022/1644470156708.pdf#page=1&zoom=page-width,-19,842

Corporate Social Responsibility – Concepts

~~Lesson 17~~

KEY CONCEPTS

■ Corporate Social Responsibility ■ CSR Committees ■ CSR Activities ■ CSR Policy ■ ~~Ongoing Projects~~ ■ ~~Annual Action Plan~~ ■ ~~CSR Reporting~~ ■ ~~Net Profit~~

Learning Objectives

To understand:

- Provisions related to CSR Compliances
- Formation of CSR Committee
- ~~CSR Spending, Disclosures and Reporting~~
- ~~Provisions related to transfer of unspent CSR amount~~

Lesson Outline

- Introduction
- CSR under the Companies Act, 2013
- CSR Activities of Company
- ~~CSR Implementation~~
- ~~CSR Expenditure~~
- ~~Computation of Net Profits~~
- ~~Disclosure Requirements~~
- ~~Consequences of Non- Compliance~~
- ~~CSR Portal~~
- ~~Lesson Round-Up~~
- ~~Glossary~~
- ~~Test Yourself~~
- ~~List of Further Readings~~
- ~~Other References~~

Lesson 17 is deleted and the topics, " Policy; Activities and CSR Committee" are relocated in Lesson 18.

The topics,"CSR Expenditure; Ongoing Project; Impact Assessment" are deleted from the Executive Programme

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Section 135)
- The Companies (Corporate Social Responsibility Policy) Rules, 2014
- Schedule VII of the Companies Act, 2013- CSR Activities

INTRODUCTION

Meaning of Corporate Social Responsibility

CSR is a concept whereby companies not only consider their profitability and growth, but also the interests of society and the environment by taking responsibility for the impact of their activities on stakeholders, environment, consumers, employees, communities, and all other members in the public sphere. The basic premise is that when the corporations get bigger in size, apart from the economic responsibility of earning profits, there are many other responsibilities attached to them which are more of non-financial/social in nature. These are the expectations of the society from the corporates to give something in return to the society with whose explicit or implicit help these entities stand where they are.

CSR aims to fulfil expectations that society has of businesses and it is viewed as a comprehensive set of social policies, practices and programs that are integrated throughout business operations. The concept of CSR has evolved over the years and now used as strategy and a business opportunity to earn stakeholder goodwill.

Corporate Social Responsibility and Corporate Governance are inseparably intertwined. In the recent scenario, there is a growing perception among enterprises that sustainable business success and shareholder value cannot be achieved solely through maximizing short-term profits, but instead through market-oriented and responsible behavior. Companies are aware that they can contribute to sustainable development by managing their operations in such a way as to enhance economic growth and increase competitiveness whilst ensuring environmental protection and promoting social responsibility, including consumer interests.

The United Nations Industrial Development Organisation (UNIDO) puts forward the following definition of Corporate Social Responsibility (CSR) –

"Corporate Social Responsibility is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stakeholders. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives ("Triple- Bottom-Line Approach"), while at the same time addressing the expectations of shareholders and stakeholders."

The philosophy of giving back to the society has been an integral part of the culture, which has also been imbibed in traditional Indian businesses since time immemorial. India's ancient wisdom, which is still relevant today, inspires people to work for the larger objective of the well-being of all stakeholders. These sound and all-encompassing values are even more relevant in current times, as organizations grapple with the challenges of modern-day enterprise, the aspirations of stakeholders and of citizens eager to be active participants in economic growth and development.

Indian business has traditionally been socially responsible and some of the business houses have demonstrated their efforts on this front in a laudable manner. However, the culture of social responsibility needs to go deeper in the governance of all business entities.

In order to integrate CSR into the core business philosophy, the Government has obligated companies, those meeting certain threshold in terms of turnover, net worth or net profit to set apart two per cent of their net profit for CSR activities.

Factors influencing CSR

Many factors and influences, including the following, have led to increasing attention being devoted to CSR:

(i) Globalization coupled with focus on cross border trade, multinational enterprises and global supply chains is increasingly raising CSR concerns related to human resource management practices, environmental protection, and health and safety, among other things.

(ii) Governments and regulatory bodies, legal prescription, international organisations such as the United Nations, the Organisation for Economic Co-operation and Development and the International Labour Organization have developed compacts, declarations, guidelines, principles and other instruments that outline social norms for acceptable conduct.

(iii) Advances in communications technology, such as the Internet, cellular phones and personal digital assistants, are making it easier to track corporate activities and disseminate information about them. Non-governmental organizations now regularly draw attention through their websites to business practices they view as problematic.

(iv) Consumers and investors responsible business practices and are demanding more information on how companies are addressing risks and opportunities related to social and environmental issues.

(v) Breaches of corporate ethics have contributed to elevated public mistrust of corporations and highlighted the need for improved corporate governance, transparency, accountability and ethical standards. There is increasing awareness.

(vi) Businesses are recognizing that adopting an effective approach to CSR can reduce risk of business disruptions, open up new opportunities, and enhance brand and company reputation.

The importance of inclusive growth is widely recognized as an essential part of India's quest for development. It reiterates the commitment to include those sections of the society in the growth process, which had hitherto remained excluded from the mainstream of development.

CSR under Indian Legislation

The importance of inclusive growth is widely recognized as an essential part of India's quest for development. It reiterates the commitment to include those sections of the society in the growth process, which had hitherto remained excluded from the mainstream of development.

In line with this national endeavor, Corporate Social Responsibility (CSR) was conceived as an instrument for integrating social, environmental and human development concerns in the entire value chain of corporate business.

The Ministry of Corporate Affairs has been taking various initiatives for ensuring responsible business conduct by companies.

SIGNIFICANT MILESTONES IN EVOLUTION OF RESPONSIBLE BUSINESS CONDUCT IN INDIA	
2009	Corporate Voluntary Guidelines released to encourage corporates to voluntarily achieve high standards of Corporate Governance
2011	Endorsement of United Nations Guiding Principles on Business & Human Rights by India
2011	National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGs) released to mainstream the concept of business responsibility

2012	Securities and Exchange Board of India (SEBI) mandates top 100 listed companies by market capitalization to file Business Responsibility Reports (BRR) based on NVGs
2013	Enactment of the Companies Act, 2013
2014	Section 135 of Companies Act, 2013 on Corporate Social Responsibility (CSR) comes in to force
2015	High Level Committee on CSR (HLC-2015) under the chairmanship of Shri. Anil Baijal makes Recommendations on the CSR framework and stakeholder concerns
2015	The SEBI extends BRR reporting to top 500 companies by market capitalization
2016	The Companies Law Committee reviews the recommendations of HLC-2015 for adoption
2018	The second High Level Committee on CSR constituted under the Chairmanship of Shri. Injeti Srinivas, Secretary, Corporate Affairs to review the CSR framework
2018	Committee on Business Responsibility reporting constituted under the chairmanship of Shri. Gyaneshwar Kumar Singh, Joint Secretary, Corporate Affairs
2018	Zero Draft of National Action Plan on Business and Human Rights released by Ministry of Corporate Affairs
2019	National Guidelines on Responsible Business Conduct released
2019	The Companies (Amendment) Act, 2019 amended the CSR provisions
2020	The CSR (Amendment) Rules, 2021 and the Companies (Amendment) Act, 2020 has decriminalised and brought a revolutionary changes in the CSR provisions
2022	The CSR (Amendment) Rules, 2022 amended the format of Annexure II (Format for the annual report on CSR activities to be included in the board's report for financial year commencing on or after the 01.04.2020)

CSR under the Companies Act, 2013

The Companies Act, 2013 is a legislation which officially embarked on one of the world's largest experiments of introducing the concept of CSR as a mandatory provision. The inclusion of CSR is an attempt by the government to engage the businesses with the national development agenda. With the introduction of new Act, there is a statutory obligation for the corporates to take initiatives towards Social, Environmental and Economic Responsibilities.

Applicability

As per section 135(1) of the Companies Act 2013, the CSR provision is applicable to companies which fulfills any of the following criteria during the immediately preceding financial year:-

- Companies having net worth of Rs. 500 crore or more; or
- Companies having turnover of Rs. 1000 crore or more; or
- Companies having a net profit of Rs. 5 crore or more.

The Companies (Corporate Social Responsibility Policy) Rules, 2014 have widen the ambit for compliance obligations to include the holding and subsidiary companies as well as foreign companies whose branches or project offices in India which fulfills the criteria specified above.

According to the Rule 3 of the CSR Rules, the CSR provision will also be applicable to every company including its holding or subsidiary, and a foreign company having its branch office or project office in India having net worth of Rs. 500 crore or more, or turnover of Rs. 1000 crore or more or a net profit of Rs. 5 crore or more during the immediately preceding financial year.

Provided further that a company having any amount in its Unspent Corporate Social Responsibility Account as per sub-section (6) of section 135 shall constitute a CSR Committee and comply with the provisions contained in sub-sections (2) to (6) of the said section.

Whether a holding or subsidiary of a company fulfilling the criteria under section 135(1) has to comply with the provisions of section 135, even if the holding and subsidiary itself does not fulfill the criteria?

Applicability of provisions of Section 135 of the Act is company specific. Hence, every company whether holding or subsidiary satisfying the prescribed criteria shall comply with the provisions. By mere relationship between two companies as Holding and Subsidiary, shall not extend the applicable provisions to the other company.

A Holding or subsidiary of a company falling within the ambit of section 135 of the Act, is not required to comply with section 135(1) unless the holding or subsidiary, as the case may be, itself fulfills the criteria [General Circular No. 1/2016 dated 12th January, 2016].

For example: Company A is covered under the criteria mentioned in section 135. Company B is holding company of company A. Since, Company B by itself does not satisfy any of the criteria mentioned in section 135, therefore Company B is not required to comply with the provisions of section 135.

If a company has not completed the period of three financial years since incorporation, is it required to comply with the CSR provisions?

As per the provisions of section 135(5), if the Company has not completed the period of three financial years since incorporation, but it satisfies any of the criteria mentioned in section 135(1), then it has to comply with CSR provisions. The Company will be required to constitute a CSR committee and comply with other requirements of section 135 including spending of at least two percent of the average net profits of the company made during such immediately preceding financial years since the date of incorporation.

Illustration:

ABC Private Ltd. was incorporated on 1st April, 2016. During the financial year 2016-17 and 2017-18 it earned the net profit of Rs. 3 crore and Rs. 6 crore respectively (calculated as per section 198 of the Act read with rule 2(h) of CSR Rules). The provisions of section 135 to the Act were applicable to the company in the financial year 2018-19 as its net profit, during the immediately preceding financial year, i.e. 2017-18 exceeds the threshold limit of Rs. 5 crore.

In accordance with the section 135(5) of the Act, the company should ensure that during the financial year 2018-19, an amount equivalent to 2% of the average net profits of the financial year 2016-2017 and 2017-2018 is spent on CSR activities.

CASE LAW

In the Matter of ***M/s. Hira Power and Steels Limited NCLT, Mumbai 2018,***

The determination of the Quantum of the CSR responsibility can only be ascertained after the finalization of accounts at the close of the Books of Accounts of a particular financial year.

Background:

Hira Power & Steels Limited, promoted by the Agrawal family is a leading player in the Steel Segment in Central India. The Company's main business interests are in Ferro Alloys, Power and Mining and it has its manufacturing facilities in Chhattisgarh, India, an area known for low cost production of Steel due to the easy availability of Raw Materials, Cheap Labour and Supportive Government Policies. The Company filed a Compounding application before Registrar of Companies (ROC), Chattisgarh and the same has been forwarded to the NCLT, Mumbai along with ROC Report.

Timeline of Events:

ROC had informed that, this application was filed because the Company had violated the provision of Section 134 (3) (o) of the Companies Act, 2013 read with Rule 8 of Companies (Corporate Social Responsibility Policy) Rules, 2014 wherein the Company fails to give explanation for the non-spending of the CSR amount for the Financial Year 2014-15 in Director's Report.

Hira Power & Steels Limited submitted that due to inadvertent mistake the Company has failed to comply with the provisions of the S. 134 (3) (o) and were willing to comply with the provisions of the Act bona fidely. They had made all endeavours to comply with the provisions of the Act however, because of number of Circulars which were issued by the Ministry of Corporate Affairs with respect to CSR there was ambiguity in the correct implementation of the provisions.

It is further stated that the Company had constituted the CSR Committee as per the provisions of the Act on August 05, 2015 and made the necessary declarations as per Section 134 (3) (o) in the Director's Report for the F.Y. 2015-16. Consequently, the Default has been made good.

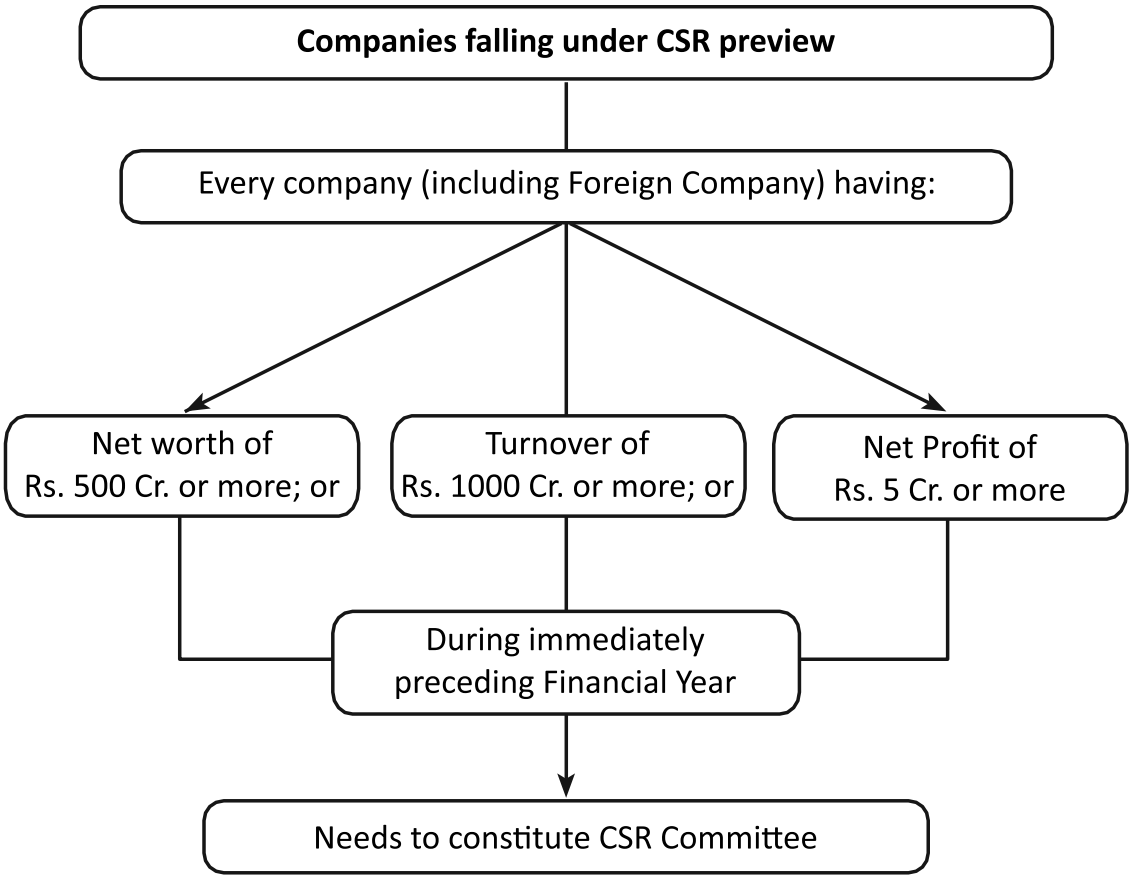
It is also submitted that, due to number of Circulars / Notifications issued by the Government the Applicants/ Defaulters herein, could not ascertain the actual position of the CSR amount to spend and therefore the said contravention has happened. In light of above submissions it is submitted that since, the Applicants/ Defaulters herein had not deliberately contravened the provisions of the Companies Act, 2013 and subsequently, after ascertaining the correct position, made the committed default hence, this Application may be allowed and minimum Compounding Fee may be imposed.

Judgment:

The Bench said that, this provision regarding CSR is newly incorporated in the Statute and thereafter number of circulars was issued and as a result of those circulars no clear clarification regarding the provision can be recorded by the Company or its Directors. It is also noticed that the Company had made the default good by constituting the CSR committee and by furnishing declaration in the Director's Report for the F. Y. 2015-16.

The determination of the Quantum of the CSR responsibility can only be ascertained / quantified after the finalisation of accounts at the close of the Books of Accounts of a particular financial year. As a result, the amount to be contributed for charitable purpose as CSR responsibility can be intimated to the concerned authorities thereafter only i.e. after the finalisation of accounts of a particular financial year.

Compounding Fee of Rs. 10,000/- by the each Applicant / Defaulter herein (i.e. Rs. 50,000/- in total) was levied on the Company.



As per section 135(9) of the Act, where the amount to be spent by a company under Section 135 (5) of the Companies Act, 2013 does not exceed Rs. 50 Lakh, the requirement under Section 135 (1) for constitution of the Corporate Social Responsibility Committee shall not be applicable and the functions of such Committee provided under this section shall, in such cases, be discharged by the Board of Directors of such company. *[Inserted by the Companies (Amendment) Act, 2020. Notification dated 28th September, 2020; Effective from 22nd January 2021.]*

The Ministry of Corporate Affair's vide its notification dated 11th February, 2022 has notified the Companies (Accounts) Amendment Rules, 2022. According to the notification rule 12 (1B) is inserted in the Companies (Accounts) Rules, 2014 stating :

- *Every company covered under the provisions of section 135(1) shall furnish a report on Corporate Social Responsibility in Form CSR-2 to the Registrar for the preceding financial year (2020-2021) and onwards as an addendum to Form AOC-4 or AOC-4 XBRL or AOC-4 NBFC (Ind AS), as the case may be.*
- *Provided that for the preceding financial year (2020-2021), Form CSR-2 shall be filed separately on or before 30th June, 2022, after filing Form AOC-4 or AOC-4 XBRL or AOC-4 NBFC (Ind AS), as the case may be.*
- *Provided further that for the financial year 2021-2022, Form CSR-2 shall be filed separately on or before 31st March, 2023 after filing Form AOC-4 or AOC-4 XBRL or AOC-4 NBFC (Ind AS), as the case may be.*

Further, MCA vide issuing notification the Companies (Accounts) Second Amendment Rules, 2023 dated 31st May, 2023 has inserted proviso that for the financial year 2022-2023, Form CSR-2 shall be filed separately on or before 31st March, 2024 after filing Form No. AOC-4 or Form No. AOC-4-NBFC (Ind AS), as specified in these rules or Form No. AOC-4 XBRL as specified in the Companies (Filing of Documents and Forms in Extensible Business Reporting Language) Rules, 2015 as the case may be.

Test Yourself:

Question 1: Are CSR provisions applicable to private / section 8 companies?

Answer: Yes, if such companies fulfill the criteria prescribed under section 135(1) of the Act.

Question 2: Are CSR provisions applicable to joint venture companies? What if such companies have no business projects in India?

Answer: Any company incorporated under the Act including joint venture company will come within the purview of CSR provisions if it fulfill the criteria prescribed under section 135(1) of the Act. Even if a company incorporated under the Act is carrying on business activities outside India and has no business activities in India, it still needs to comply with the CSR provisions if it fulfills the criteria prescribed under section 135(1) of the Act.

Question 3: Under section 135(9) of the Act, the CSR obligation of Rs. 50 lakh is to be checked for the previous year or for the current financial year?

Answer: From the language of section 135(9) of the Act, CSR obligation for the previous year is not relevant. Depending on the liability of company for a particular financial year, whether CSR Committee requirement is applicable for that particular financial year or not needs to be determined.

Important Definitions under CSR [Rule 2 of the CSR Rules, 2014]

- *"Administrative overheads"* means the expenses incurred by the company for 'general management and administration' of Corporate Social Responsibility functions in the company but shall not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular Corporate Social Responsibility project or programme;
- *"Corporate Social Responsibility (CSR)"* means the activities undertaken by a Company in pursuance of its statutory obligation laid down in section 135 of the Act in accordance with the provisions contained in these rules, but shall not include the following, namely:-

  (i) activities undertaken in pursuance of normal course of business of the company.

  However, any company engaged in research and development activity of new vaccine, drugs and medical devices in their normal course of business may undertake research and development activity of new vaccine, drugs and medical devices related to COVID-19 for financial years 2020-21, 2021-22, 2022-23 subject to the conditions that-

  (a) such research and development activities shall be carried out in collaboration with any of the institutes or organisations mentioned in item (ix) of Schedule VII to the Act;

  (b) details of such activity shall be disclosed separately in the Annual report on CSR included in the Board's Report.

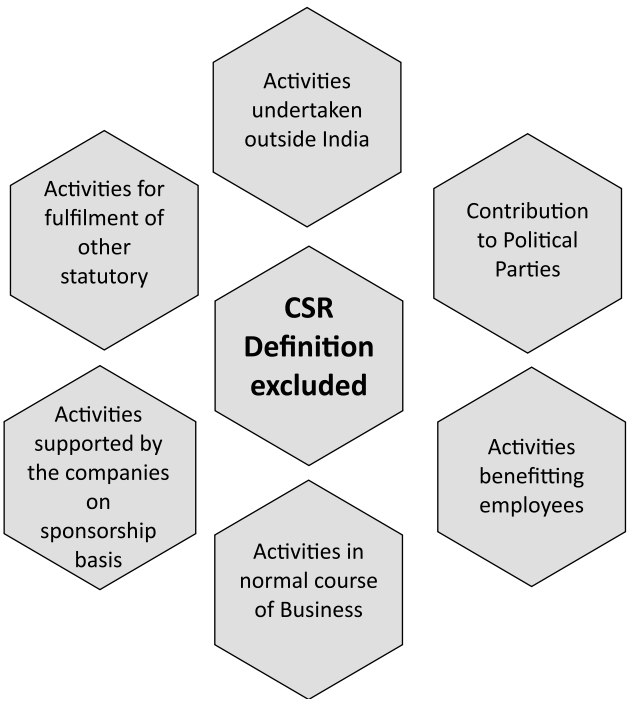
(ii) any activity undertaken by the company outside India except for training of Indian sports personnel representing any State or Union territory at national level or India at international level;

(iii) contribution of any amount directly or indirectly to any political party under section 182 of the Act;

(iv) activities benefitting employees of the company as defined in clause (k) of section 2 of the Code on Wages, 2019;

(v) activities supported by the companies on sponsorship basis for deriving marketing benefits for its products or services;

(vi) activities carried out for fulfilment of any other statutory obligations under any law in force in India.



Test Yourself:

Question: Whether distribution of free samples to customers can be considered a CSR activity?

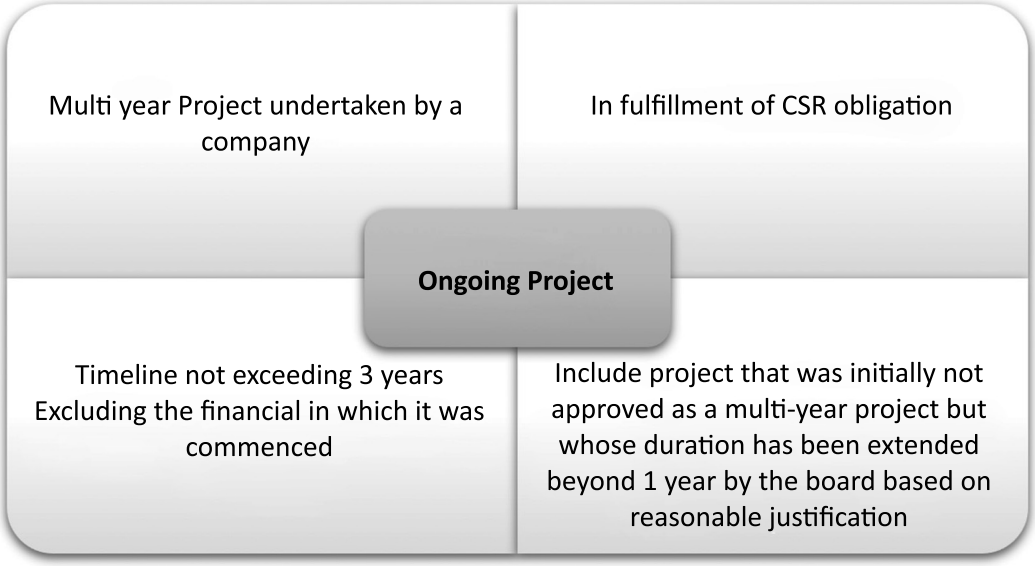
Answer: This activity will fall under 'normal course of business' and hence may not be considered as CSR activity.

Question: Whether companies organising preventive health camps or awareness programmes exclusively for its dealers, vendors and business associates can be considered as CSR activities?

Answer: Any activities where beneficiaries are exclusively the persons who are associated with the business of the company may be considered as activity in the normal course of business and hence in such cases it may not be considered as CSR.

- *"CSR Committee"* means the Corporate Social Responsibility Committee of the Board referred to in section 135 of the Act;

- *"CSR Policy"* means a statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR Committee, and includes guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan;
- *"International Organisation"* means an organisation notified by the Central Government as an international organisation under section 3 of the United Nations (Privileges and Immunities) Act, 1947, to which the provisions of the Schedule to the said Act apply;
- *"Ongoing Project"* means a multi-year project undertaken by a Company in fulfilment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification.



Does the term 'ongoing project' mean projects involving capital assets like Building, Hospital and any other Infrastructure related CSR Project which generally takes more than a year to complete?

Ongoing project has been defined under Rule 2(i) of the CSR Rules so as to mean a multi-year project undertaken by a company in fulfilment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification.

Such ongoing project may or may not involve capital assets or development of any other infrastructure.

- "Public Authority" means 'Public Authority' as defined in clause (h) of section 2 of the Right to Information Act, 2005.

CSR COMMITTEE

Companies that trigger any of the aforesaid conditions must constitute a Corporate Social Responsibility Committee of the Board to formulate and monitor the CSR policy of a company. Section 135(1) of the Act requires the CSR Committee to consist of three directors or more, including at least one independent director.

Where a company is not required to appoint an independent director under sub-section (4) of section 149, it shall have in its Corporate Social Responsibility Committee two or more directors.

Rule 5 of CSR Rules, 2014 further state that, where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors.

The CSR Committee of a foreign company shall comprise of at least two persons of which one person should be resident in India and the other person nominated by the foreign company.

The Board's report shall disclose the composition of the Corporate Social Responsibility Committee.

The composition of the CSR Committee for various categories of companies is as under:	
Listed companies	Three or more directors, out of which at least one shall be an independent director.
Unlisted public companies	Three or more directors, out of which at least one shall be an independent director. However, if there is no requirement of having an independent director in the company, two or more directors.
Private companies	Two or more directors. No independent directors are required as mentioned in the proviso under section 135(1).
Foreign company	At least two persons out of which: (a) one shall be as specified under clause (d) of subsection (1) of section 380 of the Act, and (b) another shall be nominated by the foreign company. [Refer rule 5(1) of the Companies (CSR Policy) Rules, 2014]

Question: Can a group of fifteen companies constitute a single CSR Committee with representative of all such companies?

Answer: No. The applicability of CSR provisions under the Act is company specific. Hence every company fulfilling the criteria laid down in section 135(1) of the Act, should constitute a CSR committee for itself. However, the company may align its CSR Policy and initiatives as per the group policy, which should be in accordance with the provisions of the Act.

CASE LAW

In the matter of *Precision Automation and Robotics India Private Limited (Petitioner) vs. Registrar of Companies, Maharashtra, Pune (Respondents) RoCP/ADJ/order/135/21-22/PARI/2071 dated 18.02.2022*

Every company having net worth of rupees five hundred crore or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during the immediately preceding financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more Directors, out of which at least one director shall be an independent director.

Facts of the Case:

The Company is crossing the threshold limit with regard to Net profit as per Financial Statements since 2014-15, thus has failed to constitute the Corporate Social Responsibility Committee as per Section 135 of the Act, 2013.

Decision:

The Company and its officers have defaulted the provisions of the Act as no CSR Committee was constituted. Therefore, they are liable for penalties the Companies Act, 2013. Total Penalty of Rs. 8,50,000/- imposed on the company.

The functions of CSR Committee

The CSR Committee shall formulate CSR policy and establish the steps for the effective implementation, maintenance, periodic review and improvement of CSR system.

The role and responsibilities of the CSR Committee are:

- To formulate and recommend to the Board, a CSR Policy which would indicate the activities to be undertaken by the company in areas or subject, specified in Schedule VII of the Act.
- To recommend the amount of the expenditure to be incurred on the activities undertaken in pursuance of the CSR policy.
- To monitor the CSR policy of the company time to time.

{As per Rule 5(2) of the CSR Rules, 2014: The CSR Committee shall formulate and recommend to the Board, an annual action plan in pursuance of its CSR policy, which shall include the following, namely:-

(a) the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act;

(b) the manner of execution of such projects or programmes as specified in sub-rule (1) of rule 4;

(c) the modalities of utilisation of funds and implementation schedules for the projects or programmes;

(d) monitoring and reporting mechanism for the projects or programmes; and

(e) details of need and impact assessment, if any, for the projects undertaken by the company.

However, the Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

Meeting of CSR Committee

Number of CSR Meetings: Law is silent w.r.t. number of CSR Committee meetings in a year. But as per Secretarial Standard 1 "Committees shall meet as often as necessary subject to the minimum number and frequency stipulated by the Board or as prescribed by any law or authority."

Quorum for CSR Meetings: Law is also silent w.r.t. quorum for the committee meeting. But as per Secretarial Standard 1: The presence of all the members of any Committee (applicable to CSR Committee also) constituted by the Board is necessary to form the Quorum for Meetings of such Committee unless otherwise stipulated in the Act or any other law or the Articles or by the Board.

A member of the Committee appointed by the Board or elected by the Committee as Chairman of the Committee, in accordance with the Act or any other law or the Articles, shall conduct the Meetings of the Committee. If no Chairman has been so elected or if the elected Chairman is unable to attend the Meeting, the Committee shall elect one of its members present to chair and conduct the Meeting of the Committee, unless otherwise provided in the Articles.

Functions and Responsibilities of the Board

The Board of the Company shall be fully accountable and responsible for the execution and implementation of the CSR policy and all of the projects that are formulated thereunder and ensure:

(i) Provisions of the resources for the establishment, implementation, maintenance and continual improvement of the system required for CSR;

(ii) Involvement of all concerned stakeholders in CSR Implementation;

(iii) Awareness and promotion of CSR as an integral part of the business and culture.

CSR Implementation [Rule 4 of the Companies (Corporate Social Responsibility Policy) Rules, 2014]

The Board shall ensure that the CSR activities are undertaken by the company itself or through -

(a) a company established under section 8 of the Act, or a registered public trust or a registered society, exempted under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10 or registered under section 12A and approved under 80 G of the Income Tax Act, 1961, established by the company, either singly or along with any other company; or

(b) a company established under section 8 of the Companies Act, 2013 or a registered trust or a registered society, established by the Central Government or State Government; or

(c) any entity established under an Act of Parliament or a State legislature; or

(d) a company established under section 8 of the Act, or a registered public trust or a registered society, exempted under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10 or registered under section 12A and approved under 80 G of the Income Tax Act, 1961, and having an established track record of at least three years in undertaking similar activities.

Illustration:

A company is having ongoing projects carried out by an implementing agency which is not registered under section 12A and 80G of the Income Tax Act, 1961. Will the company become non-compliant under law if it continues with the same implementing agency?

As per Rule 4 of the amended Rules, the requirement of registration for an implementing agency under section 12A and 80G of the Income Tax Act, 1961 is effective from 22nd January, 2021. In the given case, since the company has already assigned projects which are being carried out by the implementing agency, such agency should obtain the requisite registration at the earliest and in the meanwhile may continue to carry on with the projects assigned.

However, in case of new assignment, the implementing agencies should have prior registration.

- **Mandatory Registration of CSR Entity:** Every eligible entity who intends to undertake any CSR activity, shall register itself with the Central Government by filing the form CSR-1 electronically with the Registrar, with effect from the 01st day of April 2021:

However, the provisions of this sub-rule shall not affect the CSR projects or programmes approved prior to the 01st day of April 2021.

- **Certification of Professional:** Form CSR-1 shall be signed and submitted electronically by the entity and shall be verified digitally by a Chartered Accountant in practice or a Company Secretary in practice or a Cost Accountant in practice.
- On the submission of the Form CSR-1 on the portal, a unique CSR Registration Number shall be generated by the system automatically.

Example: Company A carries out its CSR project X through an implementing agency during the FY 2020-21. Company A intends to start a new CSR project Y in the FY 2021-22. The implementing agency will have to register itself for project Y by filing form CSR-1. As project X is an ongoing project, the implementing agency is not required to file form CSR-1.

- **Role of International Organisation**: A company may engage international organisations for designing, monitoring and evaluation of the CSR projects or programmes as per its CSR policy as well as for capacity building of their own personnel for CSR.
- **A collaboration of other Companies for CSR Expenditure**: A company may also collaborate with other companies for undertaking projects or programmes or CSR activities in such a manner that the CSR committees of respective companies are in a position to report separately on such projects or programmes in accordance with these rules.
- **CFO Certification:** The Board of a company shall satisfy itself that the funds so disbursed have been utilised for the purposes and in the manner as approved by it and the Chief Financial Officer or the person responsible for financial management shall certify to the effect.

Test Yourself:

Question: At what frequency should CFO certify to the Board about utilisation of CSR funds disbursed through Implementing Agencies?

Answer: It is not prescribed at what frequency the CFO should certify to the Board. Hence the CFO may certify separately for each CSR activity or may collectively certify to the Board at every quarter / half year / annual basis. It is recommended that annual CFO certification be placed at Board meeting where Board's Report containing annual report on CSR is placed for its approval.

Question: Whether CFO should certify to the Board after disbursing the amount to Implementing Agencies also?

Answer: No, after disbursing amount to Implementing Agencies, he is not required to certify. In fact, only after monitoring the spending done by the Implementing Agency to the ultimate beneficiary, CFO needs to certify to the Board about its utilization.

Question: If a company spends only by way of contribution to PM Relief Fund or PM Cares Fund, whether monitoring and CFO certification needed for the same?

Answer: In such cases, the Board would have only approved the contribution to be given to PM Relief Fund or PM Cares Fund and no other project. Hence, the CFO only needs to certify that the funds have been contributed to these funds.

- **Ongoing Projects:** In case of ongoing project, the Board of a Company shall monitor the implementation of the project with reference to the approved timelines and year-wise allocation and shall be competent to make modifications, if any, for smooth implementation of the project within the overall permissible time period.

Identifying appropriate Implementing Agency

Identifying an appropriate Implementing Agency for undertaking CSR activities is an important task as the proper utilization of funds allocated depends on how capable the Implementing Agency is.

While finalizing the Implementing Agency, the following points should be kept in mind:

- The Implementing Agency should have well established track record of 3 years or more;
- The Implementing Agency should not have any association with any political party – directly or indirectly. Otherwise the whole purpose may deviate;
- The Implementing Agency should not have any conflict of interest with the employees of the company. There should be no direct or indirect benefit to any of the employees of the company or their family members;
- The Implementing Agency should have registration under section 12A and section 80G of the Income Tax Act and from 1st April, 2021 onwards such agency should also be registered with the MCA for undertaking CSR activities;
- The antecedents of the Implementing Agency, its past reputation, the reputation of persons associated with the same should also be subjected to scrutiny before selection.
- Any other requirement as may be prescribed by Government / Regulatory Authorities is being followed by the Implementing Agency.

CSR POLICY AND ANNUAL ACTION PLAN

"CSR Policy" means a statement containing the approach and direction given by the board of a company, taking into account the recommendations of its CSR Committee, and includes guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan.

The approach and direction for CSR is to be recommended by the CSR Committee to the Board, and based on the same, the approach and direction is finalised by the Board of Directors. The CSR Policy is to be prepared and recommended by the CSR Committee to the Board for its approval as per section 135(3)(a) of the Act read with rule 2(f) of the CSR Rules. This process may happen simultaneously also depending upon the convenience of the Board.

As per section 135(3)(a) of the Act, the CSR Policy shall indicate the activities to be undertaken by the company in areas or subjects, specified in Schedule VII to the Act. The definition of 'CSR Policy' has been amended vide Companies (CSR Policy) Amendment Rules, 2021 notified on 22nd January 2021. Hence, in respect of the companies to whom CSR provisions were applicable prior to this date, it is recommended that the CSR Policy be amended in line with the revised provisions to include, inter-alia, the guiding principles for selection, implementation and monitoring of activities as well as formulation of the annual action plan.

The guiding principles to be included in the CSR Policy as contemplated in the CSR Rules appear to be macro level indicators as to the areas in which CSR projects are proposed to be undertaken, which can be articulated in the annual action plan for each financial year.

For example:

- Guiding principles for selection of CSR projects can be what parameters are to be evaluated while selecting a project, namely what should be the thrust area, local area, other areas where there exists a need for CSR project, projects of national importance, areas which deplete natural resources, etc. and what proportion of CSR spending is to be apportioned for these purposes so that there is an adequate positive impact arising out of the activities undertaken by the company.
- Guiding principles for implementation of CSR projects can be whether they will be undertaken directly or through any Implementing Agency, minimum benchmarks of various criteria while selecting an Implementing Agency such as no conflict of interest, no political background, satisfactory due diligence, track record indicators etc.
- Guiding principles for monitoring of CSR projects can be at what frequency spending shall be monitored, whether site visits would be needed, who shall visit, what evidences should be collected as to the progress of the project, etc.
- Guiding principles for formulation of annual action plan can be whether long term projects or short-term projects are to be selected, requirement of environmental clearance, compliance of local laws, evaluation while choosing a project, at what frequency impact assessment should be done, etc.

It is recommended that CSR Policy should be drawn up to the extent it is relevant in the context of company and should be compatible with the legal requirements. CSR Policy should be approved by the Board of Directors and reviewed and updated, as and when required. It is recommended that a company should:

i) Outline a CSR Policy to reflect the vision, mission and goals on a broader level;

ii) CSR Policy should articulate broadly target group (marginalized group)/ geography (local/ wider area)/ sectors (health/education/ environment).

Test Yourself:

Question: Can a company spend in projects or programmes relating to activities mentioned in Schedule VII to the Act, but not specifically covered in CSR Policy?

Answer: As provided in section 135(5) of the Act, the Board shall ensure that the company spends at least 2% of the average net profits in pursuance of its CSR Policy. If a company wishes to spend CSR funds on activities mentioned in Schedule VII to the Act, but not specifically covered in CSR Policy, it may do so by suitably amending its CSR Policy with the approval of the Board to include such activities.

Question: Is it mandatory to amend the CSR Policy after the amendments notified in CSR Rules on 22nd January 2021?

Answer: If existing CSR Policy covers the following items, CSR Policy need not be amended:-

A. Approach and direction approved by the Board based on recommendation of CSR Committee

B. Guiding principles for-

(i) Selection of CSR projects / programmes / activities;

(ii) Implementation of CSR projects / programmes / activities;

(iii) Monitoring of CSR projects / programmes / activities; and

(iv) Formulation of the annual action plan.

Otherwise, the CSR Policy needs to be amended to include the above aspects.

Annual Action Plan

In terms of the provisions of Rule 5 (2) of the amended CSR Rules, the CSR Committee shall formulate and recommend to the Board, an annual action plan in pursuance of its CSR policy which shall specifically include:

a) the list of CSR projects or programmes that are approved to be undertaken in areas or subjects specified in Schedule VII of the Act;

b) the manner of execution of such projects or programmes;

c) the modalities of utilisation of funds and implementation schedules for the projects or programmes;

d) monitoring and reporting mechanism for the projects or programmes; and

e) details of need and impact assessment, if any, for the projects undertaken by the company.

It is further provided that the Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect.

Accordingly, in the given case if the CSR project could be completed and the amount of money left unutilised, be considered by the Board for spending for other CSR projects / activities after amending the Annual Action Plan accordingly. This fact should also be disclosed in the CSR Report.

All CSR projects or activities are required to be approved in annual action plan. If company proposes to undertake any project / activity which is not approved in annual action plan, it requires approval of CSR Committee and the Board with proper justification.

The annual action plan shall change for each financial year as it is a manifestation of the guiding principles mentioned in CSR Policy, as may be relevant for each financial year. It is recommended that the annual action plan should clearly outline the mechanisms and modalities for actual implementation of CSR projects and programs with a view to ensure measurable and sustainable outcomes primarily focusing on projects/ activities which are beneficiary oriented and contribute to sustainable development. It is also recommended that the annual action plan should also speak about the expectations to be achieved during the next financial year.

For example:

- List of CSR programmes, or at least broad criteria about what constitute a CSR project, which will meet the thrust areas and make positive impact.
- Manner of execution of project can be as to how much amount to be spent on a particular project in the current year, how much amount to be spent in the next financial year, which Implementing Agencies to hire etc.
- Modalities of utilisation of funds can be at what stage funds shall be disbursed, example- funds shall be disbursed after completion of work, etc.
- Monitoring & reporting mechanism can be selection of any third party for verification of work done, deciding frequency and parameters of verification, etc.
- Fixation of who shall do the impact assessment, which projects, timelines, etc.

CSR ACTIVITIES [SCHEDULE VII OF THE COMPANIES ACT, 2013]

Some activities are specified in Schedule VII as the activities which may be included by companies in their Corporate Social Responsibility Policies. The entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the amended Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities as illustratively. These are activities related to:

(i) eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation and making available safe drinking water;

(ii) promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly and the differently abled and livelihood enhancement projects;

(iii) promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

(iv) ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agro forestry, conservation of natural resources and maintaining quality of soil, air and water including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga;

(v) protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

(vi) measures for the benefit of armed forces veteran, war widows and their dependents, Central Armed Police Forces (CAPF) and Central Para Military Forces (CPMF) veterans, and their dependents including widows;

(vii) training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports;

(viii) contribution to the Prime Minister's National Relief Fund or Prime Minister's Citizen Assistance and Relief in Emergency Situations Fund (PM Cares Fund) or any other fund set up by the Central Government for socio- economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

(ix) (a) Contribution to incubators or research and development projects in the field of science, technology, engineering and medicine, funded by the Central Government or State Government or Public Sector Undertaking or any agency of the Central Government or State Government; and

(b) Contributions to public funded Universities; Indian Institute of Technology (IITs); National Laboratories and autonomous bodies established under Department of Atomic Energy (DAE); Department of Biotechnology (DBT); Department of Science and Technology (DST); Department of Pharmaceuticals; Ministry of Ayurveda, Yoga and Naturopathy, Unani, Siddha and Homoeopathy (AYUSH); Ministry of Electronics and Information Technology and other bodies, namely Defense Research and Development Organisation (DRDO); Indian Council of Agricultural Research (ICAR); Indian Council of Medical Research (ICMR) and Council of Scientific and Industrial Research (CSIR), engaged in conducting research in science, technology, engineering and medicine aimed at promoting Sustainable Development Goals (SDGs) –*Substituted by Notification dated 24th August, 2020*].

(x) rural development projects;

(xi) slum area development where 'slum area' shall mean any area declared as such by the Central Government or any State Government or any other competent authority under any law for the time being in force;

(xii) disaster management, including relief, rehabilitation and reconstruction activities.

However, in determining CSR activities to be undertaken, preference would need to be given to local areas and the areas around where the company operates.

As per Clarification issued by MCA on 18th June, 2014; following may be noted with regard to provisions mentioned under section 135:

- *One-off events such as marathons/ awards/ charitable contribution/ advertisement/sponsorships of TV programmes etc. do not be qualified as part of CSR expenditure.*
- *Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) are not count as CSR expenditure under the Companies Act.*

How has the CSR spending pertaining to COVID-19 been inculcated in the Companies Act, 2013?

As per item no. (viii) of the Schedule VII of the Companies Act, 2013, which enumerates activities that may be undertaken by companies in discharge of their CSR obligations, *inter alia* provides that contribution to any fund set up by the Central Government for socio-economic development and relief qualifies as CSR expenditure. The PM-CARES Fund has been set up to provide relief to those affected by any kind of emergency or distress situation such as that posed by COVID 19 pandemic. Accordingly, it is clarified that any contribution made to the PM CARES Fund shall qualify as CSR expenditure under the Companies Act 2013. *[eF. No. CSR-05/1/2020-CSR-MCA OFFICE MEMORANDUM dated 28.03.2020].*

Keeping in view the spread of novel corona virus (COVID-19) in India, its declaration as pandemic by the world health organisation (WHO), and decision of Government of India to treat this as a notified disaster, it is hereby clarified that spending of CSR Funds for COVID-19 is eligible CSR activity. Funds may be spent for various activities related to COVID-19 under item nos. (i) to (xii) of schedule VII relating to promotion of health care including preventive health care and sanitation, an, disaster management. *[General Circular no. 10/2020 dated 23.03.2020].*

MCA CLARIFICATIONS

1) Clarification on spending of CSR funds for Awareness and public outreach on COVID-19 Vaccination programme (General Circular, Dated January 13, 2021)

In continuation to MCA General Circular No. 10/2020 dated March 23, 2020 wherein it was clarified that spending of CSR funds for COVID-19 is an eligible CSR activity, it is further clarified that spending of CSR funds for carrying out awareness campaigns/programmes or public outreach campaigns on COVID-19 Vaccination programme is an eligible CSR activity under item no. (i), (ii) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care and sanitization, promoting education, and, disaster management respectively.

The companies may undertake the aforesaid activities subject to fulfilment of Companies (CSR Policy) Rules, 2014 and the circulars related to CSR, issued by the MCA from time to time.

2) Clarification on spending of CSR funds for setting up makeshift hospitals and temporary COVID Care facilities-reg. (General Circular No. 05/2021, dated April 22, 2021)

The MCA has clarified that spending of CSR funds for 'setting up makeshift hospitals and temporary COVID Care facilities ' is an eligible CSR activity under item nos. (i) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care, and, disaster management respectively. The companies may undertake the aforesaid activities in consultation with State Governments subject to fulfilment of Companies (CSR Policy) Rules, 2014 and the circulars related to CSR issued by MCA from time to time.

3) Clarification on spending of CSR funds for 'creating health infrastructure for COVID care', 'establishment of medical oxygen generation and storage plants' etc. - reg. (General Circular No. : 09/ 2021, dated May 05, 2021)

The MCA has further clarified that spending of CSR funds for 'creating health infrastructure for COVID care', 'establishment of medical oxygen generation and storage plants', 'manufacturing and supply of Oxygen concentrators, ventilators, cylinders and other medical equipment for countering COVID-19' or similar such activities are eligible CSR activities under item nos. (i) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care, and, disaster management respectively.

The companies including Government companies may undertake the activities or projects or programmes using CSR funds, directly by themselves or in collaboration as shared responsibility with other companies, subject to fulfillment of the Companies (CSR Policy)Rules, 2014 and the guidelines issued by the MCA from time to time.

The companies may undertake the aforesaid activities subject to fulfilment of Companies (CSR Policy) Rules, 2014 and the circulars related to CSR, issued by the MCA from time to time.

4) Clarification on spending of CSR funds for COVID-19 vaccination General Circular No: 13/2021, dated July 30, 2021

In continuation to General Circular No. 10/2020 dated March 23, 2020 wherein it was clarified that spending of CSR funds for COVID-19 is an eligible CSR activity, the MCA has further clarified that spending of CSR funds for COVID19 vaccination for persons other than the employees and their families, is an eligible CSR activity under item no. (i) of Schedule VII of the Companies Act, 2013 relating to promotion of health care including preventive health care and item no. (xii) relating to disaster management.

The companies may undertake the aforesaid activity subject to fulfilment of Companies (CSR Policy) Rules, 2014 and the circulars related to CSR issued by the MCA from time to time.

How should the list provided in Schedule VII of the Companies Act be construed for the purpose of undertaking CSR Activities?

The statutory provision and provisions of CSR Rules, 2014, are to ensure that activities undertaken in pursuance of the CSR policy must relate to Schedule VII of the Companies Act, 2013. The entries in the said Schedule VII must be interpreted liberally so as to capture the essence of the subjects enumerated in the said Schedule. The items enlisted in the Schedule VII of the Act, are broad-based and are intended to cover a wide range of activities. It is for the Board of the company to take a call on this. [General Circular No. 1/2016 dated 12th January, 2016 and General Circular No. 21/2014 dated June 18, 2014].

Computation of net profit

"Net profit" as per explanation of Section 135(5) shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198. The net worth, turnover and net profits are to be computed in terms of Section 198 of the Companies Act, 2013 as per the profit and loss statement prepared by the company in terms of Section 381 (1) (a) and Section 198 of the Companies Act, 2013. Every company will have to report its standalone net profit during a financial year for the purpose of determining whether or not it triggers the threshold criteria as prescribed under Section 135(1) of the Companies Act.

- **Indian company:** The CSR Rules have clarified the manner in which a company's net worth will be computed to determine if it fits into the 'spending' norm. In order to determine the 'net profit', dividend income received from another Indian company or profits made by the company from its overseas branches have been excluded. Moreover, the 2% CSR is computed as 2% of the average net profits made by the company during the immediately preceding three financial years.

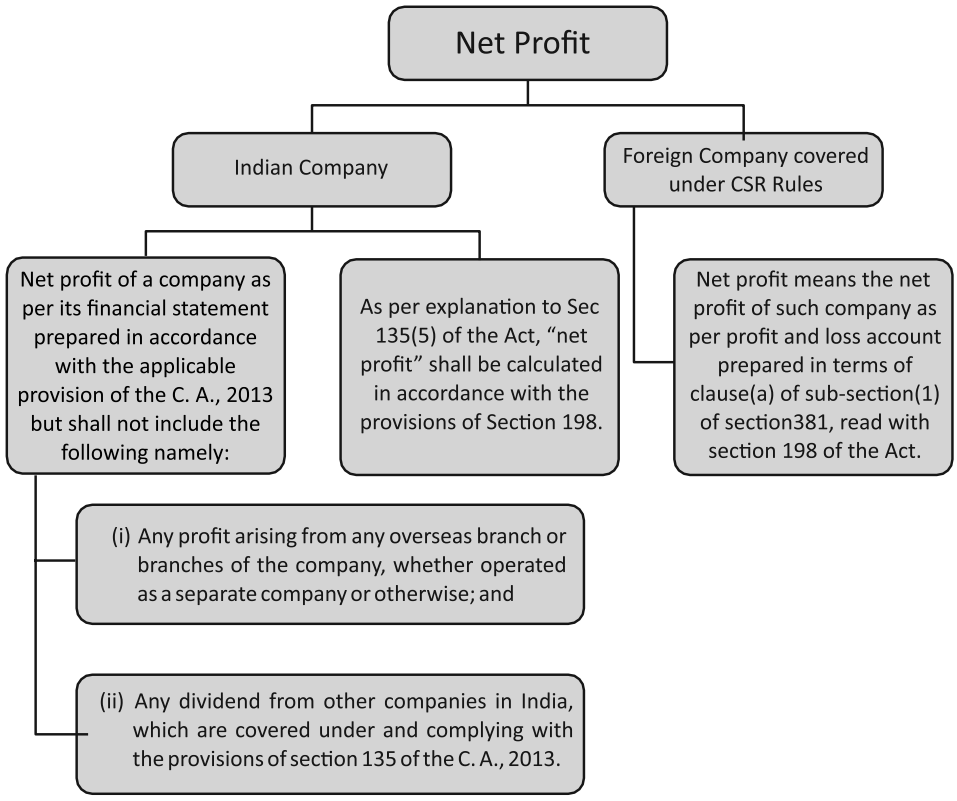
Test Yourself:

Question: While calculating net profit for the purpose of section 135, whether dividend received from every company in India is to be excluded?

Answer: Rule 2(h) of CSR Rules says "any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Act shall not be included". Hence, it can be said that dividend received from each and every company in India cannot be excluded. However, if the dividend is received from such company which is covered under section 135(1) of the Act and is complying with the requirements under section 135(5) of the Act, such dividend amount shall not be included for the purpose of calculation of "net profits" for the purpose of section 135 of the Act. It would be necessary for the company receiving dividend to ascertain from the dividend paying company whether the latter is covered under section 135(1) of the Act and is compliant therewith.

- **Foreign company:** The CSR Rules prescribe that in case of a foreign company that has its branch or a project office in India, CSR provision will be applicable to such offices. CSR Rules further prescribe that the balance sheet and profit and loss account of a foreign company will be prepared in accordance with Section 381(1)(a) and net profit to be computed as per Section 198 of the Companies Act, 2013. It is not clear as to how the computation of net worth or turnover would be arrived at in case of a branch or project office of a foreign company.

Profits from any overseas branch of the company, including those branches that are operated as a separate company would not be included in the computation of net profits of a company. Besides, dividends received from other companies in India which need to comply with the CSR obligations would not be included in the computation of net profits of a company.



CASE LAW

In the matter of M/S Shri Santosh Meenakshi Textiles (P) Ltd. vs. Roc, Tamilnadu, Coimbatore NCLT,Chennai 2019

CSR Committee must be constituted if net profit exceeds the prescribed threshold limit

Background

Sree Santhosh Meenakshi textiles private limited is established at thekkalur, the Manchester of South India. The company has carved niche of its own in the competitive yarn market. Shri Santosh Meenakshi Textiles Pvt Ltd. filed an appeal under Section 421 of the Companies Act, 2013 against the impugned order of National Company Law Tribunal, Chennai by which the appellant company is held liable to spend the amount of Corporate Social Responsibility (CSR) for the FY 2014-15 taking into account only the net profit for the FY 2013-14; the appellant company is held liable to adhere to the other provisions of Section 135 of the Act and the company is permitted to file an application for revision of financial statement or Board report after incorporating the information of CSR.

When the appellant filed its financial statement along with Board Report with the ROC, the ROC observed the same and issued a Show Cause Notice to the Company as to why they have not complied with Section 135(1), 135(5) and Section 134(3)(o) of the Companies Act, 2013. The appellant filed Company Petition before the NCLT, Chennai under Section 131 of the Companies Act, 2013 and the NCLT passed the impugned order wherein it held that – "..... Petitioner Company is liable to spend the amount on account of CSR for FY 2014-15 taking into account only the net profit before tax for the FY 2013-14...."

Issues involved

NCLAT identifies the issue involved as whether the appellant is covered under Section 135(1) of the Act or not. NCLAT observes that as per the appellant's own calculation the net profit is Rs.5,68,70,023/- for the FY 2013-14 which is apparently more than Rs. 5 crores i.e. threshold limited prescribed under Section 135(1) of the Act. Therefore, the company is covered under Section 135(1) of the Act and as such appellant was liable to constitute Corporate Social Responsibility Committee of the Board in the year 2014-15. Section 135(5) of the Act stipulates that Board of every company who comes under Section 135(1) of the Act shall ensures that the company spends in every year at least 2% of the average net profit of the company made during the three immediately preceding financial years in pursuance of the CSR. The net profit will be calculated as per Section 198 of the Companies Act, 2013 and that the profit before tax will be taken as 'Net Profit'.

Further, NCLAT examines the next issue argued by the appellant that even if it is the company is deemed to be covered under Section 135(1) of the Act, then also it is not liable to expend any sum towards CSR in as much since the company had incurred losses in FY 2011-2012 and 2012-13 and the average net profit calculated for the three FY comes in negative. NCLAT disagrees with the observations of the NCLT which directed the appellant herein to spend the amount on account of CSR for the FY 2014-15 taking into account only the net profit before tax for the FY 2013-14 as it is clearly against the mandate of law that the amount to be spent is to be at least 2% of the average net profit of the company made during the three immediately preceding financial years in pursuance to its CSR Policy. NCLAT observes that the calculations submitted by the appellant shows that in the last three years the company is made a profit of Rs.1,38,69,595/- and average net profit of three years will come to Rs.46,23,198/- and further that the company would never be covered under the average net profit of three preceding years.

NCLAT observed that the appellant has resorted to deducting the losses twice over to somehow arrives at a negative figure to show that it is not required to spend any amount on the CSR for the FY 2014-15. NCLAT states that the method of calculation of average net profit for immediately preceding three years as directed by the NCLT will not be applicable.

NCLAT further observes that the company is a defaulter for spending an amount on CSR activities during the year 2014-15 since company has not constituted the CSR Committee and no proof substantiating the amount spent by the company on CSR activities has been placed.

Judgment

NCLAT passes an order modifying the impugned order holding that the appellant is liable to constitute Corporate Social Responsibility Committee of the Board in terms of Section 135(1) in 2014-15 as net profit of the company in the preceding year was more than Rs.5 crores; and further prescribes a method of calculation for the purpose of Section 135(5).

NCLAT holds appellant liable to constitute CSR committee of the Board in terms of Section 135(1) as the net profit of the company exceeds the threshold limit under Section 135(1) of the Act; prescribes method for calculation of average net profit for immediately preceding three years for the purpose of Section 135(5).

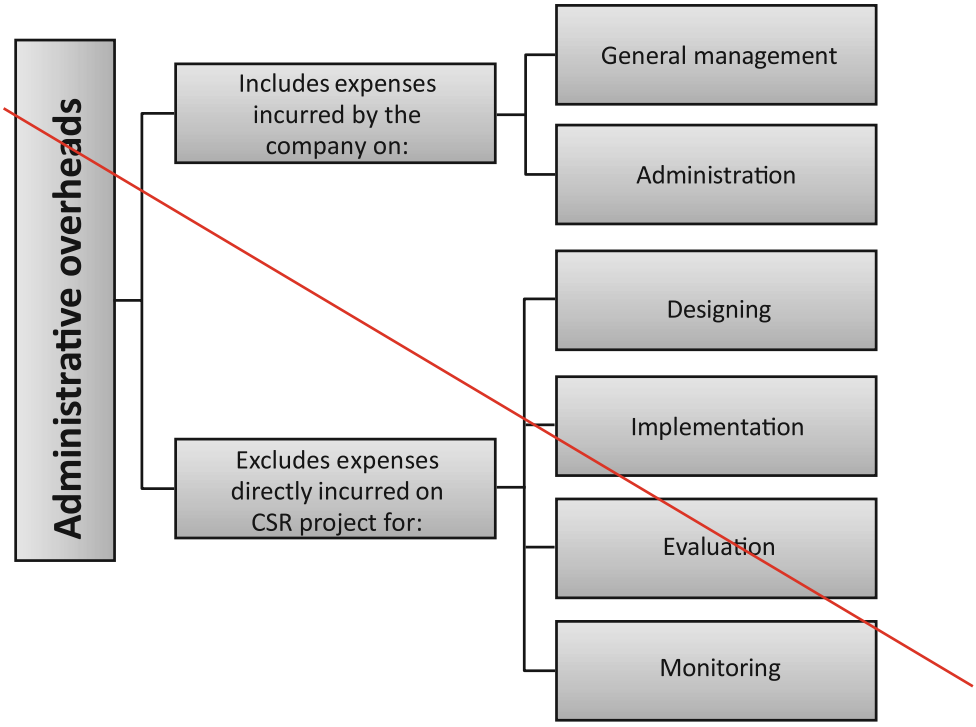
CSR Expenditure – Rule 7 of the CSR Rules, 2014

The Board of every eligible company u/s 135 (1) shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years in pursuance of its Corporate Social Responsibility Policy, this amount will be CSR expenditure.

The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

Administrative Overheads

- The board shall ensure that the administrative overheads shall not exceed **5% of total CSR expenditure of the company** for the financial year.



Surplus arising out of the CSR Activities

- Any surplus arising out of the CSR activities shall not form part of the business profit of a company and shall be ploughed back into the same project or shall be transferred to the Unspent CSR Account and spent in pursuance of CSR policy and annual action plan of the company or transfer such surplus amount to a Fund specified in Schedule VII, within a period of six months of the expiry of the financial year.

  This means in case the project is income generating by way of fees etc., such income should be ploughed back into the same project but not form part of the business profit of the company.

Excess CSR spends may be set off

- Where a Company spent on CSR in excess of the requirement (i.e. 2%), such excess amount may be set-off against the requirement of the CSR Spending u/s 135(5) upto the immediate succeeding 3 financial year subject to the conditions that:
  - ✓ The excess amount available for set off shall not include the surplus arising out of the CSR activities, if any, in pursuance of sub-rule (2) of this rule;
  - ✓ The Board of the company shall pass a resolution to that effect.

Acquisition of Capital Assets

- The CSR amount may be spent by a company for creation or acquisition of a capital asset, which shall be held by –
  - ✓ Section 8 Company, or a Registered Public Trust or Registered Society, having charitable objects and CSR Registration Number;
  - ✓ beneficiaries of the said CSR project, in the form of self-help groups, collectives, entities;
  - ✓ a public authority:

However, any capital asset created by a company prior to the commencement of the Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021, shall within a period of one hundred and eighty days from such commencement comply with the requirement of this rule, which may be extended by a further period of not more than ninety days with the approval of the Board based on reasonable justification.

Test Yourself:

Question: Whether the Capital asset created / acquired post 22nd January 2021 be held by the company or entities referred to in rule 7(4) of CSR Rules?

Answer: Post 22nd January 2021, the capital asset created / acquired out of CSR spending is required to be held by the entities referred to in rule 7(4) of CSR Rules.

Question: While undertaking CSR expenditure if an asset is being created, is it necessary for the company to route the funds through specified entities under rule 7(4) of CSR Rules or the company can spend it directly?

Answer: According to rule 7(4) of the CSR Rules, the CSR amount may be spent by a company for creation or acquisition of a capital asset, which shall be held by entities specified in said rule.

ON-GOING PROJECT

On-going project is defined in rule 2(i) of CSR Rules as under:

"Ongoing Project" means a multi-year project undertaken by a company in fulfillment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the Board based on reasonable justification."

If the Board has approved a project and subsequently Board realizes that the project and spending is going to extend to next financial year, the same project again is required to be approved by the Board as a multi-year/ on-going project with some reasonable justification.

As per rule 5(2) of CSR Rules, the CSR Committee shall formulate an annual action plan, under which it needs to include the modalities of utilisation of funds and implementation schedules for the projects or programs. Hence, in case of ongoing projects, the timelines of CSR spending and any tentative carry forward of CSR spending in a particular financial year must also be incorporated in annual action plan and should be approved.

Further as per rule 4(6) of CSR Rules, in case of ongoing project, the Board of a company shall monitor the implementation of the project with reference to the approved timelines and year-wise allocation and shall be competent to make modifications, if any, for smooth implementation of the project within the overall permissible time period.

Test Yourself:

Question: Timeline for a multi year project cannot exceed 3 years excluding the financial year in which it was commenced. So does it mean that the project can stretch to maximum total of 4 years?

Answer: A CSR project can be for more than 4 years also, but spending obligation in respect of the project for a particular year can be spread over only for 1+ 3 years.

Question: If obligation of the company to spend on CSR under section 135(5) of the Act is Rs.1 crore for the year 2020-21, whether the company could be said to have discharged its obligations with respect to the following cases involving ongoing projects:

Case A:

- Amount allocated for the project : Rs. 1 crore
- Amount spent in the current financial Year : Nil
- Amount transferred to Unspent CSR Account for the project as per section 135(6) : Rs. 1 crore

Case B:

- Amount allocated for the project : Rs. 1 crore
- Amount spent in the current financial year: Rs. 20 lakh
- Amount transferred to Unspent CSR Account for the project as per section 135(6) : 80 lakh

Answer: If Board has approved it as an on-going project based on reasonable justification and if the project has commenced during the financial year, it can be said that the company has discharged its CSR obligations.

CSR Monitoring

Monitoring of CSR projects goes concurrently with implementation and it is an integral part of the CSR activity. Monitoring is essential to assess if the progress is on expected lines in terms of timelines, budgetary expenditure and achievement of milestones. In terms of rule 4(5) of CSR Rules, the Board of a company shall satisfy itself

that the funds so disbursed by it for carrying out CSR implementation have been utilised for the purposes and in the manner as approved by it. The CSR Committee and the Board should be apprised periodically of the progress of all CSR activities undertaken.

Periodic progress report on CSR activities of the company should be placed before the CSR committee and the Board. On the basis of such reports, the CSR committee and / or the Board may recommend appropriate actions for course corrections, if need be.

To ensure that the funds are utilized prudently for the intended purpose, the company should place appropriate checks on the utilization of funds. The funds should be released in a phased manner, upon full satisfaction of the utilization of funds previously given.

Spending mandate and consequences of not spending (Change in CSR regime from Voluntary to Mandatory)

Second proviso to section 135 (5), read with section 135(6), elaborates the mandatory spending requirement:

- If the company fails to spend the CSR target, the Board in its report shall specify the reasons for not spending the amount.
- Analysis of the "unspent amount" related to ongoing project:
  - ✓ Unspent amount relating to an ongoing project, undertaken by a company in pursuance of its Corporate Social Responsibility Policy, shall be transferred by the company within a period of 30 days from the end of the financial year to a special account (Unspent CSR Account) to be opened by the company in that behalf for that financial year in any scheduled bank, and such amount shall be spent by the company in pursuance of its obligation towards the Corporate Social Responsibility Policy within a period of 3 financial years from the date of such transfer.
  - ✓ failing which, the company shall transfer the same to a Fund specified in Schedule VII of the Companies Act, 2013, within a period of thirty days from the date of completion of the third financial year.

Test Yourself:

Question: ABC Private Ltd. did not spend as per the provisions of section 135(5) of the Act on the CSR activities by 31st March, 2021 pursuant to the ongoing project undertaken in pursuance of its CSR Policy. In this case ABC Private Ltd. should:

- Open a bank account with any scheduled bank under the name, "Unspent Corporate Social Responsibility Account for financial year 2020-21";
- Transfer the unspent amount within thirty days i.e. by 30th April, 2021 to such account; and
- Spend such amount, in pursuance of its obligations towards the CSR Policy, latest by 31st March, 2024.

Answer: In the above example, if ABC Private Ltd. fails to spend the amount as was transferred to the special bank account opened for this purpose by end of 31st March, 2024, then the company needs to transfer such unspent amount to a fund specified in Schedule VII to the Act within 30 days i.e. latest by 30th April, 2024.

Question: Can a company use some currently unused existing bank A/c, which might have been lying idle with company, for making the transfer of unspent CSR amount?

Answer: No, section 135(6) of the Act says, ".... special account to be opened by the company in that behalf for that financial year...". Hence, a new bank account titled as "Unspent CSR Account" should be opened for transferring the unspent CSR amount.

- Unspent amount not relating to ongoing projects to be transferred to Funds notified in Schedule VII of the Companies Act, 2013 within a period of 6 months of the end of the financial year.

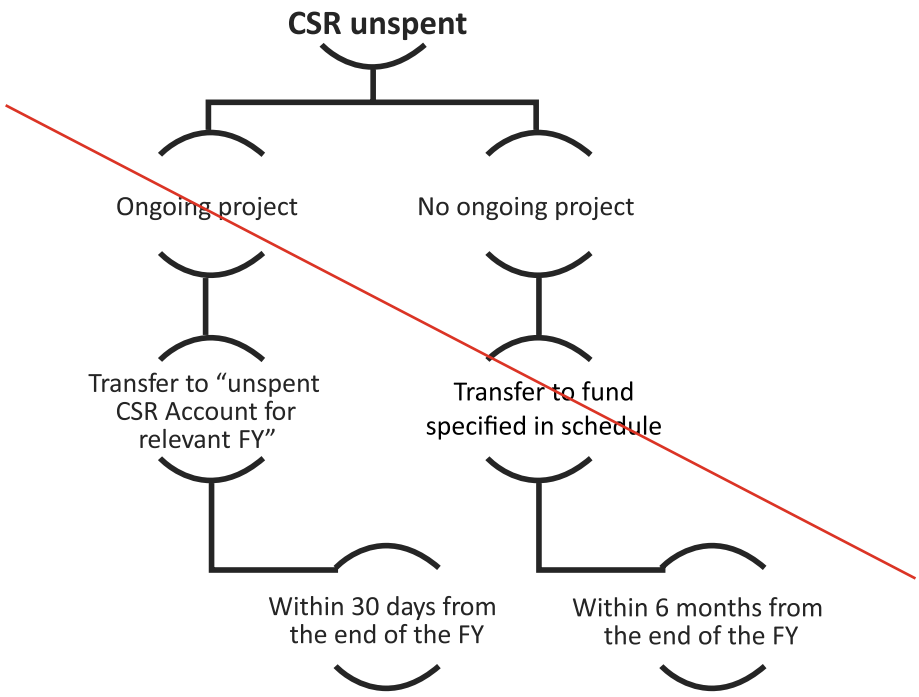


Illustration:

The net profit, calculated as per section 198 of the Act read with rule 2(h) of CSR Rules, of ABC Private Ltd. for the financial year 2019-20 is more than Rs. 5 crore and it fails to spend requisite CSR amount by 31st March, 2021 as mandated under section 135(5) of the Act. In this case, ABC Private Ltd. needs to do the following:

1. Specify the reasons for not spending the amount in the Board's Report; and
2. Transfer the unspent amount to a fund specified in Schedule VII to the Act, unless such amount relates to any ongoing project referred to in section 135(6) of the Act, by the end of 30th September, 2021.

Transfer of unspent CSR amount- Until a fund is specified in Schedule VII for the purposes of sub-section (5) and (6) of section 135 of the Companies Act, 2013 the unspent CSR amount, if any, shall be transferred by the company to any fund included in schedule VII of the Companies Act, 2013 *[Rule 10 of CSR Rules, 2014 as Inserted by The Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021 Dated 22.01.2021]*.

- Expenditure incurred on specified activities that are carried out in India only will qualify as CSR expenditure. Such expenditure includes contribution to the corpus or on projects or programs relating to CSR activities.
- Any expenditure on an item not in conformity or not in line with activities which fall within the areas or subjects, specified in Schedule VII of the Act shall not be permissible.

PENALTY

CSR Amendments- from 'comply or explain' to 'comply or suffer' to 'comply or pay'

- Earlier CSR provisions was following **"comply or explain"** approach-If a company did not comply, it only had to mention the reasons for non-compliance in their Board Report.
- Since there were serious compliance gaps, the Companies (Amendment) Act 2019 introduced Penalty for Non-Compliance of Section 135(5) & (6) that included imprisonment, and hence, the approach shifted to **"comply or pay fine",** but it was not notified.
- However, it is again amended by subsequent amendments brought in by the Companies (Amendment) Act, 2020 which in view of Decriminalisation and Ease of Doing Business, has removed the prosecution provision.
- The respective provision of the Companies (Amendment) Act, 2019 never came into force as both 2019 & 2020 Companies (Amendment) Act provision related to penal provisions of CSR came to force on the same day i.e. 22nd January, 2021.

Section 135(7) of the Companies Act, 2013, clearly states that, If a company is in default in complying with the provisions of Section 135(5) or 135(6) of the Companies Act, 2013:

Penalty on the Company:

- ✓ Upto twice the amount required to be transferred by the company to the Fund specified in Schedule VII or the Unspent Corporate Social Responsibility Account, as the case may be, or
- ✓ Rs. 1 Crore, whichever is less.

Penalty on every officer of the company who is in default

- ✓ 1/10th of the amount required to be transferred by the company to such Fund specified in Schedule VII of the Companies Act, 2013, or the Unspent Corporate Social Responsibility Account, as the case may be, or
- ✓ Rs.2 Lakhs, whichever is less.

The Central Government may give such general or special directions to a company or class of companies as it considers necessary to ensure compliance of provisions of this section and such company or class of companies shall comply with such directions.

1) Are the above mentioned penal provisions specific to not transferring the unspent amount or is applicable for any other non-compliance relating to CSR provisions?

Section 135 (7) clearly states the penalty for default in complying with the provisions of sub-section (5) or sub-section (6). In case of any other non-compliance/default under any other provision of the section, or Rules, then the provisions of general penalty under section 450 of the Act shall be applicable.

2) If a company has unspent amount Rs. 10 Lacs as on 31.03.2021, whether such amount will be transfer to said fund before 30.09.2021 or company may spend any amount (out of unspent amount) during the said six months after close of financial year and can transfer remaining unspent amount in Fund?

No. If, on or before the last day of the relevant FY falling on or after January 22, 2021 to which the

unspent amount relates, and the said unspent amount was not already allocated to an Ongoing Project already approved by the Board, then the Company cannot allocate or use such unspent amount for any other project and shall mandatorily transfer the same to the Fund specified in Schedule VII within the said 6 months from the end of the relevant FY.

3) If a company has unspent CSR amount for the financial years 2014-15, 2015-16, 2016-17, 2017-18,2018-19 and 2019-20, is the company required to transfer the entire unspent amount for the said years in the financial year ended 31st March, 2021?

Section 135 of Companies Act, 2013 was amended w.e.f 22nd January 2021 by inserting a new sub-section (6) which states the treatment of unspent amount of CSR in case of on-going projects. The second proviso to Sub section (5) of section 135 was also amended w.e.f 22nd January 2021, which now states that if the Company fails to spend the amount prescribed in Section 135(5) and unless the unspent amount relates to any on-going project referred to in sub-section (6), the Company shall transfer such amount to a Fund specified in Schedule VII, within a period of 6 months of the expiry of the financial year.

The applicability of this amendment is prospective and therefore the unspent amount for the financial year 2020-21 onwards shall be transferred to the fund specified in Schedule VII within six months of the expiry of the said financial year, unless the same pertains to any ongoing project.

However, if the Company has created a provision for unspent CSR obligation for the financial years 2014-15, 2015,-16, 2016- 17, 2017-18, 2018-19 and 2019-20, and if such provision remains outstanding as on 31st March, 2021, such amount should be transferred to separate bank account or Fund specified in Schedule VII, as the case may be.

4) If a company plans to spend 2.5% of its average net profits but out of this 0.5% remains unspent, will the penal provisions and requirement for transfer of unspent amount apply to the Company over and above the mandatory 2% spend?

In terms of the provisions of section 135 of the Act, the penal provision under sub-section 7 and requirement for transfer of unspent amount under sub-section (5) & (6) shall not be applicable on non-mandatory CSR expenditure.

5) In case, the registration of trust is not mandatory, then what would be constituted as 'Registered trust' or 'Registered public trust'?

'Registered Trust' or 'registered public trust' (as referred in Rule 4(1) of the Companies (CSR) Rules, 2014) would include Trusts registered under Income Tax Act 1961, for those States where registration of Trust is not mandatory. [General Circular No. 21/2014 dated 18th June, 2014].

6) Can the Board, for sufficient cause and reasons, change the ongoing project completely within 3 years' of time? E.g. If the Board approved a project of Rs. 80 lacs for Rain water harvesting for 3 years but after 2 years, the Company which has already spent Rs. 40 lacs on Rain water harvesting is not satisfied with the outcome. Can the Board divert the remaining funds of Rs. 40 Lacs to different project say related to Health and Medical for remaining one year?

As per the amended Rules, the Board shall be competent to make modifications, if any, for smooth implementation of the project within the prescribed time period. The Board may alter such plan at any time during the financial year, as per the recommendation of its CSR Committee, based on the reasonable justification to that effect, change the ongoing project partially or wholly. However, changing the allocation completely would not be viable.

CASE LAW

27.09.2022	***Adjudication order passed in respect of M/s Comviva Technologies Limited***	***Registrar of Companies, New Delhi (No.ROC/D/ADJ.order/Section135/ Comviva/5707-5710)***

Non-compliance of CSR Provisions will attract penalty under section 135 of the Companies Act 2013.

Facts of the Case:

M/s Comviva Technologies Limited was incorporated in 1999 having its registered office in Haryana. The company is engaged in business of courier services nationally and as well internationally. During the financial year 2020-21, the company was required to spent a total amount of Rs. 2,88,65,811/- towards the CSR activities. However, the company has spent only Rs. 2,83,15,689/- thereby leaving a balance of an unspent amount of Rs. 5,50,122/-. During the end of the financial 2020-2021, the company was required to transfer the unspent amount of Rs. 5,50,122/- to the fund specified in schedule VII of the Companies Act 2013, as per the provisions of section 135 (5) of the Companies Act 2013 read with Rule 10 of the Companies (Corporate Social Responsibility Policy) Rules 2014.

The company, accordingly transferred the unspent amount of Rs. 5,50,122/- to PM Relief Fund on 22nd April 2021. However due to some technical error, the said amount came back into the company's bank account on the same day and the same remained unnoticed by the company officials. However, the default was made good by the company and its officers by depositing the said unspent amount to the Prime Minister's National Relief Fund on 30th March 2022.The company admitted its non compliance towards section 135(5) of the Companies Act 2013 by filing an application with the Registrar of Companies on 26th of July, 2022.

The Registrar of Companies issues a show cause notice to the company and its officers on 7th September 2022 directing the company to provide the requisite information on this matter. The company in response to the show cause notice issued by the Registrar submitted all the required details and also admitted the non-compliance of section 135(5) of the Companies Act 2013 on 16th September 2022.

The Registrar of Companies concluded that the company, its directors and officers have made the default in complying with the provisions of section 135(5) of the Companies Act 2013, by not transferring the unspent CSR amount to a fund specified in schedule VII of the Companies Act 2013, within a period of 6 months from the expiry of the financial year and therefore, are liable for penalties under section 135(7) of the Companies Act 2013.

Decision: The Registrar of Companies has imposed a total penalty of Rs. 15, 40,341.60 on the company and its directors / officers in default for violation of section 135(5) of the Companies Act 2013 read with Rule 10 of the Companies (Corporate Social Responsibility Policy) Rules 2014. Penalty of Rs. 55,012.20 was imposed on each of the directors, MD, CFO and CS. Whereas the penalty of Rs. 11, 00,244.00/- was imposed on the company. The company and the directors were ordered to make the penalty payment through online by using the website www.mca.gov.in (Misc. head) in favour of "Pay and Accounts Officer," Ministry of Corporate Affairs, New Delhi, payable at Delhi, within 90 days from the receipt of this order and also intimate to the officer of Registrar of Companies with proof of penalty paid.

CSR Reporting (Rule 8 of CSR Rules, 2014]

Preparation of CSR Report

It is mandatory to include an Annual Report on CSR in the prescribed format, in the Board's report of the Company. The report containing the details of CSR Activities undertaken by the company and contents of CSR policy shall be made available on Company's website.

Directors Report:

The Company shall annex with its Board Report an annual report on CSR containing particulars specified in Annexure I (for F.Y. Commenced prior to 1st day of April, 2020) or Annexure II (w.e.f. F.Y. Commencing on or after 1st day of April, 2020), as applicable.

CASE LAW

In re Chettinad Earth Movers (P.) Ltd. CA NO. 1096/CB/2018 NCLT Chennai, in report of Board of Directors, applicants company and its two directors failed to disclose details about policy developed for implementation with respect to corporate social responsibility. Applicants contended that offence in question was not intentional and further, it was not prejudicial to interest of shareholders or creditors. They also filed E-form GNL-1 before Deputy Registrar of Companies. Deputy Registrar forwarded report stating that it was first offence by applicants and no prosecution was pending against applicants. The Hon'ble court held that instant application for compounding of offence was to be allowed and offence was to be compounded by imposing a fine on company and its two directors.

In case of a Foreign Company:

The Balance sheet filed u/s 381(1) (b) of the Companies Act, 2013 shall contain 'an annual report on CSR containing particulars specified in Annexure I (for F.Y. Commenced prior to 1st day of April, 2020) or Annexure II (w.e.f. F.Y. Commencing on or after 1st day of April, 2020), as applicable.

Question: Whether projects approved by Board as per annual action plan but spending on which yet to done, are required to be disclosed on website of the company?

Answer: Yes, CSR projects approved by the Board (as part of annual action plan or otherwise) need to be hosted on the website irrespective of spending has been done or not.

Question: Whether the projects approved by Board for financial year 2020-21 also need to be hosted on website?

Answer: The requirement of hosting CSR projects on website is prescribed under amended rule 9 effective from 22nd January, 2021. Hence, CSR projects approved by the Board for financial year 2020-21 also need to be hosted on website, irrespective of whether spending has been done or not.

IMPACT ASSESSMENT FOR BIG CSR PROJECTS IN TERMS OF THE PROVISIONS OF RULE 8(3)A) OF THE COMPANIES (CORPORATE SOCIAL RESPONSIBILITY POLICY) RULES, 2014

- Companies with average CSR obligation of Rs.10 Crore or more in the 3 immediately preceding financial years shall undertake impact assessment through an independent agency of their CSR projects having outlays of Rs.1 crore rupees or more which have been completed not less than 1 year before undertaking the impact study.
- The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR.

Test Yourself:

Question: Is it mandatory for foreign company to give report on CSR activities even if there is no need to prepare director's report by such company?

Answer: Rule 8(2) of CSR Rules provides that in case of a foreign company, the balance sheet filed by it under section 381(1)(b) of the Act, shall contain an annual report on CSR containing particulars specified in Annexure I or Annexure II, as applicable.

- A Company undertaking impact assessment may book the expenditure towards Corporate Social Responsibility for that financial year, which shall not exceed two per cent of the total CSR expenditure for that financial year or fifty lakh rupees, whichever is higher.

This is a new requirement inserted under the CSR Rules, based on the recommendation of the HLC 2018. It may be noted that the HLC 2018 (A high level committee set up by MCA in 2018) had recommeded for need and impact assessment for CSR projects. These two are different concepts, as 'need assessment' is an activity which is preparatory to starting any CSR project, whereas 'impact assessment' is an activity which can be done only post completion of CSR projects. However, rule 8(3) of CSR Rules speaks only about the need for an 'impact assessment', whereas rule 5(2) of CSR Rules which requires a company to prepare an annual action plan says that one of the contents of annual action plan shall be 'details of need and impact assessment, if any, for the projects undertaken by the company'. Hence, though impact assessment is mandatory in case of certain companies and for certain projects, it is recommended to carry out a need assessment also, although it is not mandatorily prescribed.

Test Yourself:

Question: Whether impact assessment is mandatory for all projects to be undertaken from financial year 2021-22 onwards?

Answer: It is required to have impact assessment by the specified companies for the projects mentioned in rule 8(3)(a) of the CSR Rules which have completed on or after 22nd January, 2021.

Question: Who can conduct the impact assessment?

Answer: There are no qualifications or criteria prescribed as to who can conduct the impact assessment. However, it is advisable that the impact assessment should be done by an independent entity not related to Implementing Agency or the company.

Question: Whether impact assessment needs to be done every year?

Answer: Impact assessment is to be undertaken for a project which have spends beyond the threshold of Rs.1 crore. Hence it is to be done project wise and not financial year wise. The timeline of impact assessment may vary from project to project. For some projects, assessment after one year of completion may be sufficient and for some projects, the impact assessment may be appropriate after a period longer than one year. The only requirement is that the impact assessment report needs to be placed before the Board and shall be annexed to the annual report on CSR.

Question: If a company has obligation of spending Rs. 10 crore or more in three immediately preceding financial years, but company has spent partial amount only (whose average is less than Rs. 10 crore) or if company has not spent at all, whether impact assessment still needs to be done?

Test Yourself:

If the company has an obligation of spending as per rule 8(3) of CSR Rules, or if none of the projects where it has spent have outlays of Rs. 1 crore or more and have completed at least 1 year, impact assessment is not necessary. Further, if company has not spent at all, there is no question of impact assessment.

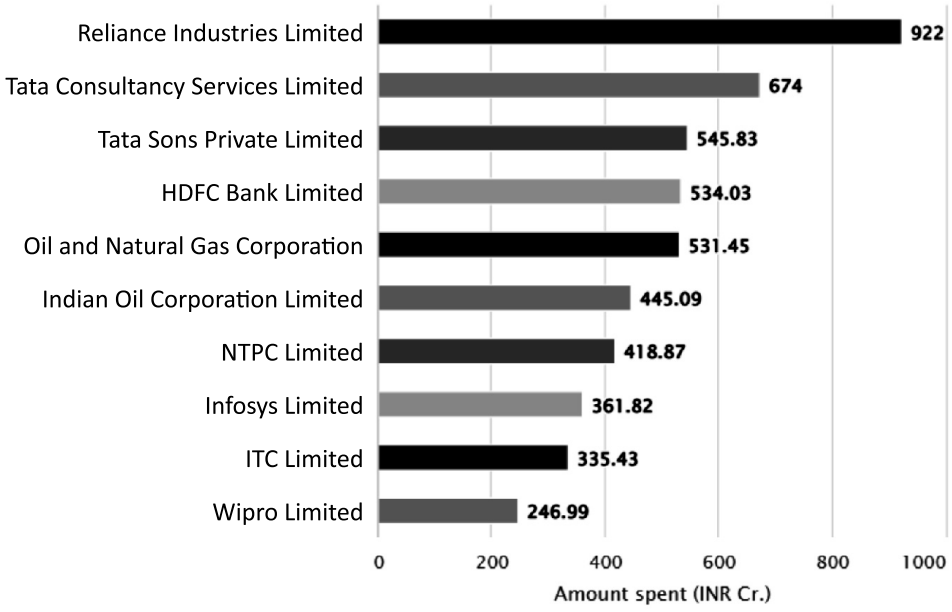
Website Disclosure (Rule 9 of the CSR Rules, 2014)

The Board of every eligible company referred to in sub-section (1) of Section 135 shall, after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any and ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

The Board of Directors of the Company shall ensure essential disclosure of the following on the website of the Company, if any:

- The composition of the CSR Committee;
- CSR Policy and Projects approved by the Board.

CSR Spent: Top Companies (2020-21)



Source: https://www.csr.gov.in/content/csr/global/master/home/home.html

~~Do You Know ?~~

~~Snow Ltd. is a closely held public company in the manufacturing sector. The company's net worth is Rs.250 crore as on 31st March, 2015. The turnover of the company for the year 2019-20 is Rs.750 crore. The profits earned by the company during the last five years are as under :~~

~~*Year*~~	~~*Profit (Rs. in crore)*~~
~~2019-20~~	~~7.50~~
~~2018-19~~	~~6.00~~
~~2017-18~~	~~4.50~~
~~2016-17~~	~~3.60~~
~~2015-16~~	~~3.00~~

~~The company has spent Rs.14 lakh during the year 2019-20 in an approved Corporate Social Responsibility (CSR) project for the benefit of weaker sections of the society. Examine whether the company is mandatorily required to comply with the CSR initiative and whether the action of the company is in adherence to the relevant provisions of the Companies Act, 2013 ?~~

~~Tax Benefit under CSR~~

~~No specific tax exemptions have been extended to CSR expenditure *per se*. The Finance Act, 2014 also clarifies that expenditure on CSR does not form part of business expenditure. While no specific tax exemption has been extended to expenditure incurred on CSR, spending on several activities like contributions to Prime Minister's Relief Fund, scientific research, rural development projects, skill development projects, agricultural extension projects, etc., which find place in Schedule VII, already enjoy exemptions under different sections of the Income Tax Act, 1961. *[General Circular No. 1/2016 dated 12th January, 2016]*.~~

Non Applicability of CSR provisions on specified companies

In case of Specified IFSC Public Company/Specified IFSC Private Company - Section 135 shall not apply for a period of five years from the commencement of business of a Specified IFSC public company/ Specified IFSC Private Company - *Notification Dated 4th January, 2017*.

CSR Portal

The National Corporate Social Responsibility Data Portal is an initiative by Ministry of Corporate Affairs, Government of India to establish a platform to disseminate Corporate Social Responsibility related data and information filed by the companies registered with it.

The CSR ambit is getting bigger and for upcoming years it would turn as a unique knowledge base for analyzing and achieving sustainability goals as among various large economies India is a country which has assured by mandating CSR through its legislative action.

The National CSR Awards

Ministry of Corporate Affairs, Government of India has instituted National Corporate Social Responsibility Awards to recognize companies that have made a positive impact on the society through their innovative & sustainable CSR initiatives.

The National CSR Awards seek to:

- Recognize the companies that have positively impacted both business and society by taking a strategic approach to CSR through collaborative program.
- Recognize the companies that are leading transformation by integrating sustainability in their core business model.
- Recognize companies for implementing measures for conservation and sustainable management of the biodiversity and ecosystem in the value chain.
- Identifying innovative approaches and employing application and technologies that will help to build a robust CSR programs to further the cause of inclusive and sustainable development.

This Award seeks to recognize the companies that have made a transformative impact on society. The NCSRA seeks to recognize outstanding projects in following three categories:

i) Four awards for excellence in CSR, based on CSR spend;

ii) Five awards for CSR projects in Aspirational Districts;

iii) Eleven awards for CSR projects in National Priority Areas.

Three separate awards are for micro, small and medium enterprises (MSMEs).

What are the Various other aspects that may be kept in mind while undertaking CSR?

(i) It should be noted that companies, while undertaking Corporate Social Responsibility activities under provision of the Companies Act, 2013, shall not contravene any other prevailing laws of the land including Cigarettes and Other Tobacco Products Act (COTPA), 2003. *[General Circular No. 05/2016 dated 16th May, 2016].*

(ii) Contribution and involvement of employees in CSR activities of the company will no doubt generate interest/ pride in CSR work and promote transformation from Corporate Social Responsibility (CSR) as an obligation to Socially Responsible Corporate (SRC) in all aspects of their functioning. Companies therefore, should be encouraged to involve their employees in CSR activities. However monetization of pro bono services of employees would not be counted towards CSR expenditure. *[General Circular No. 1/2016 dated 12th January, 2016].*

(iii) It is further clarified that CSR activities should be undertaken by the companies in project/ programme mode [as referred in Rule 4 (1) of Companies CSR Rules, 2014]. One-off events such as marathons/ awards/ charitable contribution/ advertisement/ sponsorships of TV Programmes etc. would not be qualified as part of CSR expenditure. *[General Circular No. 21/2014 18th June, 2014]*

(iv) Expenses incurred by companies for the fulfillment of any Act/ Statute of regulations (such as Labour Laws, Land Acquisition Act etc.) would not count as CSR expenditure under the Companies Act. *[General Circular No. 21/2014 18th June, 2014- also covered in rules].*

Business Responsibility Reports by Listed Companies

Ministry of Corporate Affairs, Government of India, in July 2011, came out with the 'National Voluntary Guidelines ("NVGs") on Social, Environmental and Economic Responsibilities of Business'. These guidelines contain comprehensive principles to be adopted by companies as part of their business practices and a structured business responsibility reporting format requiring certain specified disclosures, demonstrating the steps taken by companies to implement the said principles.

SEBI, in 2012, mandated the top 100 listed entities by market capitalisation to file BRR as per the disclosure requirement emanating from the NVGs. The requirement for filing BRRs was extended to the top 500 entities companies by market capitalisation from the financial year 2015-16. In December 2019, SEBI extended the BRR requirement to the top 1000 listed entities by market capitalisation, from the financial year 2019-20.

In terms of Regulation 34(2)(f) of SEBI's Listing Regulations, the top 1000 listed entities based on market capitalization (calculated as on March 31 of every financial year) are required to include Business Responsibility Report, as part of their annual report, describing the initiatives taken by them from an environmental, social and governance perspective, in the format as specified by the SEBI from time to time.

In November 2018, the MCA constituted a Committee on Business Responsibility Reporting ('Committee on BRR') for finalising Business Responsibility Reporting formats for listed and unlisted companies, based on the framework of the NGRBC. SEBI was also part of this Committee and worked on the report. The report of the Committee was released on 11th August, 2020. The Committee on BRR recommends that the Business Responsibility Report be called the Business Responsibility and Sustainability Report (BRSR).

Based on the report of the committee, SEBI issued a consultation paper on the format for BRSR on 18th August, 2020, wherein, it is proposed that the format for BRSR, as recommended by the Committee, shall be applicable to the top 1000 listed entities by market capitalization. It is also proposed that to begin with, the new format will be adopted by such listed entities on a voluntary basis for the financial year 2020 – 21 (for those who choose not to adopt the new format, the existing format will apply) and mandatorily from the financial year 2021-22. SEBI in its Board meeting held on 25th March, 2021 has mentioned that the BRSR shall be applicable to the top 1,000 listed entities by market capitalization on a voluntary basis from financial year 2021-22 and mandatory from financial year 2022-23.

Question: What is the impact of BRR reporting as far as CSR spends are concerned?

Answer: BRR expects the company to report impact assessment of CSR programs. Further it also requires the reporting on the steps taken by the company to ensure that the community development initiative is successfully adopted by the community.

Guidelines on CSR and Sustainability for Central Public Sector Enterprises (CPSEs)

The first guidelines on CSR were issued by Department of Public Enterprises (DPE) in April 2010 to make it mandatory for public sector enterprises to set aside a fixed percentage of their profits for CSR activities. Subsequently, DPE explored a new dimension of CSR as a form of responsible business to be adopted voluntarily by the companies. After extensive consultations with all key stakeholders, DPE issued revised guidelines on CSR and Sustainability, effective from 1st April 2013, which incorporated the global best practices but retained focus on the domestic socio- economic requirements of our country.

The thrust of DPE guidelines on CSR and Sustainability has been on inclusive growth, development of backward regions, upliftment of the marginalized and under privileged and weaker sections of the society, empowerment of women, environment sustainability, promotion of green and energy efficiency technologies and sustainability development in all its diverse aspects.

The Act makes it mandatory for companies which fulfil the specified criteria to spend at least 2% of their average net profits of three preceding financial years on CSR activities. Considering the CSR provisions under the Act and rules made there under, the DPE has issued revised Guidelines on Corporate Social Responsibility and Sustainability for CPSEs w.e.f. 01.04.2014.

Social Stock Exchange

India is the only country in the world to have mandatory provisions of CSR for the corporates. The Hon'ble Finance Minister as part of the Budget Speech for FY 2019-20 had proposed to initiate steps towards creating a Social Stock Exchange (SSE), under the regulatory ambit of Securities and Exchange Board of India, for listing social enterprise and voluntary organizations.

Accordingly, SEBI constituted a working group on 'Social Stock Exchanges' (SSE) under the Chairmanship of Shri Ishaat Hussain on September 19, 2019. The broad terms of reference to the working group were to review and recommend:

(i) Possible structures and mechanisms, within the securities market domain, to facilitate raising of funds by social enterprises and voluntary organizations;

(ii) Associated regulatory framework inter-alia covering the issues relating to eligibility norms for participation, disclosures, listing, trading, oversight etc.

The committee observed that the designing of Social Stock Exchange (SSE) also requires a recognition that for-profit social enterprises (FPEs) are different from non-profit social enterprises (NPOs) as they operate in different ways and have different financing needs. NPOs (which include section 8 companies, trusts and societies) and FPEs uses different kinds of capital. The working group has, therefore, suggested different approaches for each under the aegis of the SSE. The committee proposed unifying elements and common approaches for the two under the SSE umbrella. These constitute the common minimum reporting standard for all enterprises. The standard incorporates reporting of social impact, governance and financials.

While analysing the comments received on this report, it was felt that further expert advice and clarity may be needed on certain critical operational issues before comprehensively firming up views in the matter. Accordingly, a Technical Group (TG) was constituted by SEBI on September 21, 2020 to review and make recommendations on certain critical operational issue, in the context of the recommendations made by the Working Group on the Social Stock Exchange.

After detailed deliberations, the SEBI vide notification dated July 25, 2022 inserted Chapter X-A on Social Stock Exchange in SEBI (ICDR) Regulations, 2018.

As per regulation 292A (i) "Social Stock Exchange" means a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations and / or list the securities issued by Not for Profit Organizations in accordance with provisions of these regulations.

SPECIMEN RESOLUTIONS

Sample Board Resolution for Constitution of CSR Committee

"RESOLVED THAT pursuant to the provisions of Section 135 of the Companies Act, 2013, a Corporate Social Responsibility (CSR) Committee of the Board of Directors of the Company be and is hereby constituted comprising of the following members of the Board of Directors of the Company as members of CSR Committee:

1. Mr. ABC, Chairman
2. Mr. EFG, Member
3. Mr. HIJ, Member.

RESOLVED FURTHER THAT the terms of reference of CSR Committee shall, inter-alia, include the following:

a. To formulate and recommend to the Board, a CSR policy which shall indicate the activities to be undertaken by the Company as per the Companies Act, 2013;

b. To review and recommend the amount of expenditure to be incurred on the activities to be undertaken by the company;

c. To monitor the CSR policy of the Company from time to time; d. Any other matter as the CSR Committee may deem appropriate after approval of the Board of Directors or as may be directed by the Board of Directors from time to time.

RESOLVED FURTHER THAT the quorum for the CSR Committee Meeting shall be one-third of its total strength (any fraction contained in that one-third be rounded off as one) or two members, whichever is higher.

RESOLVED FURTHER THAT Company Secretary to the Company shall act as Secretary to the CSR Committee."

Sample Board Resolution to approve and adopt a new CSR Policy

"RESOLVED THAT pursuant to section 135 of the Companies Act, 2013 read with the Companies (Corporate Social Responsibility Policy) Rules, 2014 as amended from time to time and such other provisions as may be applicable and based on the recommendation of the CSR committee, the Board of Directors of the company do and hereby approve a new CSR Policy in suppression of the existing CSR Policy dated

..... in compliance with the requirements under Companies (Corporate Social Responsibility Policy) Amendment Rules, 2021.

RESOLVED FURTHER THAT the new CSR Policy be and is hereby approved and signed by Mr./Ms. ..... Director.

RESOLVED FURTHER THAT the Directors of the company be and are hereby authorized severally to take necessary steps to give effect to the above resolutions and do all such acts, deeds and things as may be required to ensure compliance of the CSR Policy including disseminating the contents of revised policy on the website of the company."

LESSON ROUND-UP

- As per section 135 of the Companies Act 2013, the CSR provision will be applicable companies which fulfills any of the following criteria during the immediately preceding financial year:-
  - Companies having net worth of rupees five hundred crore or more; or
  - Companies having turnover of rupees one thousand crore or more; or
  - Companies having a net profit of rupees five crore or more.
- The Board of every company shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. This amount will be CSR expenditure.
- It is mandatory for companies to disclose in Board's Report, an annual report on CSR.
- ~~Administrative overheads means the expenses incurred by the company for 'general management and administration' of Corporate Social Responsibility functions in the company but shall not include the expenses directly incurred for the designing, implementation, monitoring, and evaluation of a particular Corporate Social Responsibility project or programme.~~
- ~~Ongoing Project means a multi-year project undertaken by a Company in fulfilment of its CSR obligation having timelines not exceeding three years excluding the financial year in which it was commenced, and shall include such project that was initially not approved as a multi-year project but whose duration has been extended beyond one year by the board based on reasonable justification~~
- Rule 5 of CSR Rules, 2014 further state that, where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors.
- The Board of the Company shall be fully accountable and responsible for the execution and implementation of the CSR policy.

GLOSSARY

Registered Trust: As per section 3 of Indian Trust Act 1882 "A Trust is an obligation annexed to the ownership of the property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner".

A trust may either be a private trust or public trust.

As per section 5 of the Indian Trusts Act, a private Trust in relation to an immovable property must be created by a non-testamentary instrument in writing, signed by the author of the trust or the trustee and registered(under Section 17 of Indian Registration Act) . Thus, registration of a trust is necessary when it is declared by a non-testamentary instrument. This registration would still be required, even if the instrument declaring the trust is exempt from registration under the Indian Registration Act. In case of a Private Trust declared by a will, registration will not be necessary, even if it involves an immovable property. Registration will not be required, of a trust in relation to movable property. In case of Public Trust, whether in relation to movable property or an immovable property and whether created under a will or inter vivos, registration is optional but desirable.

Registered Society: A society registration can be done for the development of fine arts, science, or literature or else for diffusion of purposeful knowledge or charitable purposes of political education. According to section 20 of The Society Registration Act, 1860 a society registration can be done for following purposes:

- Promotion of fine arts
- Diffusion of political education
- Grant of charitable assistance
- Promotion of science and literature
- Creation of military orphan funds
- Maintenance or foundation of galleries or public museum
- Maintenance or foundation of reading rooms or libraries
- Promotion or diffusion or instruction of useful knowledge

Section 8 Company: A limited company can be incorporated under section 8 of Companies Act, 2013 with the following:

(a) It has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

(b) it intends to apply its profits, if any, or other income in promoting its objects; and

(c) it intends to prohibit the payment of any dividend to its members.

Importantly, these are incorporated with the object of promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object.

Net profit: For the purposes of section 135 of Companies Act, 2013 “net profit” shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198.

Further according to Rule 2(f) of the Companies (Corporate Social Responsibility Policy) Rules, 2014 “Net profit” means the net profit of a company as per its financial statement prepared in accordance with the applicable provisions of the Act, but shall not include the following, namely:-

(i) any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

(ii) any dividend received from other companies in India, which. Are covered under and complying with the provisions of section 135 of the Act:

Provided further that in case of a foreign company covered under these rules, net profit means the net profit of such company as per profit and loss account prepared in terms of clause (a) of sub-section (1) of section 381 read with section 198 of the Act.

HLC-2018 : A High Level Committee was constituted by the Ministry of Corporate Affairs (MCA) in 2018.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Is every company required to constitute CSR committee? Explain the role and function of CSR Committee constituted by the company.
2. ABC Ltd. Failed to contribute towards CSR despite falling under the category of section 135(1). Explain the consequences.
3. What are the means/channel a company can adopt to pursue its CSR activities?
4. Can the CSR expenditure be spent on the activities beyond Schedule VII?
5. In case of companies having multi-locational operations, which local area of operations should the company choose for spending the amount earmarked for CSR operations?
6. Whether resolution can be pass by Circulation resolution by CSR Committee?
7. Zeba Ltd. has a net worth of Rs. 400 crore, turnover for the financial year 2019-20 at Rs. 1,200 crore and a net profit for the financial year ended 31st March, 2020 at Rs. 25 crore. The company has asked you as a Company Secretary to prepare a check-list of compliances with respect to Corporate Social Responsibility (CSR) as per the provisions contained in the Companies Act, 2013. Also state the circumstances in which a company is required to constitute a CSR Committee?
8. Can CSR Funds to be utilized to fund Government Scheme?
9. If a Company plans to empanel an agency to execute its proposed CSR Project and finds an implementing agency which was enrolled on a website. The website host charges an amount of Rs. 1,00,000 as fee for providing the information regarding the implementing agency. Can the same be considered as administration expense towards CSR and be claimed under the 5% limit?
    (a) the expenditure shall not be treated as an administrative expense.
    (b) the expenditure shall be treated as an administrative expense.
    (c) Company is not eligible to empanel an agency to execute its proposed CSR Project.
    (d) the expenditure shall be treated as an administrative expense but with specified conditions.
10. Mars Traders Pvt Ltd. is incorporated as a small company. Whether it is required to set up a Corporate Social Responsibility Committee ?
    (a) As Mars Traders Pvt Ltd. is incorporated as small company, it does not meet the criteria specified in section 135 of the Companies Act, 2013 therefore not be required to constitute a Corporate Social Responsibility Committee.
    (b) As Mars Traders Pvt Ltd. is incorporated as small company, it meets the criteria specified in section 135 of the Companies Act, 2013 therefore it shall be required to constitute a Corporate Social Responsibility Committee.
    (c) As Mars Traders Pvt Ltd. is incorporated as small company with the permission of ROC may constitute Corporate Social Responsibility Committee.
    (d) As Mars Traders Pvt Ltd. is incorporated as small company with the permission of Regional Directors may constitute Corporate Social Responsibility Committee.

LIST OF FURTHER READINGS
• Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI • ICSI Premier on Company Law • Bare Act- Companies Act, 2013 • ICSI FAQ on CSR-April, 2021 • MCA FAQ on CSR - August, 2021 • ICSI Guidance note on CSR

OTHER REFERENCES (Including Websites/Video Links)
• https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ== • https://www.mca.gov.in/Ministry/pdf/FAQ_CSR.pdf

Annual Report - Concepts

Lesson 18

KEY CONCEPTS

■ Annual Report ■ Board's Report ■ Annual Return ■ Management Discussion and Analysis ■ Corporate Governance Report

Learning Objectives

To understand:

- Contents of Annual Report
- Contents of the Directors' Report whether mandated by law or adopted as a good corporate practice
- Various other disclosures required to be made to the shareholders
- Annual Return
- Abridged Board Report for OPC and small company

Lesson Outline

- Introduction
- Annual Report
- Board's Report
- Annual Return
- Secretarial Standard on Report of the Board of Directors
- Procedure for preparation of Board's Report
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013
- The Companies (Share Capital & Debenture Rules), 2014
- The Companies (Accounts) Rules, 2014
- The Companies (Meetings of Board & its Powers) Rules, 2014
- The Companies (Management & Administration) Rules, 2014
- The Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014
- The Companies (Incorporation) Rules, 2014
- SEBI (LODR) Regulations, 2015
- SEBI (Share Based Employee Benefits) Regulations, 2014
- Secretarial Standard (SS-4)- Secretarial Standard on Report of Board of Directors

INTRODUCTION

Transparency is a pivotal feature in the market based monitoring of companies and is central to shareholders' ability to exercise their ownership rights on an informed basis, which can help attract capital and maintain confidence in the capital markets.

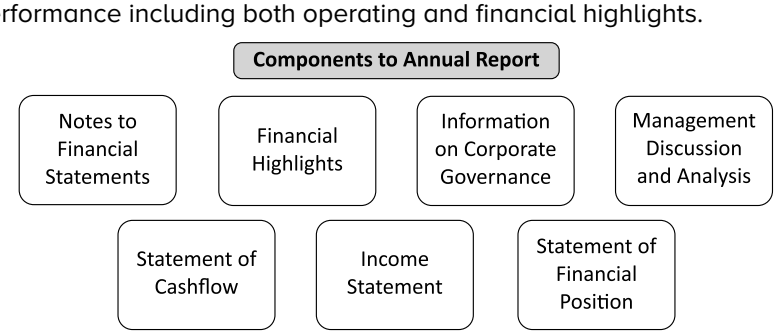
Adequate disclosure also helps improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the communities in which they operate. Disclosures are made both through the print media and the electronic media. Today corporates have to disclose mandatorily under various legislations such as: —

Disclosures by Board

- Disclosures under the Companies Act, 2013 and Rules made thereunder;
- SEBI (LODR) Regulations, 2015 and other regulations applicable for Listed Companies;
- Secretarial Standard on Board's Report-SS4 (Recommendatory);
- Disclosure under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 and rules made thereunder;
- Disclosures under other applicable Acts.

1. ANNUAL REPORT

The annual report is a comprehensive report provided by most public companies to disclose their corporate activities over the past year. The report is typically issued to shareholders and other stakeholders who use it to evaluate the firm's performance including both operating and financial highlights.



An annual report is interactive in nature to its shareholders. It generally starts with the board's message to shareholders in form of dedicated report. Their message intends to brief the shareholders about the key performance angles of the current year. It also demonstrates the growth prospects relative to its industry landscape in order to get shareholders' attention to the company's potential for excellence.

Annual reports also give an account of corporate activities, legal highlights and corporate governance arena. In addition, the management discussion and analysis report emphasizes management commentary on risks and concerns of the business.

Financial statements give financial details of the current year and the past year by showcasing year-on-year comparisons easier for a shareholder. In addition, the notes to financial statements describe the technical anomalies and assumptions taken in preparing the financial statements.

The annual report also present changes in accounting policies, financial disclosure, capital projects, and other information/disclosures relevant to shareholders.

As per Regulation 34 of the SEBI (LODR), Regulations, 2015, the listed entity shall submit to the stock exchange and publish on its website-

(a) A copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders;

(b) In the event of any changes to the annual report, the revised copy along with the details of and explanation for the changes shall be sent not later than 48 hours after the annual general meeting.

Such annual report shall contain the following:

(a) Audited financial statements i.e. balance sheet, profit and loss account etc, and Statement on Impact of Audit Qualifications as stipulated in regulation 33(3)(d), if applicable;

(b) Consolidated financial statements audited by its statutory auditors;

(c) Cash flow statement presented only under the indirect method as prescribed in Accounting Standard-3 or Indian Accounting Standard 7, as applicable, specified in Section 133 of the Companies Act, 2013 read with relevant rules framed thereunder or as specified by the Institute of Chartered Accountants of India, whichever is applicable;

(d) Directors Report;

(e) Management discussion and analysis report - either as a part of directors report or addition thereto;

(f) For the top one thousand listed entities based on market capitalization, a business responsibility report describing the initiatives taken by the listed entity from an environmental, social and governance perspective, in the format as specified by the Board from time to time.

The requirement of submitting a business responsibility report shall be discontinued after the financial year 2021–22 and thereafter, **with effect from the financial year 2022–23, the top one thousand listed entities based on market capitalization shall submit a business responsibility and sustainability report in the format as specified by the Board from time to time.**

Further that even during the financial year 2021–22, the top one thousand listed entities may voluntarily submit a business responsibility and sustainability report in place of the mandatory business responsibility report.

Also, the remaining listed entities including the entities which have listed their specified securities on the SME Exchange, may voluntarily submit such reports.

Explanation: For the purpose of this clause, market capitalization shall be calculated as on the 31st day of March of every financial year.

Further it is provided that the annual report shall contain any other disclosures specified in Companies Act, 2013 along with other requirements as specified in Schedule V of SEBI (LODR) Regulations, 2015.

As per SEBI (LODR) Regulations, 2015, the annual report shall contain the following additional disclosures:

A. Related Party Disclosure

1. The listed entity which has listed its non-convertible securities shall make disclosures in compliance with the Accounting Standard on "Related Party Disclosures".

2. The disclosure requirements shall be as follows:

Sr.	*In the accounts of*	*Disclosures of amounts at the year end and the maximum amount of loans/ advances/ Investments outstanding during the year.*
1	Holding Company	• Loans and advances in the nature of loans to subsidiaries by name and amount. • Loans and advances in the nature of loans to associates by name and amount. • Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount.
2	Subsidiary	Same disclosures as applicable to the parent company in the accounts of subsidiary company.
3	Holding Company	Investments by the loanee in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan.

For the purpose of above disclosures directors' interest shall have the same meaning as given in Section 184 of Companies Act, 2013.

2A. Disclosures of transactions of the listed entity with any person or entity belonging to the promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.

3. The above disclosures shall not be applicable to listed banks.

B. Management Discussion and Analysis

1. This section shall include discussion on the following matters within the limits set by the listed entity's competitive position:

   (a) Industry structure and developments;

   (b) Opportunities and Threats;

   (c) Segment–wise or product-wise performance;

   (d) Outlook;

   (e) Risks and concerns;

   (f) Internal control systems and their adequacy;

   (g) Discussion on financial performance with respect to operational performance;

   (h) Material developments in Human Resources / Industrial Relations front, including number of people employed;

   (i) Details of significant changes (i.e. change of 25% or more as compared to the immediately previous financial year) in key financial ratios, along with detailed explanations therefor, including:

      (i) Debtors Turnover

      (ii) Inventory Turnover

      (iii) Interest Coverage Ratio

      (iv) Current Ratio

      (v) Debt Equity Ratio

      (vi) Operating Profit Margin (%)

      (vii) Net Profit Margin (%)

      or sector-specific equivalent ratios, as applicable.

   (j) Details of any change in Return on Net Worth as compared to the immediately previous financial year along with a detailed explanation thereof.

2. Disclosure of Accounting Treatment:

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction.

C. Corporate Governance Report

The following disclosures shall be made in the section on the corporate governance of the annual report.

(1) A brief statement on listed entity's philosophy on code of governance.

(2) Board of Directors:

   (a) composition and category of directors (e.g. promoter, executive, non-executive, independent non- executive, nominee director - institution represented and whether as lender or as equity investor);

(b) attendance of each director at the meeting of the board of directors and the last annual general meeting;

(c) number of other board of directors or committees in which a directors is a member or chairperson, and with effect from the Annual Report for the year ended 31st March 2019, including separately the names of the listed entities where the person is a director and the category of directorship;

(d) number of meetings of the board of directors held and dates on which held;

(e) disclosure of relationships between directors *inter-se*;

(f) number of shares and convertible instruments held by non- executive directors;

(g) web link where details of familiarisation programmes imparted to independent directors is disclosed;

(h) A chart or a matrix setting out the skills/expertise/competence of the board of directors specifying the following:

(i) With effect from the financial year ending March 31, 2019, the list of core skills/expertise/ competencies identified by the board of directors as required in the context of its business(es) and sector(s) for it to function effectively and those actually available with the board; and

(ii) With effect from the financial year ended March 31, 2020, the names of directors who have such skills / expertise/ competence.

(i) confirmation that in the opinion of the board, the independent directors fulfill the conditions specified in these regulations and are independent of the management;

(j) detailed reasons for the resignation of an independent director who resigns before the expiry of his/ her tenure along with a confirmation by such director that there are no other material reasons other than those provided.

(3) Audit Committee:

(a) brief description of terms of reference;

(b) composition, name of members and chairperson;

(c) meetings and attendance during the year.

(4) Nomination and Remuneration Committee:

(a) brief description of terms of reference;

(b) composition, name of members and chairperson;

(c) meeting and attendance during the year;

(d) performance evaluation criteria for independent directors.

(5) Stakeholders' Relationship Committee:

(a) name of the non-executive director heading the committee;

(b) name and designation of the compliance officer;

(c) number of shareholders' complaints received during the financial year;

(d) number of complaints not solved to the satisfaction of shareholders;

(e) number of pending complaints.

(5A) Risk Management Committee:

(a) brief description of terms of reference;

(b) composition, name of members and chairperson;

(c) meetings and attendance during the year;

(6) Remuneration of Directors:

(a) all pecuniary relationship or transactions of the non-executive directors *vis-a-vis* the listed entity shall be disclosed in the annual report;

(b) criteria of making payments to non-executive directors. Alternatively, this may be disseminated on the listed entity's website and reference drawn thereto in the annual report;

(c) disclosures with respect to remuneration: in addition to disclosures required under the Companies Act, 2013, the following disclosures shall be made:

(i) all elements of remuneration package of individual directors summarized under major groups, such as salary, benefits, bonuses, stock options, pension etc;

(ii) details of fixed component and performance linked incentives, along with the performance criteria;

(iii) service contracts, notice period, severance fees;

(iv) stock option details, if any and whether issued at a discount as well as the period over which accrued and over which exercisable.

(7) General body meetings:

(a) location and time, where last three annual general meetings held;

(b) whether any special resolutions passed in the previous three annual general meetings;

(c) whether any special resolution passed last year through postal ballot – details of voting pattern;

(d) person who conducted the postal ballot exercise;

(e) whether any special resolution is proposed to be conducted through postal ballot;

(f) procedure for postal ballot.

(8) Means of communication:

(a) quarterly results;

(b) newspapers wherein results normally published;

(c) any website, where displayed;

(d) whether it also displays official news releases; and

(e) presentations made to institutional investors or to the analysts.

(9) General shareholder information:

(a) annual general meeting - date, time and venue;

(b) financial year;

(c) dividend payment date;

(d) the name and address of each stock exchange(s) at which the listed entity's securities are listed and a confirmation about payment of annual listing fee to each of such stock exchange(s);

(e) stock code;

(f) market price data- high, low during each month in last financial year;

(g) performance in comparison to broad-based indices such as BSE Sensex, CRISIL Index etc;

(h) in case the securities are suspended from trading, the directors report shall explain the reason thereof;

(i) registrar to an issue and share transfer agents;

(j) share transfer system;

(k) distribution of shareholding;

(l) dematerialization of shares and liquidity;

(m) outstanding Global Depository Receipts or American Depository Receipts or warrants or any convertible instruments, conversion date and likely impact on equity;

(n) commodity price risk or foreign exchange risk and hedging activities;

(o) plant locations;

(p) address for correspondence;

(q) list of all credit ratings obtained by the entity along with any revisions thereto during the relevant financial year, for all debt instruments of such entity or any fixed deposit programme or any scheme or proposal of the listed entity involving mobilization of funds, whether in India or abroad.

(10) Other Disclosures:

(a) disclosures on materially significant related party transactions that may have potential conflict with the interests of listed entity at large;

(b) details of non-compliance by the listed entity, penalties, strictures imposed on the listed entity by stock exchange(s) or the board or any statutory authority, on any matter related to capital markets, during the last three years;

(c) details of establishment of vigil mechanism/ whistle blower policy, and affirmation that no personnel has been denied access to the audit committee;

(d) details of compliance with mandatory requirements and adoption of the non-mandatory requirements;

(e) web link where policy for determining 'material' subsidiaries is disclosed;

(f) web link where policy on dealing with related party transactions;

(g) disclosure of commodity price risks and commodity hedging activities;

(h) details of utilization of funds raised through preferential allotment or qualified institutions placement as specified under Regulation 32 (7A);

(i) a certificate from a Company Secretary in practice that none of the directors on the board of the company have been debarred or disqualified from being appointed or continuing as directors of companies by the Board/Ministry of Corporate Affairs or any such statutory authority;

(j) where the board had not accepted any recommendation of any committee of the board which is mandatorily required, in the relevant financial year, the same to be disclosed along with reasons thereof: Provided that the clause shall only apply where recommendation of / submission by the committee is required for the approval of the Board of Directors and shall not apply where prior approval of the relevant committee is required for undertaking any transaction under these Regulations;

(k) total fees for all services paid by the listed entity and its subsidiaries, on a consolidated basis, to the statutory auditor and all entities in the network firm/network entity of which the statutory auditor is a part;

(l) disclosures in relation to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013:

(a) number of complaints filed during the financial year

(b) number of complaints disposed of during the financial year

(c) number of complaints pending as on end of the financial year

(m) disclosure by listed entity and its subsidiaries of 'Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount'. Provided that this requirement shall be applicable to all listed entities except for listed banks.

(11) Non-compliance of any requirement of corporate governance report of sub-paras (2) to (10) above, with reasons thereof shall be disclosed.

(12) The corporate governance report shall also disclose the extent to which the discretionary requirements as specified in Part E of Schedule II have been adopted.

(13) The disclosures of the compliance with corporate governance requirements specified in regulation 17 to 27 and clauses (b) to (i) of sub-regulation (2) of regulation 46 shall be made in the section on corporate governance of the annual report.

D. Declaration signed by the chief executive officer stating that the members of Board of Directors and senior management personnel have affirmed compliance with the code of conduct of board of directors and senior management.

E. Compliance certificate from either the auditors or practicing Company Secretaries regarding compliance of conditions of corporate governance shall be annexed with the directors' report.

F. Disclosures with respect to demat suspense account/ unclaimed suspense account

The listed entity shall disclose the following details in its annual report, as long as there are shares in the demat suspense account or unclaimed suspense account, as applicable :

(a) aggregate number of shareholders and the outstanding shares in the suspense account lying at the beginning of the year;

(b) number of shareholders who approached listed entity for transfer of shares from suspense account during the year;

(c) number of shareholders to whom shares were transferred from suspense account during the year;

(d) aggregate number of shareholders and the outstanding shares in the suspense account lying at the end of the year;

(e) that the voting rights on these shares shall remain frozen till the rightful owner of such shares claims the shares.

Statement of deviation(s) or variation(s)

As per Regulation 32 of SEBI(LODR) Regulations, 2015, The listed entity shall submit to the stock exchange the following statement(s) on a quarterly basis for public issue, rights issue, preferential issue etc:

(a) indicating deviations, if any, in the use of proceeds from the objects stated in the offer document or explanatory statement to the notice for the general meeting, as applicable;

(b) indicating category wise variation (capital expenditure, sales and marketing, working capital etc.) between projected utilisation of funds made by it in its offer document or explanatory statement to the notice for the general meeting, as applicable and the actual utilisation of funds.

The statement(s) shall be continued to be given till such time the issue proceeds have been fully utilised or the purpose for which these proceeds were raised has been achieved and shall be placed before the audit committee for review and after such review, shall be submitted to the stock exchange(s).

The listed entity shall furnish an explanation for such variation in the directors' report in the Annual Report.

The listed entity shall prepare an annual statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice, certified by the statutory auditors of the listed entity, and place it before the audit committee till such time the full money raised through the issue has been fully utilized.

Where the listed entity has appointed a monitoring agency to monitor utilisation of proceeds of a public issue or rights issue or preferential issue or qualified institutions placement, the listed entity shall submit to the stock exchange(s) any comments or report received from the monitoring agency within forty-five days from the end of each quarter.

Where the listed entity has appointed a monitoring agency to monitor the utilisation of proceeds of public issue or rights issue or preferential issue or qualified institutions placement, the monitoring report of such agency shall be placed before the audit committee on a quarterly basis, promptly upon its receipt.

Explanation —For the purpose of sub-regulations (6) and (7), "monitoring agency" shall mean the monitoring agency as specified in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

Where an entity has raised funds through preferential allotment or qualified institutions placement, the listed entity shall disclose every year, the utilization of such funds during that year in its Annual Report until such funds are fully utilized.

Documents & Information to shareholders

According to Regulation 36 of SEBI (LODR) Regulations the listed entity shall send the annual report in the following manner to the shareholders:

(a) Soft copies of full annual report to all those shareholder(s) who have registered their email address(es) either with the listed entity or with any depository;

(b) Hard copy of statement containing the salient features of all the documents, as prescribed in Section 136 of Companies Act, 2013 or rules made thereunder to those shareholder(s) who have not so registered;

(c) Hard copies of full annual reports to those shareholders, who request for the same.

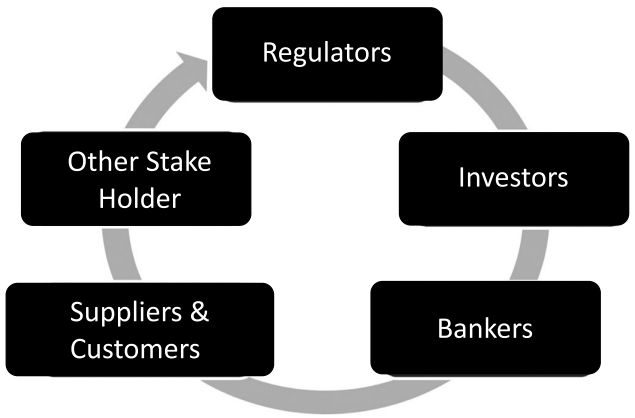
The listed entity shall send annual report to the holders of securities, not less than twenty-one days before the annual general meeting.

2. BOARD'S REPORT

The Board's Report is the most important means of communication by the Board of Directors of a company with its shareholders. It is a comprehensive document which serves to inform the shareholders about the performance and various other aspects of the company, its major policies, relevant changes in management, future programmes of expansion, modernization and diversification, capitalization or reserves, etc. The Board's Report enables not only the shareholders but also the lenders, bankers, government and the public to make an appraisal of the company's performance and provides an insight into the future growth and profitability of the company.

The Companies Act, 2013 is based on enhanced disclosures and transparency. The Board's Report is a document, preparation of which requires thorough understanding of the subject. The Act requires the Board of Directors to disclose on various parameters including the risk management, board evaluation, implementation of Corporate Social Responsibility, a statement of declaration given by independent directors. The Secretarial Audit Report is also required to be annexed to the Board's Report.

It is mandatory for the Board of Directors of every company to present financial statement to the shareholders along with its report, known as the "Board's Report" at every annual general meeting. Apart from giving a complete review of the performance of the company for the year under report, material changes till the date of the report, the report highlights the significance of various national and international developments which can have an impact on the business and indicates the future strategy of the company. The Board's Report enables shareholders, lenders, bankers, government, prospective investors, all the stakeholders and the public to make an appraisal of the company's performance and reflects the level of corporate governance in the company.



Practical Issues

The Board's Report is prepared by Secretarial Department under the supervision and guidance of Company Secretary. It is of utmost importance for Company Secretary of a company that when new financial year begins, he sends to all branches of business, finance, accounts etc.

The Board's Report is prepared by Secretarial Department under the supervision and guidance of Company Secretary. It is of utmost importance for Company Secretary of a company that when new financial year begins, he sends to all branches of business, finance, accounts etc.

A detailed **"To Do List"** that these branches of business must follow during the financial year. It should also consist of instruction that as and when any significant event or happening takes place that potentially has bearing on company's business, operations, future viability, profits etc, it must be reported forthwith. This will enable to make timely disclosure within 24 hours, if the event is covered u/r 30 of SEBI (LODR) Regulations, 2015. Else, a noting will go to the AGM folder for reference when the Annual Report is being finalized.

Getting regular inputs and collecting them in AGM folder is important for ensuring preparation of an exhaustive and complete Board's Report without missing any reportable event. Every CS should inculcate the habit and remember that preparation of Annual Report / Board's Report is an ongoing project throughout the year. When the year is about to close or soon thereafter, a reminder should also go.

The matters to be included in the Board's Report have been specified in Section 134 of the Companies Act, 2013 and Rule 8 of the Companies (Accounts) Rules, 2014. Apart from this, under Sections 67, 92, 129, 131, 135, 149, 160, 168, 177, 178, 188, 197, 204 of the Companies Act, 2013, relevant information has to be disclosed in the Board's Report. The Board's Report of companies whose shares are listed on a stock exchange must include additional information as specified in the SEBI (LODR) Regulations, 2015.

DISCLOSURE IN BOARD'S REPORT PURSUANT TO THE COMPANIES ACT, 2013

Disclosures under Section 134(3)	Issue of Equity Shares with differential rights under Section 43 r\w Rule 4 of the Companies (Share Capital & Debentures) Rules, 2014	Issue of Sweat Equity Shares under Section 54 r\w Rule 8 of the Companies (Share Capital & Debentures) Rules, 2014
Details of Employees Stock Option Scheme – Section 62(1)(b) r\w Rule 12(9) of the Companies (Share Capital & Debentures) Rules, 2014	Restrictions on purchase by company or giving of loans by it for under Section 67 r\w Rule 16 of the Companies (Share Capital & Debentures) Rules, 2014	Disclosures pertaining to Consolidated Financial Statements under Section 129
Voluntary revision of Financial Statements or Board's Report – Section 131(1)	Corporate Social Responsibility – Section 135	Appointment/ Re-Appointments of an Independent Director – Section 149(10)
Resignation of Director – Section 168(1)	Composition of Audit Committee – Section 177(8)	Details of Vigil Mechanism – Section 177(10)
Policy relating to the remuneration for the directors, key managerial personnel and other employees – Section 178(4)	Related party transactions – Section 188(2)	Disclosures pertaining to remuneration of directors and employees – Section 197(12)
Remuneration received by MD and WTD from holding or subsidiary companies – Section 197(14)	Secretarial Audit Report – Section 204(1)	

Secretarial Standard on Report of the Board of Directors" (SS-4)

The "Secretarial Standard on Report of the Board of Directors" (SS-4), formulated by the Secretarial Standards Board (SSB) of the Institute of Company Secretaries of India (ICSI) and issued by the Council of the ICSI, has

been effective from 1st October, 2018. Adherence to SS-4 is recommendatory. SS-4 prescribes a set of principles for making disclosures in the Report of the Board of Directors of a company and matters related thereto. SS-4 is in conformity with the provisions of the Companies Act, 2013. This Standard is in conformity with the provisions of the Act. However, if due to subsequent changes in the Act, any part of this Standard becomes inconsistent with the Act, the provisions of the Act shall prevail.

For example, SS-4 provides that even if no amount is proposed to be transferred to reserves, or if no dividend has been recommended by the Board, a statement to that effect should be included in the Board's Report. The purpose of this requirement is to ensure the inclusion of certain important information that should be presented to the stakeholders in a single document.

The lesson sets out the explanations, procedures and practical aspects in respect of the provisions contained in SS-4 to facilitate compliance thereof by the stakeholders.

In addition to the disclosure requirements prescribed in this Standard, some sector specific Regulations/ Guidelines may require additional disclosures to be made in the Board's Report/Annual Report of companies operating in specific sectors such as Public Sector Undertakings (PSUs), Insurance Companies, NonBanking Financial Companies, Housing Finance Companies etc. Hence, such companies should make requisite disclosures in accordance with applicable sector specific Regulations/Guidelines in its Board's Report/Annual Report.

Disclosures under Section 134(3)

Section 134 of the Act enjoins upon the Board a responsibility to make out its report to the shareholders and attach the said report to financial statements laid before the shareholders at the annual general meeting, in pursuance of Section 129 of the Act.

The Board's Report shall be prepared based on the stand alone financial statements of the company and shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

In terms of Sub-section (3) of Section 134, the Board's Report shall include:

(a) **The web address,** if any, where annual return referred to in sub-section (3) of section 92 has been placed;

(b) **Number of meetings of the Board:** Board's Report should contain total number of Board Meetings held during the year;

According to SS-4, the number and dates of meetings of the Board held during the year shall be disclosed in the Report.

(c) **Directors' Responsibility Statement:** Section 134(5) of the Act specifically provides that the Directors' Responsibility Statement shall set out the following affirmations:

(i) in the preparation of the annual accounts, the applicable accounting standards had been followed along with proper explanation relating to material departures;

(ii) the directors had selected such accounting policies and applied them consistently and made judgments and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period;

(iii) the directors had taken proper and sufficient care for the maintenance of adequate accounting

records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

(iv) the directors had prepared the annual accounts on a going concern basis; and

(v) the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively; and

(vi) The directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively.

Explanation – The term "internal financial controls" means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

In the matter of *Cambridge Technology Enterprises Ltd., CA NO. 59/621A/HDB/2016, NCLT-Hyderabad*, it was held that where company did not follow accounting standards in preparation of annual account as stated in Director's Responsibility statement, hence, violated provision of section 217, on company's application, compounding was allowed subject to payment of compounding fees.

(ca) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government:

- Nature of Fraud with description;
- Approximate Amount involved;
- Parties involved, if remedial action not taken; and
- Remedial action taken.

The auditor shall report the matter related to details of frauds under sub-section (12) of section 143 to the Central Government involving an amount of Rupees One Crore or above.

(d) A statement on declaration given by independent directors under sub-section (6) of section 149: Every Independent Director shall give a declaration that he meets the criteria of independence laid down in sub- section (6) of section 149, which is to be given by him at the first meeting of the Board in which he participates as a director and thereafter at the first meeting of the Board in every financial year or whenever there is any change in the circumstances which may affect his status as an independent director. The Board's Report should contain a statement to the effect that the independent directors have given such a declaration.

SS-4 provides that Board's Report should include a statement to the effect:

(a) *that necessary declaration with respect to independence has been received from all the Independent Directors of the company;*

(b) that the Independent Directors have complied with the Code for Independent Directors prescribed in Schedule IV to the Act.

(e) Company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178: The Board' Report of companies which are required to constitute Nomination and Remuneration Committee shall include:

- criteria for determining qualifications,
- positive attributes and independence of a director, and
- recommend to the Board a policy relating to the remuneration of directors, Key Managerial Personnel and other employees.

Section 178(4) provides that the Nomination and Remuneration Committee shall formulate and recommend to the Board a policy, relating to the remuneration for the directors, key managerial personnel and other employees. Such policy shall ensure that –

(a) the level and composition of remuneration is reasonable and sufficient to attract, retain and motivate directors of the quality required to run the company successfully;

(b) relationship of remuneration to performance is clear and meets appropriate performance benchmarks; and

(c) remuneration to directors, key managerial personnel and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals.

Such policy shall be placed on the website of the company, if any, and the salient features of the policy and changes therein, if any, along with the web address of the policy, if any, shall be disclosed in the Board's Report.

Exceptions:

Government companies are given certain exemptions from the contents of the Board's report vide notification G.S.R. 463 (E) dated 05.06.2015. Clause (e) of sub-section (3) of section 134 which deals with policy of appointment and remuneration of directors does not apply to such companies. Further, clause (p) dealing with formal evaluation of performance of board or its committees does not apply if the directors are evaluated by the evaluation methodology used by the Department or Ministry of State or Central Government, as the case may be, which is administratively in charge of the company.

In case of an unlisted public/private company which is licensed to operate by RBI or SEBI or IRDA from the International Financial Services Centre located in an approved multi services SEZ set-up under the SEZ Act, sub-section (3) of this section will be applicable with modification such that if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors (Notification No. GSR 8(E), dated 4-1-2017).

(f) Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made –

- **Auditor's report under section 143:** Clause (h) of Section 143(3) provides that the auditor's report shall state any qualification, reservation or adverse remark relating to the maintenance of accounts and other matters connected therewith.
- **Cost Audit Report under section 148:** Section 148(5) of the Act and Rule 6 of the Companies (Cost Records and Audit) Rules, 2014 provides that the rights, duties and obligations applicable to the Auditor under Chapter X of the Act shall *mutatis mutandis* apply to a cost auditor appointed under Section 148 of the Act. It also provides that the cost auditor shall submit his report to the Board of

Directors of the company. The cost auditor's report shall also state any qualification, reservation or adverse remark relating to the maintenance of cost accounts and other matters connected therewith.

- **Secretarial Audit Report under Section 204(3):** Section 204(3) of the Act provides that the Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the Company Secretary in practice in his secretarial audit report. Thus, the Board should state detailed explanation in its Board's Report for all the observations and qualifications given by the Secretarial auditor in his secretarial audit report including the reasons for such material deviations and reasons that led to such deviations.

(g) **Particulars of loans, guarantees or investments under section 186:** The particulars of loans given, guarantees provided or investments in securities and acquisition made during the year under section 186 of the Act should be attached to the Board's Report.

(h) **Particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the prescribed form;** The Report of the Board shall contain the details of contracts or arrangements entered with Related Parties as referred to in Section 188 (1) in **Form AOC-2** pursuant to Rule 8(2) of Companies (Accounts) Rules, 2014.

(i) **The state of the company's affairs:** Information and data which are usually considered pertinent and necessary for the purpose of a proper appreciation of the state of affairs of a company relating to the period for which the financial statements have been prepared must be disclosed in the report. Relevant changes which have occurred, as compared to the position as stated in the previous year's Board's Report which have a material bearing on the performance of the company should be indicated in the Board's Report.

The figures of the previous year relating to achievement of targets of production and sales should also be given in the Board's Report to facilitate comparison and the reasons for any substantial deviation there from should be explained in brief.

(j) **The amounts, if any, which it proposes to carry to any reserves**: A company may, before the declaration of any dividend in any financial year, transfer such percentage of its profits for that financial year as it may consider appropriate to the reserves of the company. If no amount is proposed to be transferred to reserves, a statement to that effect shall be included.

Illustration:

If no amount is transferred to the Reserves, the following statement be included in the Report:

"The Board of Directors of your company, has decided not to transfer any amount to the Reserves for the year under review."

(k) **The amount, if any, which it recommends should be paid by way of dividend**: The Board's Report shall disclose the amount per share and the percentage which the Board recommends to be paid as dividend under section 123 of the Act.

According to SS-4, following should be disclosed in the Board's Report:

a. The amount and the percentage of interim dividend declared, if any, during the year.

b. The total amount of dividend for the year.

c. A statement on compliance with the Dividend Distribution Policy, if applicable, and the reasons for deviation and the rationale for additional parameters considered, if any.

d. Payment of dividend from reserves.

In case no dividend has been recommended by the Board, a statement to that effect shall be made in Board's Report as good governance practice.

(l) Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report: The Board's Report should include material changes and commitments, if any, affecting the financial position of the company and occurring between the date of balance sheet and the date of the report. The Directors' Report should, therefore, contain material changes pertaining to post-financial statement events impacting the operations and performance of the Company.

(m) The conservation of energy, technology absorption, foreign exchange earnings and outgo, in such manner as prescribed:

Rule 8(3) of the Companies (Accounts) Rules, 2014, prescribes the following details:

A. Conservation of energy

(i) the steps taken or impact on conservation of energy;

(ii) the steps taken by the company for utilising alternate sources of energy;

(iii) the capital investment on energy conservation equipment.

B. Technology absorption

(i) the efforts made towards technology absorption;

(ii) the benefits derived like product improvement, cost reduction, product development or import substitution;

(iii) in case of imported technology (imported during the last three years reckoned from the beginning of the financial year):

(a) the details of technology imported;

(b) the year of import;

(c) whether the technology been fully absorbed;

(d) if not fully absorbed, areas where absorption has not taken place, and the reasons thereof; and

(iv) the expenditure incurred on Research and Development.

C. Foreign exchange earnings and Outgo: The Foreign Exchange earned in terms of actual inflows during the year and the Foreign Exchange outgo during the year in terms of actual outflows.

Exemptions:

The requirement of furnishing information and details under Rule 8(3) of the Companies (Accounts) Rules, 2014 shall not apply to a Government company engaged in producing defence equipment.

Illustration:

If there are no such disclosures applicable to a company, a statement should be disclosed in the Report as under:

"Disclosures pertaining to conservation of energy, technology absorption, foreign exchange earnings and outgo, are not applicable to your company during the year under review."

(n) A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company: The company should provide about the overall risk management framework of the company, whether it has constituted risk management committee, the risk management policy of the company, the possible risks and steps taken to mitigate those risks in this section.

(o) Details about the policy developed and implemented by the company on Corporate Social Responsibility initiatives taken during the year: Section 135(4) of the Act provides that the Board of every company having net worth of Rs. 500 Crores or more or turnover of Rs. 1,000 Crores or more or net profit of Rs. 5 Crores or more during the immediately preceding financial year shall disclose contents of Corporate Social Policy in its report and also place it on the company's website.

Further, Section 135(2) requires that the composition of the CSR Committee shall be disclosed in the Board's Report.

The Board of every company referred to in Section 135 (1) of the Companies Act, 2013, shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years or where the company has not completed the period of three financial years since its incorporation, during such immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

However, if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-section (3) of section 134, specify the reasons for not spending the amount.

Preparation of CSR Report

It is mandatory to include an Annual Report on CSR in the prescribed format, in the Board's report of the Company The report containing the details of CSR Activities undertaken by the company and contents of CSR policy shall be made available on Company's website.

- **Directors Report:**

  The Company shall annex with its Board Report an annual report on CSR containing particulars specified in Annexure I (for F.Y. Commenced Prior To 1st day of April, 2020) or Annexure II (w.e.f. F.Y. Commencing on or after 1st day of April, 2020), as applicable.

- **In case of a Foreign Company:**

  The Balance sheet filed u/s 381(1) (b) of the Companies Act, 2013 shall contain an annual report on CSR containing particulars specified in Annexure I (for F.Y. Commenced prior to 1st day of April, 2020) or Annexure II (w.e.f. F.Y. Commencing on or after 1st day of April, 2020), as applicable.

Impact Assessment for big CSR projects

- Companies with average CSR obligation of 10 Crore or more in the three immediately preceding financial years shall undertake impact assessment through an independent agency for projects of Rs.1 crore or more which have been completed not less than 1 year before undertaking the impact study.
- The impact assessment reports shall be placed before the Board and shall be annexed to the annual report on CSR.
- A Company undertaking impact assessment may book the expenditure towards Corporate Social Responsibility for that financial year, which shall not exceed five percent of the total CSR expenditure for that financial year or ₹ 50 Lakh, whichever is less.

(p) Board evaluation: Section 134 of the Act read with Rule 8(4) of the Companies (Accounts) Rules, 2014 provides that every listed company and every other public company having a paid up share capital of twenty five crore rupees or more calculated at the end of the preceding financial year shall include, in the report by its Board of directors, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors has been made.

Exceptions:

1. In case Government company - clause (e) of Sub-section (3) of Section 134 shall not apply.- Notification dated 5th June, 2015.
2. In case of Government company - clause (p) of Sub-section (3) of Section 134 shall not apply, in case the directors are evaluated by the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government, as per its own evaluation methodology – Notification dated 5th June, 2015.
3. In case of Specified IFSC Public Company/Specified IFSC Private Company- In Sub-section (3) of section 134, following proviso shall be inserted as per Notification Dated 4th January, 2017:

   "if any information listed in this sub-section is provided in the financial statement, the company may not include such information in the report of the Board of Directors".

(q) Such other matters as prescribed: -

Rule 8(5) of the Companies (Accounts) Rules, 2014, prescribes that the Board's Report shall also include following matters -

(i) The financial summary or highlights;

The financial summary and highlights thereof should be accompanied by the macro-economic, geo-political, financial, industry specific as well as any company specific information affecting the business of the company and the market in which it operates, along with the industry performance vis-à-vis the company's performance.

(ii) The change in the nature of business, if any;

In case the company has commenced any new business or discontinued/sold or disposed off any of its existing businesses or hived off any segment or division during the year, the Report shall disclose the details of the same highlighting the key focus areas.

(iii) The details of directors or key managerial personnel who were appointed or have resigned during the year;

As per SS-4, the disclosure shall include the following:

(a) names of the persons who have been appointed / ceased to be Directors and/or Key Managerial Personnel of the company:

  (i) during the year;

  (ii) after the end of the year and up to the date of the Report;

(b) mode of such appointment/cessation;

(c) names of the Directors retiring by rotation at the ensuing annual general meeting and whetheror not they offer themselves for re-appointment.

(iiia) A statement regarding opinion of the Board with regard to integrity, expertise and experience (including the proficiency) of the independent directors appointed during the year;

Explanation.-For the purposes of this clause, the expression "proficiency" means the proficiency of the independent director as ascertained from the online proficiency self-assessment test conducted by the institute notified under sub-section (1) of section 150.

(iv) The names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year;

(v) The details relating to deposits, covered under Chapter V of the Act,-

(a) accepted during the year;

(b) remained unpaid or unclaimed as at the end of the year;

(c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved–

- at the beginning of the year;
- maximum during the year;
- at the end of the year.

(vi) The details of deposits which are not in compliance with the requirements of Chapter V of the Act;

(vii) The details of significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;

(viii) The details in respect of adequacy of internal financial controls with reference to the financial statements;

(ix) A disclosure, as to whether maintenance of cost records as specified by the Central Government under sub- section (1) of section 148 of the Companies Act, 2013, is required by the Company and accordingly such accounts and records are made and maintained;

(x) a statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013;

(xi) the details of application made or any proceeding pending under the Insolvency and Bankruptcy Code, 2016 during the year along with their status as at the end of the financial year;

(xii) the details of difference between amount of the valuation done at the time of one time settlement and the valuation done while taking loan from the Banks or Financial Institutions along with the reasons thereof.

Where disclosures referred to in sub-section (3) of Section 134 of the Companies Act,2013 have been included in the financial statements, such disclosures shall be referred to instead of being repeated in the Board's Report.

Further, where the policy referred to in clause (e) or clause (o) of sub-section (3) of Section 134 of the Companies Act,2013 is made available on company's website, if any, it shall be sufficient compliance of the requirements under such clauses if the salient features of the policy and any change therein are specified in brief in the Board's Report and the web-address is indicated therein at which the complete policy is available.

Rule 8 of the Companies (Accounts) Rules, 2014 shall not apply to One Person Company or Small Company.

Abridged Board Report for OPC and Small Company

The Central Government has been empowered to prescribe an abridged Board's report, for the purpose of compliance with section 134 of the Companies Act, 2013 by One Person Company or Small Company.

Rule 8A of the Companies (Accounts) Rules, 2014, prescribes the Matters to be included in Board's Report for One Person Company and Small Company.

1. The Board's Report of One Person Company and Small Company shall be prepared based on the stand alone financial statement of the company, which shall be in abridged form and contain the following:-
   (a) the web address, if any, where annual return referred to in sub-section (3) of section 92 has been placed;
   (b) number of meetings of the Board;
   (c) Directors' Responsibility Statement as referred to in sub-section (5) of section 134;
   (d) details in respect of frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government;
   (e) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report;
   (f) the state of the company's affairs;
   (g) the financial summary or highlights;
   (h) material changes from the date of closure of the financial year in the nature of business and their effect on the financial position of the company;
   (i) the details of directors who were appointed or have resigned during the year;
   (j) the details or significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future.
2. The Report of the Board shall contain the particulars of contracts or arrangements with related parties referred to in sub-section (1) of section 188 in the **Form AOC-2**.

Disclosures pertaining to Issue of Equity Shares with differential rights

Section 43 of the Act provides that a company limited by shares can issue equity shares with differential rights as to dividend, voting or otherwise in accordance with rules prescribed under Rule 4 of the Companies (Share Capital and Debentures) Rules, 2014.

Rule 4(4) of the Companies (Share Capital and Debentures) Rules, 2014, provides that the Board of Directors shall, *inter alia*, disclose in the Board's Report for the financial year in which the issue of equity shares with differential rights as to dividend, voting or otherwise was completed, the following details, namely:-

(a) total number of shares allotted with differential rights;

(b) details of the differential rights relating to voting rights and dividends;

(c) percentage of shares with differential rights to the total post-issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting rights shall carry to the total voting rights of the aggregate equity share capital;

(d) price at which such shares have been issued;

(e) particulars of promoters, directors or key managerial personnel to whom such shares are issued;

(f) change in control, if any, in the company consequent to the issue of equity shares with differential voting rights;

(g) diluted Earnings Per Share pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;

(h) pre and post issue shareholding pattern along with voting rights shall be in the format specified under Rule 4(2).

Disclosures pertaining to Issue of Sweat Equity Shares

Section 54(1)(d) of the Act provides that where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by the SEBI and if they are not so listed, the sweat equity shares are issued in accordance with Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014.

As per rule 8(13) of the Companies (Share Capital and Debentures) Rules, 2014, the Board of Directors shall, *inter alia,* disclose in the Directors' Report for the year in which such shares are issued, the following details of issue of sweat equity shares namely:-

(a) the class of director or employee to whom sweat equity shares were issued;

(b) the class of shares issued as Sweat Equity Shares;

(c) the number of sweat equity shares issued to the directors, key managerial personnel or other employees showing separately the number of such shares issued to them, if any, for consideration other than cash and the individual names of allottees holding one percent or more of the issued share capital;

(d) the reasons or justification for the issue;

(e) the principal terms and conditions for issue of sweat equity shares, including pricing formula;

(f) the total number of shares arising as a result of issue of sweat equity shares;

(g) the percentage of the sweat equity shares of the total post issued and paid up share capital;

(h) the consideration (including consideration other than cash) received or benefit accrued to the company from the issue of sweat equity shares;

(i) the diluted Earnings Per Share (EPS) pursuant to issuance of sweat equity shares.

Disclosures of Details of Employees Stock Option Scheme - Section 62(1)(b)

Section 62(1)(b) of the Act read with Rule 12(9) of the Companies (Share Capital and Debentures) Rules, 2014 provides that the Board of directors, shall, *inter alia,* disclose in the Directors' Report for the year, the following details of the Employees Stock Option Scheme:

(a) options granted;

(b) options vested;

(c) options exercised;

(d) the total number of shares arising as a result of exercise of option;

(e) options lapsed;

(f) the exercise price;

(g) variation of terms of options;

(h) money realized by exercise of options;

(i) total number of options in force;

(j) employee wise details of options granted to:

(i) key managerial personnel;

(ii) any other employee who receives a grant of options in any one year of option amounting to five percent or more of options granted during that year;

(iii) identified employees who were granted option, during any one year, equal to or exceeding one percent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant.

Disclosures pertaining to Restrictions on purchase by company or giving of loans by it for purchase of its shares – Section 67

Proviso to Section 67(3) read with Rule 16(4) of Companies (Share Capital and Debentures) Rules, 2014 provides that where the voting rights are not exercised directly by the employees in respect of shares to which the scheme for provision of money for purchase of or subscription for shares by employees or by trustees for the benefit of employees relates, the Board of Directors shall, *inter alia,* disclose in the Board's Report for the relevant financial year the following details, namely:-

(a) the names of the employees who have not exercised the voting rights directly;

(b) the reasons for not voting directly;

(c) the name of the person who is exercising such voting rights;

(d) the number of shares held by or in favour of, such employees and the percentage of such shares to the total paid up share capital of the company;

(e) the date of the general meeting in which such voting power was exercised;

(f) the resolutions on which votes have been cast by persons holding such voting power;

(g) the percentage of such voting power to the total voting power on each resolution;

(h) whether the votes were cast in favour of or against the resolution.

Disclosures pertaining to Consolidated Financial Statements

Rule 8(1) of the Companies (Accounts) Rules, 2014 specifies that the Board's Report:

- shall be prepared on the basis of standalone financial statements of the company; and
- shall report on the highlights of performance of subsidiaries, associates and joint venture companies and their contribution to the overall performance of the company during the period under report.

Proviso to Section 129(3) read with Rule 5 of the Companies (Accounts) Rules, 2014 states that the company shall also attach along with its financial statement a separate statement containing the salient features of the financial statements of a company's subsidiary or subsidiaries, associate company or companies and joint venture or ventures in **Form AOC-1.**

Voluntary revision of Financial Statements or Board's Report – Section 131(1)

Section 131(1) of the Act provides that revised financial statements or a revised report may be prepared in respect of any of the three preceding financial years after obtaining approval from the Tribunal, where it appears to the directors of a company that the financial statements or the report of the Board, do not comply with the provisions of section 129 or section 134 of the Act, and the detailed reasons for revision of such financial statements or report should be disclosed in the Board's Report in the relevant financial year in which such revision is being made.

In the matter of *Technicolor India (P.) Ltd. vs. Registrar of Companies CP NO. 124 (BB) OF 2019 NCLT Bengaluru,* the Petitioner filed company petition before NCLT under section 131, read with section 134 seeking to approve decision of company to revise Board's report with specific reference to Corporate Social Responsibility (CSR) annexed to Board's report for fiscal year dated 31-3-2018. Due to mismatch of amount spent on CSR some error occurred, the petition was filed in accordance with law and due notice were ordered to ROC and Income Tax Department, thus, the company was permitted to revise the Board's report.

In the matter of *Indiavidual Learning (P.) Ltd. vs. Registrar of Companies, C.P. NO. 83/BB/2019, NCLT-Bengaluru,* where in Board Report of company filed with RoC, certain matters were unintentionally omitted to be reported, it could be permitted to revise said Board Report if same would not prejudice interest of company, its shareholders or stakeholders or violate any provisions.

Appointment / Re-Appointment of an Independent Director - Section 149(10)

Subject to the provisions of Section 152 of the Act, an independent director shall hold office for a term up to five consecutive years on the Board of a company, but shall be eligible for reappointment on passing of a special resolution by the company and disclosure of such appointment in the Board's Report.

As per SS-4, the disclosure shall include the following:

(a) in case of appointment of Independent Directors, the justification for choosing the proposed appointees for appointment as Independent Directors; and

(b) in case of re-appointment after completion of the first term, the rationale for such re-appointment.

Resignation of Director - Section 168(1)

A director may resign from his office by giving notice in writing to the company and the Board. Section 168(1) of the Act, requires the Board to place the fact of resignation of a director in report of directors laid in the immediately following general meeting by the Company.

Composition of Audit Committee - Section 177(8)

The Board's Report shall disclose the following –

(a) Composition of an Audit Committee;

(b) Where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in the report along with the reasons thereof.

Details of Vigil Mechanism - Section 177(10)

Section 177(9) read with Rule 7 of the Companies (Meeting of Board and its Powers) Rules, 2014 provides that every listed company and the following class or classes of companies shall establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances-

(a) Companies which accept deposits from the public;

(b) Companies which have borrowed money from banks and public financial institutions in excess of fifty crore rupees.

The details of establishment of such mechanism shall be disclosed by the company on its website, if any, and in the Board's Report.

Disclosures pertaining to remuneration of directors and employees –Section 197(12)

Section 197(12) read with Rule 5 of the Companies (Appointment & Remuneration of Managerial Personnel) Rules, 2014 provides that Board's Report of:-

(1) Every listed company shall include :

(a) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;

(b) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;

(c) the percentage increase in the median remuneration of employees in the financial year;

(d) the number of permanent employees on the rolls of company;

(e) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(f) affirmation that the remuneration is as per the remuneration policy of the company.

Explanation : the expression "median" means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one;

If there is an even number of observations, the median shall be the average of the two middle values.

(2) The Board's Report shall include a statement showing the names of the top ten employees in terms of remuneration drawn and the name of every employee, who, -

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(3) The statement referred to in sub-rule (2) shall include the following as under:

(i) designation of the employee;

(ii) remuneration received;

(iii) nature of employment, whether contractual or otherwise;

(iv) qualifications and experience of the employee;

(v) date of commencement of employment;

(vi) the age of such employee;

(vii) the last employment held by such employee before joining the company;

(viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) above; and

(ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Provided that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board's Report, but such particulars shall be filed with the Registrar of Companies while filing the financial statements and Board's Report.

These particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Provided also that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

As per Section 197(14) any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's Report.

Auditors

Names of the Statutory Auditor, Cost Auditor and Secretarial Auditor and details of any change in such Auditors, during the year and up to the date of the Report due to resignation / casual vacancy / removal / completion of term shall be disclosed in the Report.

Secretarial Auditor Report

As per provisions of Section 204(1) of Companies Act, 2013, every listed company or every public company having a paid- up share capital of 50 crore rupees or more or a turnover of 250 crore rupees or more or every company having outstanding loans or borrowings from banks or public financial institutions of 100 crore rupees or more shall annex with its Board's Report, a Secretarial audit report, given by a company secretary in practice in **Form MR-3.**

Regulation 24A of the SEBI (LODR) Regulations, 2015 states that every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a **secretarial audit report** given by a company secretary in practice, in such form as specified, with the annual report of the listed entity.

Every listed entity shall submit a **secretarial compliance report** in such form as specified, to stock exchanges, within sixty days from end of each financial year.

Compliance with Secretarial Standards

SS-4 provides that, the Board's Report shall include a statement on compliance of applicable Secretarial Standards and other Secretarial Standards voluntarily adopted by the company.

Disclosures under SEBI (Share Based Employee Benefits) Regulations, 2014

Regulation 14 of the Regulations provides that in addition to the information that a company is required to disclose, in relation to employee benefits under the Companies Act, 2013, the Board of directors of such a company shall also disclose the details of the scheme(s) being implemented, as specified by SEBI in this regard.

As per SS-4, the following disclosure are to be made in the Board's Report.

- The Board of directors in their report shall disclose any material change in the scheme(s) and whether the scheme(s) is / are in compliance with the SEBI (Share Based Employee Benefits) Regulations, 2014;
- web-link of disclosures made on the website of the company, as required under SEBI (Share Based Employee Benefits) Regulations, 2014.

Disclosure Requirements under the Sexual Harassment of Women at Workplace (Prevention, Prohibition & Redressal) Act, 2013

The Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 is applicable to every workplace, establishment, company or organisation employing 10 or more employees irrespective of its location or nature of industry. The said Act provides for constitution of a Committee to be known as the "Internal Complaints Committee".

Section 21 of the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 mandates that Internal Committee shall prepare an Annual Report and Section 22 of the said Act provides that the employer shall include in its report the number of cases filed, if any, and their disposal under this Act in the Annual Report.

Rule 14 of Sexual Harassment of Women at Workplace (Prevention, Prohibition & Redressal) Rules,2013 provides that the annual report which the Complaints Committee is required to prepare under Section 21 of the Sexual Harassment of Women at Workplace (Prevention, Prohibition & Redressal) Act, 2013 shall contain the following details:

- Number of complaints of sexual harassment received in the year;
- Number of complaints disposed off during the year;
- Number of cases pending for more than 90 days;
- Number of workshops or awareness programme against sexual harassment carried out;
- Nature of action taken by the employer or District Officer.

Investor Education and Protection Fund

The Board should, as a good corporate practice, inform the shareholders about the amounts, if any, which have been transferred during the year to the Investor Education and Protection Fund established under sub-section of section 125 of the Act and the IEPF (Accounting, Audit, Transfer and Refund) Rules, 2016.

Further, the Board's Report should clearly state the amounts, if any, which were to be transferred to the Investor Education and Protection Fund but have not been so transferred, along with the reasons for such failure.

According to SS-4, the disclosure shall include the following:

(a) details of the transfer/s to the IEPF made during the year as mentioned below:

i. amount of unclaimed/unpaid dividend and the corresponding shares;

ii. redemption amount of preference shares;

iii. amount of matured deposits, for companies other than banking companies, along with interest accrued thereon;

iv. amount of matured debentures along with interest accrued thereon;

v. application money received for allotment of any securities and due for refund along with interest accrued;

vi. sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation.

(b) details of the resultant benefits arising out of shares already transferred to the IEPF;

(c) year wise amount of unpaid/unclaimed dividend lying in the unpaid account upto the year and the corresponding shares, which are liable to be transferred to the IEPF, and the due dates for such transfer;

(d) The amount of donation, if any, given by the company to the IEPF;

(e) Such other amounts transferred to the IEPF, if any, during the year.

Credit Rating of Securities

According to SS-4, as a good governance practice the disclosure on credit rating should also be included in the Board's Report:

(a) credit rating obtained in respect of various securities;

(b) name of the credit rating agency;

(c) date on which the credit rating was obtained;

(d) revision in the credit rating;

(e) reasons provided by the rating agency for a downward revision, if any.

In addition to the above, as per the Listing Regulations, listed companies are required to disclose in the Corporate Governance Report a list of all credit ratings obtained by the company along with any revisions thereto during the relevant financial year, for all debt instruments of such entity or any fixed deposit programme or any scheme or proposal of the listed entity involving mobilization of funds, whether in India or abroad.

In case a company obtains the credit rating but has not used / using the same, the reasons thereof should be mentioned in the Report.

As a matter of good corporate governance it is desirable that such material events like credit rating of the various securities of the company including the revision in credit rating should also be disclosed in the Report. Hence, the Standard requires appropriate disclosure in the Report.

APPROVAL OF THE BOARD'S REPORT

The Board's Report should be considered, approved and signed at a meeting of the Board duly convened or held through video conferencing or other audio visual means.

Note: The MCA vide Notification dated June 15, 2021 has omitted Rule 4 of the Companies (Meetings of Board and its Powers) Rules, 2014 which was related to the matters not to be dealt with in a meeting through video conferencing or other audio-visual means.

Accordingly, with the said amendment, now the approval of the Board's report can be considered in a Board Meeting held through video conferencing or other audio-visual means.

Signing of Board's Report - Section 134(6)

The Board's Report and any annexures thereto under section 134(3) shall be signed by the chairperson of the company if he is authorised by the Board and where he is not so authorised, shall be signed by at least two directors, one of whom shall be a managing director, or by the director where there is one director.

Where Chairperson is authorised by the Board	Chairperson of the Company	As per SS-4, the annexures to the Board's Report shall be signed in the similar manner as the Board's Report, except the Report on CSR activities of the company, which is required to be signed by the Chief Executive Officer or the Managing Director or any other Director of the company and by the Chairman of the CSR Committee of the company.
Where Chairperson is not authorised by the Board	At least by two directors, one of whom shall be Managing Director, or by the director where there is one director	

Situation where the Company is under CIRP and powers of the Board are suspended

As per clause (b) of sub-section (1) of section 17 of Insolvency and Bankruptcy Code (IBC), a company of which Interim Resolution Professional (IRP) is appointed, the powers of the Board of Directors stands suspended and shall be exercised by IRP. It may be noted that though the powers of the Board of Directors are suspended, they are bound to provide all assistance to IRP as only the powers of the Board are suspended and not their duties.

Further, sub-section (1) of section 19 of IBC provides that the personnel of the Corporate Debtor, its promoters or any other person associated with the management of the Corporate Debtor shall extend all assistance and cooperation to the IRP as may be required by him in managing the affairs of the corporate debtor.

An insolvency professional should ensure that the company undergoing insolvency process complies with the applicable laws. It should be the responsibility of the Management/KMPs of the company to continue to comply with the applicable laws and report periodically to the insolvency professional. The order passed by NCLAT in the case of *M/s. Subasri Realty Private Limited* strengthens this view by stating that after appointment of the Resolution Professional (RP) and declaration of moratorium, the Board of Director stands suspended, but that does not amount to suspension of Managing Director or any of the Director or officer or employee of the Corporate Debtor. To ensure that the Corporate Debtor remains a going concern, all the Director/ employees are required to function and to assist the Resolution Professional who manages the affairs of the Corporate Debtor during the period of moratorium.

Since the ultimate responsibility and powers of the Board lies with IRP/ RP, in the aforesaid context, it appears that IRP/RP should approve and sign the Report. The IRP/RP may also direct the Directors/Officials of the Corporate Debtor to sign the Report and take all necessary actions for compliance of applicable laws.

Circulation of the Board's Report

The copy of Board's Report shall be issued, circulated or published along with a signed copy of every financial statement, including consolidated financial statement if any, all the notes annexed to or forming part of such financial statement and the Auditors' Report . [Section 134(7)]

RIGHT OF MEMBERS TO RECEIVE COPIES OF FINANCIAL STATEMENTS, BOARD'S REPORT, ETC.

Section 136 of the Act provides that, a copy of the financial statements, including consolidated financial statements, if any, auditor's report and every other document required by law to be annexed or attached to the financial statements, which are to be laid before a company in its general meeting, shall be sent to:

- every member of the company,
- every trustee for the debenture holder of any debentures issued by the company, and
- all persons other than such member or trustee, being the person so entitled, not less than 21 clear days before the date of the meeting.

However, if the copies of the documents are sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by members—

(a) holding, if the company has a share capital, majority in number entitled to vote and who represent not less than ninety-five per cent. of such part of the paid-up share capital of the company as gives a right to vote at the meeting; or

(a) having, if the company has no share capital, not less than ninety five per cent. of the total voting power exercisable at the meeting.

Exceptions:

In case of section 8 companies, the said documents shall be sent to the members not less than fourteen clear days before the date of the annual general meeting.

In the case of a listed company, it shall be deemed to be complied with, if the copies of the documents are made available for inspection at its registered office during working hours for a period of twenty-one days before the date of the meeting and a statement containing the salient features of such documents in the prescribed form or copies of the documents, as the company may deem fit, is sent to every member of the company and to every trustee for the holders of any debentures issued by the company not less than twenty-one days before the date of the meeting unless the shareholders ask for full financial statements.

A listed company shall also place its financial statements including consolidated financial statements, if any, and all other documents required to be attached thereto, on its website, which is maintained by or on behalf of the company.

FILING OF THE BOARD'S REPORT

Section 137(1) of the Act provides that copies of financial statement along with all documents required to be annexed should be filed with the Registrar of Companies within 30 days along with the prescribed fees, after the financial statements, including consolidated financial statements have been adopted at the annual general meeting. The Board's Report has to be attached to the financial statements.

In case a company does not hold an annual general meeting in any year, a statement of facts and reasons along with financial statement and attachment shall be filed with Registrar.

Pursuant to the provisions of section 117/ 179 of the Companies Act, and the Rules made thereunder the resolution for approving the Board's Report is also required to be filed to the Registrar within 30 days from the approval by the Board in MGT-14. (*The Central Government vide its notification dated 05th June 2015 exempted Private Limited Companies from filing of the above stated approval resolutions with the Registrar of Companies*).

Third Proviso of Section 137(1) of the Act also provides that a One Person Company should file a copy of the financial statements duly adopted by its member, along with all the documents which are required to be attached to such financial statements, within one hundred eighty days from the closure of the financial year.

Fourth Proviso of Section 137(1) of the Act provides that, a company shall, along with its financial statements to be filed with the Registrar, attach the accounts of its subsidiary or subsidiaries which have been incorporated outside India and which have not established their place of business in India.

In the case of a subsidiary which has been incorporated outside India (herein referred to as "foreign subsidiary"), which is not required to get its financial statement audited under any law of the country of its incorporation and which does not get such financial statement audited, the requirements of the fourth proviso of Section 137(1) of the Act, shall be met if the holding Indian company files such unaudited financial statement along with a declaration to this effect and where such financial statement is in a language other than English, along with a translated copy of the financial statement in English.

Test Your Knowledge

Whether a company covered under above provisions can place/file unaudited accounts of a foreign subsidiary if the audit of such foreign subsidiary is not a mandatory legal requirement in the country where such foreign subsidiary has been incorporated and such audit has not been conducted ?

PROCEDURE FOR PREPARATION OF BOARD'S REPORT

1. Section 136(1) of the Companies Act, 2013 provides that every company, public or private shall forward to its member along with its annual financial statements, the Board's Report. The Board's Report is an important document in which the Board gives a complete review of the performance of the company during the year under review and other information as explained below.
2. The Board's Report shall be prepared based on the standalone financial statements of the company and the report shall contain a separate section wherein report on the performance and financial position of each of the subsidiaries, associates and joint venture companies included in the consolidated financial statement is presented.
3. Board's Report and the financial statements shall be approved in Board Meeting either duly convened or held through Video-Conferencing or audio-visual means.
4. Section 134(3) read with rule 8(3) of Companies (Accounts) Rules, 2014 lists down various items to be included in the Board's Report as already detailed in the chapter.
5. As per Rule 8A of the Companies (Accounts) Rules, 2014, the Board's Report of One Person Company and Small Company shall be prepared based on the standalone financial statements of the company, which shall be in abridged form (as already detailed in the chapter).
6. Where it is proposed to pay dividend on equity or preference shares, the Board's Report shall contain the recommendation of the Board as to the rate of dividend for the year under review for the approval of members at the annual general meeting. The Board's proposal about dividend shall be in conformity with the relevant rules.

7. As there must be some interval of time between the end of the financial year and the day on which the Board finalised the Board's Report, the Board shall indicate in the report the up-to-date status and position affecting the financial impact on the operations of the company as well as material changes that have occurred which have a bearing on the working of the company. It would include events such as the following:-

    a. Disposal of a substantial part of the undertaking;

    b. Changes in the capital structure;

    c. Any serious breakdown which has happened and the steps taken to reduce its adverse impact;

    d. Alteration in wage structure arising out of trade union negotiation;

    e. Material changes concerning purchase of raw materials and sale of the products etc.

    Subject to following the necessary precaution of not to disclose any information which is not in the interest of the business of the company or which may help the competitors, the Board's Report shall give details of the changes, if any, that have occurred during the year under review, in the nature of the business of the company and in the class of business in which the company has interest and also in the nature of its subsidiary, if any.

8. The company shall disclose composition of the committees of the company viz. Corporate Social Responsibility Committee, Audit Committee, Nomination and Remuneration Committee and Stakeholders Relationship Committee in the Board's Report as per the requirement of Section 135, 177, 178 of the Act, if applicable.

    Section 177(8) of the Act, provides that the Board's Report shall disclose the composition of an Audit Committee and where the Board had not accepted any recommendation of the Audit Committee, the same shall be disclosed in such report along with the reasons therefore.

9. The details of Loans, Guarantee and investment shall be mentioned in the Board's Report as per provisions of Section 186 of the Act.

10. The company shall disclose in its Board's Report regarding all the particulars of contracts or arrangements with related parties referred to in section 188(1) in the Form AOC-2. [Rule 8 of Companies (Accounts) Rules, 2014]

11. It is provided that in Board's Report, a statement must be enclosed which shows the development and implementation of risk management policy of the company. The suggested items for this statement are as follows:

    a. Introduction

    b. Meaning and definitions Risk Management

    c. Types of Risks

    d. Risk Management

    e. Risk Assessment

    f. Risk Identification Activities

    g. Risk Handling

    h. Monitoring and Reporting

    i. Conclusion

12. Section 177(10) of the Act, provides for disclosure of details of establishment of vigil mechanism by the company on its website, if any, and in the Board's Report.

13. Section 197(12) read with Rule 5 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides for disclosures which are discussed earlier in the chapter.

14. Section 204(1) read with Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 requires to annex the Secretarial Audit Report in the Form – MR-3 with the Board's Report of the specified class of companies.

    Such secretarial audit report under section 134, is required to be given by a Company Secretary in practice.

15. Section 134(3)(f) of the Act, provides that the board of directors shall be bound to give full information and contain a suitable explanation in the Board's Report on any qualification, reservation or adverse remark made by the Auditors in their report on the accounts audited by them and by the company secretary in practice in his secretarial audit report.

16. Rule 8(3) Companies (Accounts) Rules, 2014 provides that the Board's Report to include the particulars in respect of conservation of energy/technology absorption as already detailed in this Chapter. (Sample Board's Report is placed at the end of lesson).

3. ANNUAL RETURN

Annual Return is a significant document for the stakeholders of a company as it provides in a nutshell, very comprehensive information about various aspects of a company. It is perhaps the most important document required to be filed by every company with the Registrar of Companies. Apart from the Financial Statements, this is the only document to be compulsorily filed with the Registrar every year irrespective of any events / happenings in the company. While the Financial Statements give information on the financial performance of a company, it is the Annual Return which gives extensive disclosure and greater insight into the non-financial matters of the company and the people behind management of the company.

Objective of filing Annual Return

The basic purpose behind filing of Annual Returns with the Registrar is to provide Annual information in respect of company, promoters, members, meetings, remuneration of directors and key managerial persons etc., to the Registrar of Companies/shareholders/other stakeholders. Filing of Annual returns yearly to the Registrar of Companies is the responsibility of the management of the Company. It helps stakeholders to ensure that the company is administered in a proper way in the interest of its members and creditors.

Applicability

As per section 92 of the Companies Act, 2013, every company is required to prepare the Annual Return in **Form No. MGT-7** except One Person Company (OPC) and Small Company. One Person Company and Small Company shall file annual return from the financial year 2020-2021 onwards in **Form No.MGT-7A** containing the particulars as they stood on the close of the financial year.

Annual Return is to be filed with the Registrar within 60 days from the date on which Annual General Meeting (AGM) is actually held or from the last day on which AGM should have been held.

Applicability to Foreign Companies

- As provided in sub-section (2) of section 384 of the Act, the provisions of section 92 regarding filing of annual return apply to a foreign company subject to such exceptions, modifications and adoptions as may be provided for in the Rules.

- Rule 7 of the Companies (Registration of Foreign Companies) Rules, 2014 provides that every foreign company shall prepare and file, within a period of sixty days from the last day of its financial year, to the Registrar annual return in **Form FC-4** along with fee, containing the particulars as they stood on the close of the financial year.

Contents of Annual Return

Annual Return shall contain the following particulars in consonance with the Section 92(1) of the Act:

(a) its registered office, principal business activities, particulars of its holding, subsidiary and associate companies;

(b) its shares, debentures and other securities and shareholding pattern;

(c) its indebtedness;

(d) its members and debenture-holders along with changes therein since the close of the previous financial year;

(e) its promoters, directors, key managerial personnel along with changes therein since the close of the previous financial year;

(f) meetings of members or a class thereof, Board and its various committees along with attendance details;

(g) remuneration of directors and key managerial personnel;

(h) penalty or punishment imposed on the company, its directors or officers and details of compounding of offences and appeals made against such penalty or punishment;

(i) matters relating to certification of compliances, disclosures as may be prescribed;

(j) details, as may be prescribed, in respect of shares held by or on behalf of the Foreign Institutional Investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them; and

(k) such other matters as may be prescribed.

Additional contents

Secretarial Standard on General Meetings (SS-2) provides that the annual return shall disclose the date of Annual General Meeting (AGM) held during the financial year.

Attachments to E-form MGT-7/MGT-7 A

- List of Shareholders/ debenture holders
- Approval letter for extension of AGM (if any)
- Copy of MGT-8 (if applicable)
- List of Directors
- Optional Attachments, if any

Signing of Annual Return

Under section 92(1) of the Act, the Annual Return is required to be signed both by a director and the Company Secretary, or where there is no Company Secretary, by a Company Secretary in Practice.

The Annual Return of One Person Company and Small Company shall be signed by the Company Secretary or where there is no company secretary, by the director of the company. The Act authorises the Central Government to prescribe abridged form of annual return for "One Person Company, Small Company and such other class or classes of companies as may be prescribed. Accordingly, Rule 11(1) has prescribed separate Annual Return for these companies.

Certification of Annual Return

Certification of Annual Return under sub-section (2) of section 92 of the Act read with rule 11(2) of the Companies (Management and Administration) Rules, 2014, the Annual Return of a listed company or of a company having a paid-up share capital of Rs. 10 Crores or more or turnover of Rs. 50 Crores or more shall be certified by a Company Secretary in Practice in the **Form No. MGT-8**.

The certificate shall state that the annual return discloses the facts correctly and adequately and that the company has complied with all the provisions of this Act.

For the purpose of certification, PCS should carry out a scrutiny of the data available and check the correctness of the same. The PCS should be prudent in understanding the events and its impact and consequences, while certifying the same. For ensuring the correctness of information contained in the Annual Return, the primary source documents should be looked into. While doing the detailed scrutiny, he may rely on certified copies of the resolutions, forms, agreements and also certificates from the management.

Indicative list of Required Documents / Records for Annual Return preparation/certification

- Memorandum and Articles of Association;
- Shareholding pattern and its breakup;
- List of Promoters;
- Statutory Registers :
  - Register of Members - Form MGT-1;
  - Register of Debenture-holders and other security holders- Form MGT-2;
  - Foreign Registers of Members / Debenture holder / other security holder;
  - Register of Directors and Key Managerial Personnel & their Shareholding;
  - Register of loans, guarantee, security and acquisition made by the company- Form MBP-2;
  - Register of Investment not held in its own name by the company-Form MBP-3;
  - Register of Contracts or Arrangements with related party and with bodies corporate etc. in which directors are interested- Form MBP-4;
  - Register of deposit;
  - Register of Charge- Form CHG-7;
  - Register of Employee Stock Option- Form SH-6;

- Register of Buyback - Form SH-10;
- Register of Sweat Equity shares - Form SH-3;
- Other Statutory Registers and Records.

- Minutes of the Meetings:
  - Board Meeting;
  - General Meeting;
  - Committee Meeting;
  - Class Meeting;
  - Creditors Meeting;
  - Debenture holders Meeting;
  - Court convened Meetings for the purpose of restructuring and amalgamation.
- Attendance Registers of all Meetings;
- Forms & receipts filed with the Registrar of Companies;
- Copy of Notices and agenda papers for convening meetings of the Board / Committees / Annual General Meeting/Extraordinary General Meetings/Postal Ballots/Court convened Meetings / Creditors Meetings / Class Meetings/ Debenture holders Meeting;
- Copy of Latest Financial Statements along with the Board's Report and Auditor's Report;
- Shareholder List, details of Share Transfers taken place between close of the previous financial year and close of the financial year to which Annual Return relates, controls of the data as on the date of Annual General Meeting of the company or the beneficial positions as on close of financial year downloaded from the records of the Depository participants by Registrar Transfer Agent (RTA) of the company on record/book closure date prior to AGM;
- Certificate from RTA stating the number of shareholders as on the close of the financial year;
- Change of name of the company, change in the face value of the shares of the company, new ISIN No. of the company in respect of the allotment or as a result of any change in capital structure due to any corporate action taken by the company during the Financial year;
- Board Resolution for any type of corporate actions taken by the company;
- Corporate Action Forms filed by the company with Depositories;
- Any orders received by the company, Director or officer from Tribunal/court or from any other regulatory body under any act;
- Listing and Trading Approval(s) from Stock Exchanges, Credit Confirmation from Depositories namely NSDL and CDSL respectively/confirmation from both depositories in respect of allotment of equity shares of the company;
- Intimation to Stock Exchanges, Confirmation from National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) for change of the name of the company, change in the face value of equity shares, change in ISIN of the company and the Scrip Code/Symbol of the company, etc.;
- Other prescribed documents.

Practical Scenario

As per the ICSI Unique Document Identification Number (UDIN) Guidelines, 2019.

UDIN generation is mandatory for the following services rendered by a PCS, including:

- Certification of Annual Return in Form MGT-8 under Section 92(2) of the Companies Act, 2013 and Rule 11(2) of the Companies (Management and Administration) Rules, 2014.
- Issuance of Secretarial Audit Report in terms of Section 204 of the Companies Act, 2013.
- Issuance of Secretarial Audit Report to material unlisted subsidiaries of listed entities (whose equity shares are listed) in terms of Regulation 24A of SEBI (LODR) Regulations, 2015.
- Issuance of Annual Secretarial Compliance Report to Listed entities (whose equity shares are listed) under SEBI Circular No. CIR/CFD/CMD1/27/2019 dated 8th February, 2019.
- Compliance Certificate regarding compliance of conditions of Corporate Governance as prescribed under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- Signing of Annual Return in Form MGT-7 under Section 92(1) of the Companies Act, 2013 and Rule 11(1) of the Companies (Management and Administration) Rules, 2014.

Inclusion in Board's Report & Website

According to Section 92(3), every company shall place a copy of the annual return on the website of the company, if any, and the web-link of such annual return shall be disclosed in the Board's Report (*Notified on 28.08.2020*).

Filing of Annual Return with Registrar

Every company is required to file with the Registrar a copy of the annual return, within sixty days from the date on which the AGM is held or where no AGM is held in any year within sixty days from the date on which the AGM should have been held together with the statement specifying the reasons for not holding the AGM in **Form MGT-7**, with such fees or additional fees as may be prescribed. From the financial year 2020-21 onwards, One Person Company and Small Company shall file return in **Form MGT-7A**.

For foreign company the filing is to be done in **E-Form FC-4**.

In the matter of *R. Vardharajan, Judicial Member vs. Registrar of Companies CP. NO. 338/441/ND/18, NCLT-New Delhi*, Applicant-company filed application for compounding of default in compliance with provisions of sections 159 and 220 of Companies Act, 1956 for not filing its annual return, balance sheet and profit and loss account for financial year 2013-14. Applicant contended that said default was inadvertent mistake with no mala fide intention and it had put an end to offence by filing annual return and annual accounts for financial year 2013-14. RoC in its report stated that no complaint had been received nor was there any inspection or investigation proceedings pending against applicant. The court held that based on facts, the offence was compounded subject to remittance of certain fine.

Preservation of Annual Return

According to Rule 15 of the Companies (Management and Administration) Rules, 2014:

- The Company is required to keep and maintain copies of the Annual Return filed under Section 92 of the Companies Act, 2013 at the registered office of the company.

- However, such copies of Annual Return may also be kept at any other place in India in which more than one- tenth of the total number of members entered in the register of members resides, if approved by a special resolution passed at a general meeting of the company.
- Copies of all Annual Returns and copies of all certificates and documents required to be annexed thereto shall be preserved for a period of eight years from the date of filing with the Registrar.

Inspection of Annual Return - Section 94 r/w Rule 14 of the Companies (Management & Administration) Rules, 2014

- Copies of Annual returns prepared pursuant to Section 92, shall be open for inspection during business hours, of not less than two hours on every working day as the board may decide, by any member, debenture holder, other security holder or beneficial owner without payment of fee and by any other person on payment of such fee as may be specified in the articles of association of the company but not exceeding 50 rupees for each inspection.
- Any such member, debenture holder, security holder or beneficial owner or any other person may require a copy of return on payment of such fee as may be specified in the articles of association of the company but not exceeding 10 rupees for each page. Such copy of return shall be supplied within 7 days of deposit of such fee.
- The Central Government may also, by order, direct an immediate inspection of the document, or direct that the extract required shall forthwith be allowed to be taken by the person requiring it.

Return to be Evidence - Section 95

Copies of annual returns maintained under Section 94 of the Companies Act, 2013 shall be *prima facie* evidence of any matter directed or authorised to be inserted therein by or under the Companies Act, 2013.

Contravention and Consequences

If any company fails to file its annual return under section 92(4), before the expiry of the period specified therein, such company and its every officer who is in default shall be liable to a penalty of ten thousand rupees and in case of continuing failure, with further penalty of one hundred rupees for each day during which such failure continues, subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default.

In terms of section 92(6), if a Company Secretary in Practice certifies the annual return otherwise than in conformity with the requirements of section 92 or the rules made thereunder, he shall liable to a penalty of two lakh rupees.

CASE LAWS

1) In the matter of *Anil kumar Poddar vs. Nessville Trading (P.) Ltd.,* Appellant made an application for inspection of register of members and annual return of respondent company for the years 2009 to 2012.When company failed to provide copies of aforementioned documents, he filed petition for supply of documents. The Respondent relied upon doctrine of “ejusdem generis” saying the word “any other person” mentioned in Section 163(2) of the erstwhile Companies Act, 1956 (corresponding to section 94 of the Companies Act, 2013) is limited to the person holding commercial interest such as creditor, financier, customer etc., because the preceding would the member and debenture holder to this word “any other person” being the persons having interest in the company, then the following word “any other person” cannot be said as extendable to any person who has no interest in the company,

normally, a person considered to aggrieved when his interest is affected by the act of somebody else, but whereas this Petitioner has no interest in these companies, therefore, he cannot be called aggrieved to file these company petitions against the Respondent. The NCLT, Mumbai Bench held that, since petitioner was neither a shareholder, nor debenture holder nor holding commercial interest in respondent company, he was not entitled to seek relief under Section 163 of the erstwhile Companies Act, 1956 (corresponding to section 94 of the Companies Act, 2013) regarding supply of copies of documents for inspection.

2) In the matter of *Suhas Chakma vs. South Asia Human Rights Documentation Centre Pvt. Ltd.*, the contention of the petitioner is that he never executed any instrument of transfer of his shareholdings to the 2nd respondent, and that he came to know that he was not a shareholder of the 1st respondent company by virtue of inspection of the Annual Return and that in relation to the illegal and fraudulent transfer of his shares, he came to know about the same only upon perusal of the Annual Returns. The NCLT, New Delhi Bench observed that, in view of the wordings used in section 164 of the Companies Act, 1956 (now Section 95 under the Companies Act,2013) to the effect that registers, returns and documents shall be only *prima facie* evidence and hence subject to rebuttal, and therefore, cannot be treated as conclusive evidence and in absence of share transfer forms and specified share certificates/letter of allotment in question, transfer of equity shares of Petitioner by Respondents were fraudulent and sham and declare it to be illegal and void.

Test Your knowledge

1) XYZ Ltd., a listed company, seeks your advice, as the Secretarial Auditor of the company, on the inclusion of Extract Annual Return in the Board's Report for the financial year 2020-21?

2) Every Company shall place a copy of its annual return on the website of the Company. Comment.

3) Vinod, Chairperson of the Monika Ltd. is going to USA for official work and instructed to the Company Secretary for signing of Board's Report in his absence from other directors of the Company. Whether the other directors can sign the Board's Report? If yes, explain the provisions for signing of Board's Report in the absence of Chairperson in the Company. What would be your answer if this company is One Person Company.

4) The Board of Directors of ABC Ltd. approaches you for advice on the voluntary revision of financial statements or board reports of the company as per the Companies Act, 2013. Advise the Board of Directors.

5) RST Ltd.'s annual general meeting should have been held on 30th Sept., 2020. However, as the accounts for the year 2019-2020 were not ready, the AGM could not be held. In order to avoid legal action against himself and the company what are the compliances required to be met by the Company Secretary under Section 92 of the Companies Act 2013?

Active Company Tagging Identities and Verification (ACTIVE)

Rule 25A of the Companies (Incorporation) Rules, 2014

Every company incorporated on or before the 31st December, 2017 shall file the particulars of the company and its registered office, in e-Form ACTIVE (Active Company Tagging Identities and Verification) on or before 15.06.2019.

Provided that any company which has not filed its due financial statements under section 137 or due annual

returns under section 92 or both with the Registrar shall be restricted from filing e-Form-ACTIVE, unless such company is under management dispute and the Registrar has recorded the same on the register:

Provided further that companies which have been struck off or are under process of striking off or under liquidation or amalgamated or dissolved, as recorded in the register, shall not be required to file e-Form ACTIVE:

Provided also that in case a company does not intimate the said particulars, the Company shall be marked as "ACTIVE-non-compliant" on or after 16th June, 2019 and shall be liable for action under sub-section (9) of section 12 of the Act:

Provided also that no request for recording the following event based information or changes shall be accepted by the Registrar from such companies marked as "ACTIVE-non-compliant", unless "e-Form ACTIVE" is filed –

(i) SH-07 (Change in Authorized Capital);

(ii) PAS-03 (Change in Paid-up Capital);

(iii) DIR-12 (Changes in Director except in case of :

  (a) cessation of any director; or

  (b) appointment of directors in such company where the total number of directors are less than the minimum number provided in clause (a) of sub-section (1) of section 149 on account of disqualification of all or any of the director under section 164;

  (c) appointment of any director in such company where DINs of all or any its director(s) have been deactivated;

  (d) appointment of director(s) for implementation of the order passed by the Court or Tribunal or Appellate Tribunal under the provisions of the Companies Act, 2013 or under the Insolvency and Bankruptcy Code, 2016).

(iv) INC-22 (Change in Registered Office);

(v) INC-28 (Amalgamation, de-merger).

Where a company files "e-Form ACTIVE", on or after 16th June, 2019, the company shall be marked as "ACTIVE Compliant", on payment of fee of ten thousand rupees.

SPECIMEN RESOLUTION/FORMATS

Specimen Board Resolution for Approval of the Board's Report

"RESOLVED THAT the Boards' Report to be sent to the Shareholders of the company for the year ended 31st March..... is prepared in accordance with the provisions of Section 134 of the Companies Act, 2013 together with its Annexures and also contain suitable explanation and fullest information on every reservation, qualification or adverse remarks, if any, contained in Auditor's reports, as submitted to the meeting, be and is hereby approved and the same be signed by Shri..... Chairman of the company, by Shri..... Managing Director and Shri ..... Director for and on behalf of the Board of Directors of the company."

Specimen Resolution to be Passed by the Board of Directors for Approval of the Board's Report Containing Board's Response to Auditors' Comments and Qualifications

"RESOLVED THAT, pursuant to Section 134 of the Companies Act, 2013, the draft of the Board's Report for the year ended 31st March..... as circulated earlier and as modified by incorporating the information and explanation given by the Board on every reservation, qualification or adverse remark contained in the Auditors' Report under Section 143 (2), and as laid on the table, be and is hereby approved and that the Board's Report be signed by the Chairman on behalf of the Board and that the Secretary of the company be directed to issue the same to the members of the company together with the printed copies of the audited accounts, and the Auditors' Report."

Specimen Board's Report

Your Directors are pleased to present 21st Annual Report and the audited financial statements for the financial year ended on 31st March, 20.....

Financial Results:

The financial performance of the Company, for the year ended on 31st March, 20..... is summarized below:

Particulars	***Standalone***		***Consolidated***	
	For the year ended 31st March 20..... (C.Y.)	***For the year ended 31st March 20..... (P.Y.)***	***For the year ended 31st March 20..... (C.Y.)***	***For the year ended 31st March 20..... (P.Y.)***
Sales and Other Income	23,956	21,494	45,831	42,254
Profit before Interest, Depreciation, Exceptional	11,332	9,307	12,751	10,841
Expenses & Tax [PBIDET]	455	243	773	465
Less: Depreciation	10,877	9,064	11,978	10,376
Profit before Interest, Exceptional Expenses & Tax	5	4	13	13
(PBIET)	10,872	9,060	11,965	10,363
Less: Interest	-23	-585	850	532
Profit Before Tax [PBT] Less: Provision for Tax Profit After Tax [PAT] *Less*: Minority Interest	10,895	9,645	11,115	9,831
Profit attributable to shareholders	-	-	220	186
Add: Profit brought forward from the previous year	10,895	9,645	10,895	9,645
Less: Additional depreciation upon revision in useful lives of tangible assets	24,149	18,247	24,149	18,247
Profit available for appropriation, which is appropriated as follows:	35,018	27,892	35,018	27,892
Proposed Final Dividend	2,344	2,344	2,344	2,344
Corporate Dividend Tax on Dividend	477	399	477	399
Transfer to General Reserve	0	1,000	0	1,000
Balance carried to Balance Sheet	32,197	24,149	32,197	24,149
Total	35,018	27,892	35,018	27,892
Basic and Diluted Earning Per Share (EPS of FV Rs. 10) [in Rupees]	27.88	24.69	27.88	24.69

Annual Report 20..... - 20.....

The Company proposes to retain an amount of Rs. 32,197 lacs in the Statement of Profit and Loss. The consolidated financial highlights include the financials of ABC, XYZ, a partnership firm.

Results of operations:

During the year under review, the consolidated gross sales grew by 3.1%. On standalone basis, the Company has earned total revenue of Rs.23,956 lacs. The PBDT increased by 21.8 % to Rs.11,332 lacs and the Profit Before Tax increased by 20% to Rs.10,872 lacs. The Profit after Tax has increased to Rs.10,895 lacs as compared to Rs.9,645 lacs in the previous year and the EPS has increased from Rs.24.69 in the previous year to Rs.27.88. A detailed analysis of performance for the year has been included in the Management Discussion and Analysis, which forms part of the Annual Report.

Dividend

Your Directors have recommended a dividend of Rs.6/- [i.e. 60%] per equity share [last year Rs.6/- per equity share] on 3,90,72,089 equity shares of Rs.10/- each fully paid-up for the financial year ended on 31st March, 2020, amounting to Rs.2,821 lakhs [inclusive of corporate dividend tax of Rs.477 lakhs]. The dividend, if declared by the shareholders at the ensuing Annual General Meeting, will be paid to those shareholders, whose names stand registered in the Register of Members as on ..... In respect of shares held in dematerialized form, it will be paid to the members whose names are furnished by the National Securities Depository Limited and the Central Depository Services [India] Limited, as beneficial owners. The Dividend Payout ratio for the current year (inclusive of Corporate Dividend Tax) is 25.90 percent on profits.

During the year, the unclaimed dividend pertaining to the dividend for the year ended 31st March, 2015 was transferred to Investor Education and Protection Fund.

Consolidated financial Statements

ABC, XYZ is under the majority control of the Company and hence the accounts of ABC, XYZ are consolidated with the accounts of the Company in accordance with the provisions of Accounting Standard [AS]- 21 on Consolidated Financial Statements issued by the Institute of Chartered Accountants of India, Companies Act, 2013 ["Act"] read with Schedule III of the Act and Rules made thereunder and the Listing Agreement with the Stock Exchanges. The audited Consolidated Financial Statements are provided in this Annual Report.

Though Company does not have any subsidiary Company, the Company has formed a policy relating to material subsidiaries, which is approved by the Board of Directors and can be accessed on the Company's website at the link:

Related Party Transactions

All transactions entered by the Company during the financial year with related parties were in the ordinary course of business and on an arm's length basis. During the year, the Company had not entered into any transactions with related parties which could be considered as material in accordance with the policy of the Company on materiality of related party transactions.

The Policy on materiality of related party transactions and dealing with related party transactions as approved by the Board may be accessed on the Company's website at the link: ..... Disclosures on related party transactions are set out in Note No. 34 to the financial statements.

Directors

i. Cessation:

Mr. P [DIN-XXXXXXXX], Director and Mr. Q [DIN-XXXXXXXX], Managing Director of the Company have resigned with effect from ..... and ..... respectively.

The Board places on record its appreciation for contributions and guidance provided by Mr. P and Mr. Q during their respective tenure as a Director / Managing Director of the Company.

ii. Retirement by rotation:

In accordance with the provisions of section 152[6] of the Act and in terms of Articles of Association of the Company, Mr. X [DIN-XXXXXXXX] will retire by rotation at the ensuing Annual General Meeting and being eligible, offer himself for reappointment. The Board recommends his reappointment.

iii. Appointment of Additional / Whole Time Director:

Mr. R was appointed as an Additional Director and Whole time Director w.e.f....., subject to the approval of the Members at the ensuing Annual General Meeting. Mr. R is designated as the Key Managerial Personnel pursuant to the provisions of section 203 of the Act.

iv. Independent Directors:

The Independent Directors have submitted their declarations of independence, as required pursuant to the provisions of section 149(7) of the Act, stating that they meet the criteria of independence as provided in section 149(6).

v. Chairman:

Upon cessation of Mr. M [DIN-XXXXXXXX] as the Director of the Company, Dr. N was appointed as the Chairman of the Board and Company w.e.f. .....

vi. Key Managerial Personnel:

The following persons were designated as Key Managerial Personnel:

1. Mr. Q, Managing Director, [up to .....]
2. Mr. R, Whole Time Director, [w.e.f. .....]
3. Mr. O, Chief Financial Officer, and
4. Mr. J, Company Secretary.

vii. Board Evaluation:

Pursuant to the provisions of the Companies Act, 2013 and Rules made thereunder and as provided under Schedule IV of the Act and SEBI (LODR), Regulation, 2015 the Board has carried out the annual performance evaluation of itself, the Directors individually as well as the evaluation of its committees. The manner in which the evaluation was carried out is provided in the Corporate Governance Report, which is part of this Annual Report.

viii. Remuneration Policy:

The Board has on the recommendations of Nomination and Remuneration Committee, framed a Policy on selection and appointment of Directors, Senior Management and their remuneration. The Remuneration Policy is stated in the Corporate Governance Report, which is part of this Annual Report.

Directors' Responsibility Statement

In terms of section 134[3][c] of the Act, your Directors state that:

i. in the preparation of the annual financial statements for the year ended on 31st March, 20....., applicable accounting standards read with requirements set out under schedule III of the Act, have been followed along with proper explanation relating to material departures, if any;

ii. such accounting policies have been selected and applied consistently and judgements and estimates made that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company as at 31st March, 20..... and of the profit of the company for the year ended on that date;

iii. the directors had taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of this Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities;

iv. the annual financial statements are prepared on a going concern basis;

v. proper internal financial control are in place and that the financial controls are adequate and are operating;

vi. the systems to ensure compliance with the provisions of all applicable laws are in place and are adequate and operating effectively.

Board Meetings

A calendar of meetings to be held in a year is decided in advance by the Board and circulated to the Directors. During the year, four Board and four Audit Committee Meetings were convened and held, the details of which are provided in the Corporate Governance Report, forming part of the Directors' Report. The gap between two consecutive meetings was not more than one hundred and twenty days as provided in section 173 of the Act.

Corporate Governance

The Company has complied with the Corporate Governance requirements under the Act and as stipulated in Listing Regulations. A separate section on detailed report on the Corporate Governance practices followed by the Company under the Listing Agreement along with a certificate from M/s. DEF & Associates, Practicing Company Secretary, confirming the compliance, is part of the Annual Report.

i. Statutory Auditor and their Report:

M/s. D, Chartered Accountants, [Firm Registration No. .....] Statutory Auditor of the Company hold office until the conclusion of the ensuing 21st Annual General Meeting and are eligible for reappointment. Pursuant to provisions of section 139 of the Companies Act, 2013 and the Rules made thereunder, the Board proposes to reappoint M/s. &, Chartered Accountants as Statutory Auditor of the Company from the conclusion of the ensuing 21st Annual General Meeting till the conclusion of 26th Annual General Meeting. They have furnished a certificate confirming the eligibility under section 141 of the Companies Act, 2013 and Rules made thereunder.

The Board based on the recommendation of Audit Committee, recommends the reappointment of M/s, Chartered Accountants, as the Statutory Auditor of the Company.

The Board has duly reviewed the Statutory Auditor's Report on the Accounts. The observations and comments, appearing in the Auditor's Report are self-explanatory and do not call for any further explanation/ clarification by the Board of Directors as provided under section 134 of the Act.

ii. Cost Auditor:

Pursuant to the provisions of section 148 [3] of the Act read with The Companies [Cost Records and Audit] Amendment Rules, 2014, the cost audit records maintained by the Company in respect of its product is required to be audited. The Board had, on the recommendation of Audit Committee, appointed M/s UV & Associates, Cost Accountants [Firm Registration No.....] to audit the cost records of for the financial year ended on 31st March, 20..... on a remuneration of Rs.1.80 lacs As required under the Act and Rules made thereunder, the remuneration payable to the Cost Auditor is required to be placed before the Members General Meeting for ratification. Accordingly, a resolution to ratify the remuneration payable to M/s. UV & Associates for the financial year ending on 31st March, 20..... is included at Item No. 8 of the Notice convening 21 Annual General Meeting.

iii. Secretarial Auditor and Secretarial Audit Report:

Pursuant to the provisions of section 204 of the Act and The Companies [Appointment and Remuneration of Managerial Personnel] Rules, 2014, the Company has appointed M/s. DEF & Associates, Practicing Company Secretary to undertake Secretarial Audit for the financial year ended on 31st March, 20. Secretarial Audit Report. The Board has duly reviewed the Secretarial Auditor's Report and the observations and comments, appearing in the report are self-explanatory and do not call for any further explanation / clarification by the Board of Directors as provided under section 134 of the Act.

Corporate Social Responsibility [CSR]

The Board of Directors of the Company has constituted a Corporate Social Responsibility [CSR] Committee under the Chairmanship of Dr. N. Other members of the Committee are Mr. Y and Prof. Z. CSR Committee has recommended to the Board, a CSR Policy, indicating the activities to be undertaken by the Company, which is approved by the Board. The CSR Policy is posted on the website of the Company.

As part of its initiatives under Corporate Social Responsibility [CSR], the Company has contributed for healthcare, education and research in cancer and for eradicating poverty and malnutrition for the year under review. Other details of the CSR activities as required under section 135 of the Act are given in the CSR Report as Annexure-B.

Business Risk Management

A well-defined risk management mechanism covering the risk mapping and trend analysis, risk exposure, potential impact and risk mitigation process is in place. The objective of the mechanism is to minimize the impact of risks identified and taking advance actions to mitigate it. The mechanism works on the principles of probability of occurrence and impact, if triggered. A detailed exercise is being carried out to identify, evaluate, monitor and manage both business and non-business risks.

Discussion on risks and concerns are covered in the Management Discussion and Analysis Report, which forms part of this Annual Report.

Internal control systems and its adequacy

The Company has internal control systems commensurate with the size, scale and complexity of its business operations. The scope and functions of internal auditor are defined and reviewed by the Audit committee. The internal auditor reports to the Chairman of the Audit Committee. Internal Auditors presents their quarterly report to the Audit Committee, highlighting various observations, system and procedure lapses and corrective actions are taken. The internal auditor also assesses opportunities for improvement of business processes, systems and controls, to provide recommendations, which can add value to the organization and it also follows up on the implementation of corrective actions and processes. The Management Auditor also ensures the compliance of the observations of internal and statutory auditors and presents his report to the Audit Committee.

Managing the Risks of fraud, corruption and unethical business practices

i. Vigil Mechanism/ Whistle Blower Policy:

The Company has established vigil mechanism and framed whistle blower policy for Directors and employees to report concerns about unethical behavior, actual or suspected fraud or violation of Company's Code of Conduct or Ethics Policy. Whistle Blower Policy is disclosed on the website of the Company.

ii. Business Conduct Policy:

The Company has framed "ABC Business Conduct Policy". Every employee is required to review and sign the policy at the time of joining and an undertaking shall be given for adherence to the Policy. The objective of the Policy is to conduct the business in an honest, transparent and in an ethical manner.

The policy provides for anti- bribery and avoidance of other corruption practices by the employees of the Company.

Weblink of Annual Return

The weblink of the Annual Return is_____.

Constitution of Audit Committee

The Board has reconstituted the Audit Committee which comprises of Mr. H as the Chairman and Dr. B.M. Hegde, Prof. Z and Mr. Y as the members. More details on the Committee are given in the Corporate Governance Report.

Particulars of Employees

The information required under section 197 of the Act read with Rule 5(1) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 is attached as Annexure-C.

Energy Conservation, Technology Absorption and Foreign Exchange Earnings and Outgo

Information on conservation of energy, technology absorption, foreign exchange earnings and outgo, as required to be disclosed under section 134(3)(m) of the Act read with the Companies (Accounts) Rules, 2014, and forms part of this Report.

General Disclosure

Your Directors state that the Company has made disclosures in this report for the items prescribed in section 134(3) of the Act and Rule 8 of The Companies (Accounts) Rules, 2014 to the extent the transactions took place on those items during the year.

Disclosure, regarding maintenance of cost records

Disclosure, regarding maintenance of cost records as specified by the Central Government under sub-section (1) of section 148 of the Companies Act, 2013, is required by the Company and accordingly such accounts and records are made and maintained.

Disclosure relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013

A statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013.

Acknowledgement

Your Directors wish to place on record their sincere appreciation for significant contributions made by the employees at all levels through their dedication, hard work and commitment, enabling the Company to achieve good performance during the year under review.

Your Directors also take this opportunity to place on record the valuable co-operation and support extended by the banks, government, business associates and the shareholders for their continued confidence reposed in the Company and look forward to having the same support in all future endeavors.

For and on behalf of the Board

(Company Name)

Place: Ahmedabad — Mr. N

Date : ..... — Chairman

LESSON ROUND-UP

- The annual report is a comprehensive report provided by most public companies to disclose their corporate activities over the past year.
- According to Regulation 34 of SEBI (LODR) Regulation, 2015, the listed entity shall submit to the stock exchange and publish on its website a copy of the annual report sent to the shareholders along with the notice of the annual general meeting not later than the day of commencement of dispatch to its shareholders.
- The listed entity shall send annual report to the holders of securities, not less than twenty-one days before the annual general meeting.
- Disclosures in the Board's Report are derived from various places, apart from disclosures specified in section 134 of the Act.
- Section 134 of the Act enjoins upon the Board a responsibility to make out its report to the shareholders and attach the said report to financial statements laid before the shareholders at the annual general meeting.
- As per section 92 of the Companies Act, 2013, every company shall file its annual return in Form No.MGT-7 except One Person Company (OPC) and Small Company. One Person Company and Small Company shall file annual return from the financial year 2020-2021 onwards in Form No.MGT-7A.
- Annual Return is to be filed with the Registrar within 60 days from the date on which Annual General Meeting (AGM) is actually held or from the last day on which AGM should have been held.

GLOSSARY

Holding Company: "holding company", in relation to one or more other companies, means a company of which such companies are subsidiary companies (Section 2(46) of Companies Act, 2013)

Explanation – For the purposes of this clause, the expression "company" includes any body corporate.

Subsidiary Company: "subsidiary company" or "subsidiary", in relation to any other company (that is to say the holding company), means a company in which the holding company–

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total voting power either at its own or together with one or more of its subsidiary companies:

Provided that such class or classes of holding companies as may be prescribed shall not have layers of subsidiaries beyond such numbers as may be prescribed.

Explanation – For the purposes of this clause,–

(a) a company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

(b) the composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

(c) the expression "company" includes any body corporate;

(d) "layer" in relation to a holding company means its subsidiary or subsidiaries.

[Section 2(87) of Companies Act, 2013)]

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What information is required to be disclosed in Annual Report?
2. Draft a Directors' Report of your company.
3. What forms the Directors' Responsibility Statement?
4. What points should be kept in mind while preparing Annual Report?
5. What are the contents of Abridged Board's Report in case of small company?
6. Copies of all annual returns prepared under section 92 and copies of all certificates and documents required to be annexed thereto shall be preserved from the date of filing with the Registrar.
   (a) For a period of 6 years
   (b) For a period of 5 years
   (c) For a period of 8 years
   (d) For a period of 7 years
7. Mr. Alex is the chairperson of M/s XYZ Ltd. The directors are of the view that the board report can be signed by Mr. Alex as he is the chairperson of the company and he do not need any kind of authorization from board before signing the board report. As a Company Secretary advice the board of directors:
   (a) Mr. Alex can sign the board report being the chairperson of the Company
   (b) The board report must be sign by the two directors on of whom shall be MD or by the director where there is one director.
   (c) Mr. Alex and the Company Secretary can sign the board report.
   (d) MD and Company Secretary can sign the board report.

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- Bare Act- The Companies Act, 2013
- ICSI Premiere on Company Law
- ICSI Guidance Note on Report of Board of Director
- The SEBI (LODR) Regulations, 2015

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==
- Sebi.gov.in

Key Managerial Personnel (KMP's) and their Remuneration

Lesson 19

KEY CONCEPTS

■ Management ■ Key Managerial Personnel ■ Managing Director ■ Whole-time Director ■ Company Secretary ■ CFO ■ CEO ■ Manager ■ Remuneration ■ Officer who is in default

Learning Objectives

To understand:

- Appointment procedure and conditions for appointment of KMP
- Filling of vacancies in office of Key Managerial Personnel
- Role of KMP
- Role and duties of a Company Secretary as Key Managerial Personnel
- Provisions related to appointment of Managing Director, Whole Time Director or Manager
- Provisions related to Managerial Remuneration

Lesson Outline

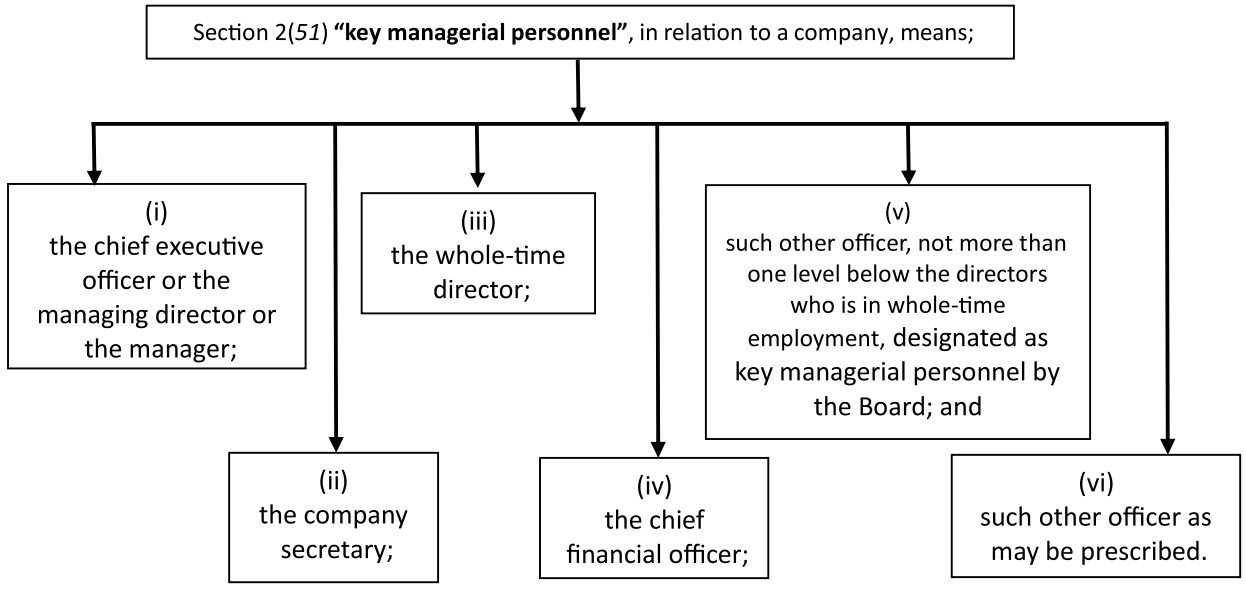
- Appointment of Key Managerial Personnel
- Managing and Whole-Time Directors
- Chief Executive Officer
- Chief Financial Officer
- Company Secretary – Appointment, Roles and Responsibilities
- Company Secretary as a Key Managerial Personnel
- Functions of Company Secretary
- Provisions related to remuneration of managerial personnel
- Officer who is in default
- Remuneration of Managerial Personnel
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- Other References

REGULATORY FRAMEWORK

- The Companies Act, 2013 (Sections 196 to 205)
- The Companies (Appointment and Qualification of Managerial Personnel) Rules, 2014
- Schedule V - Provisions related to Appointment & Remuneration of MD/WTD/Manager
- The SEBI (LODR) Regulations, 2015

INTRODUCTION

Key Managerial Personnel (KMP) or Key Management Personnel refers to whole time employees of a company who are vested with the most important roles and functionalities. They are the first point of contact between the company and its stakeholders and are responsible for the formulation of strategies and its implementation. KMP is a group of people in charge of the company's operations. They are the decision-makers and responsible for the company's smooth functioning. They are employees vested with certain essential functionalities and roles. Accounting Standard 18(AS-18) states that Key Managerial Personnel (KMP) are people who have authority and responsibility for planning, directing, and controlling the activities of the reporting enterprise. Chief Executive Office, Chief Financial Officer, Company Secretary, Whole Time Director are the Key Managerial Personnel.



Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of key managerial personnel including managing director, whole-time director or manager, managerial remuneration, etc.

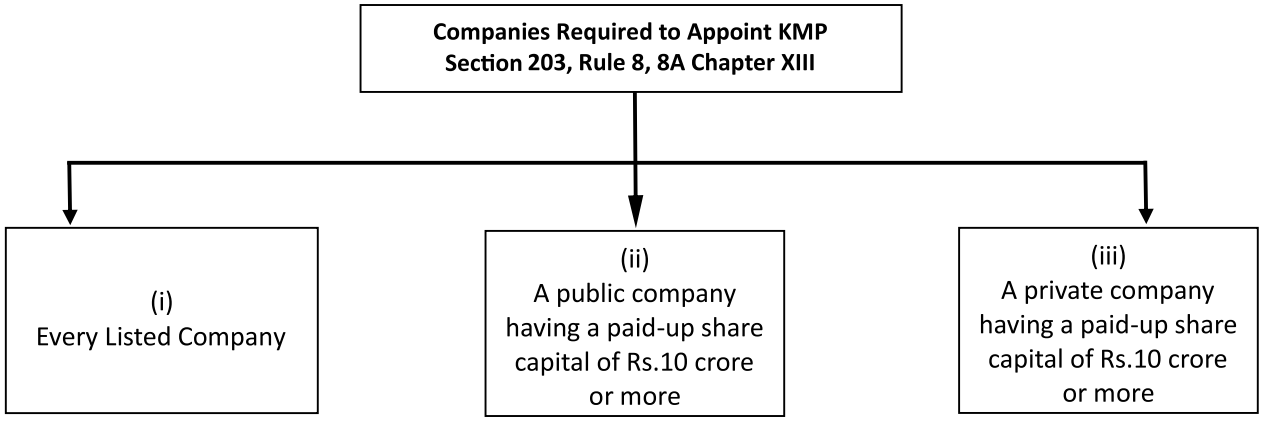
Section 196 and 197 read with schedule V of the Companies Act, 2013 provides for conditions for appointment and remuneration of Managing Director, Whole-time Director or Manager.

VARIOUS KMP'S POSITIONS & DEFINITION THEREOF UNDER THE COMPANIES ACT, 2013

S. No.	*Particulars*	*Section*	*Definition*
1.	Chief Executive Officer (CEO)	Section 2(18)	"Chief Executive Officer" means an officer of a company, who has been designated as such by it.

S. No.	Particulars	Section	Definition
2.	Chief Financial Officer (CFO)	Section 2(19)	"Chief Financial Officer" means a person appointed as the Chief Financial Officer of a company.
3.	Company Secretary (CS)	Section 2(24)	"Company Secretary" or "Secretary" means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 who is appointed by a company to perform the functions of a company secretary under this Act.
4.	Manager	Section 2(53)	"Manager" means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole, of the affairs of a company, and includes a director or any other person occupying the position of a manager, by whatever name called, whether under a contract of service or not.
5.	Managing Director (MD)	Section 2(54)	"Managing Director" means a director who, by virtue of the articles of a company or an agreement with the company or a resolution passed in its general meeting, or by its Board of Directors, is entrusted with substantial powers of management of the affairs of the company and includes a director occupying the position of managing director, by whatever name called. Explanation.—For the purposes of this clause, the power to do administrative acts of a routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within the substantial powers of management.
6.	Whole Time Director (WTD)	Section 2(94)	"Whole-time director" includes a director in the whole-time employment of the company.

APPOINTMENT OF KEY MANAGERIAL PERSONNEL



As per section 203(1) of the Companies Act, 2013 read with the Rule 8 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the following class of Companies are required to appoint KMP-

- Every listed company, and
- Every other public company having paid up share capital of Rs. 10 Crores or more.

Such Companies shall have the following whole time key managerial personnel, -

- Managing Director, or Chief Executive Officer or manager and in their absence, a whole-time director;
- Company secretary; and
- Chief Financial Officer.

CASE LAW

The Hamlin Trust and Others vs. Rattan India Finance Private Limited (RFPL) and Others Company Appeal (AT) No. 77 of 2022

According to Section 203 of the Companies Act, 2013, every listed company and every other public company having a paid-up share capital of ten crore rupees shall have the CFO as whole-time key managerial personnel.

Provided a whole time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

As per Article of Association of RFPL the right to appoint CFO is with Rose Investments however other 50% of shareholder have the right to reject such candidates.

Provided candidates proposed by the Rose Investments were those individuals who were associated with other entities and were not available full time for RFPL.

The remaining 50% of shareholders object the appointment of such candidates on the grounds that this is not in adherence to the provision of Section 203 of the Companies Act, 2013.

In this matter NCLAT held that in the absence of any specific mention regarding eligibility and the method of selection of the CFO in the Article of Association, it would be logical to take reference to Section 203 of the Companies Act, 2013 even by a private company, in the selection and appointment of CFO, as Section 203 prescribes the appointment of KMP which includes a CFO of the company.

NCLAT, after hearing the arguments of both the parties, held that even if RFPL is a private company the provisions of Section 203 shall apply to a company that voluntarily appoints a CFO.

Since, the CFO is a key managerial personnel (KMP) in terms of Section 2(51) of Companies Act, 2013, directed that eligibility for appointment of CFO as mentioned in Section 203 of the Companies Act, 2013 would apply between the parties.

Further, as per Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, every private company which has a paid-up share capital of ten crore rupees or more shall have a whole-time Company Secretary.

Illustrations:

1. ABC limited, is a listed company having paid up share capital of twelve cores rupees and more. It is mandatory for the ABC company to have following whole time KMP:
   i. MD or CEO or Manager and in their absence, a WTD;
   ii. Company Secretary; and
   iii. CFO.
2. ABC Limited is a public company having paid up share capital of five crore rupees. It is not compulsory for the company to have following whole time KMP:
   i. MD or CEO or Manager and in their absence, a WTD;
   ii. Company Secretary; and
   iii. CFO.

No Person shall act as Chairman and Managing Director/CFO at the same time

First proviso to section 203(1) states that an individual shall not be appointed or reappointed as the chairperson of the company, in pursuance of the articles of the company, as well as the managing director or Chief Executive Officer of the company at the same time after the date of commencement of this Act unless-

a) the articles of such a company provide otherwise; or

b) the company carries only a single business; or

c) the company is engaged in multiple businesses and has appointed one or more Chief Executive Officers for each such business as may be notified by the Central Government. [Second Proviso to Section 203(1)]

Exception under second proviso to section 203(1)

MCA notification [S.O. 1913(E)] on 25th July, 2014- In exercise of the powers conferred by the second proviso to sub-section (1) of Section 203 of the Companies Act, 2013, the Central Government hereby notifies that-

- public companies having paid-up share capital of rupees one hundred crore or more; and
- annual turnover of rupees one thousand crore or more

which are engaged in multiple businesses and have appointed Chief Executive Officer for each such business shall be the class of companies for the purposes of the second proviso to sub-section (1) of Section 203 of the said Act.

MCA further explained for the purposes of this notification, the paid-up share capital and the annual turnover shall be decided on the basis of the latest audited balance sheet.

Manner of Appointment of KMP

As per Section 203 (2) every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

Under Section 203 (3) a Whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time.

Further, key managerial personnel may become a director of any company with the permission of the Board. A company may appoint or employ a person as its managing director, if he is the managing director or manager of one, and of not more than one, other company and such appointment or employment is made or approved by a resolution passed at a meeting of the Board with the consent of all the directors present at the meeting and of which meeting, and of the resolution to be moved thereat, specific notice has been given to all the directors then in India.

Illustrations:

1. ABC Limited, is a listed company having paid up share capital of rupees 15 crores. It is compulsory for the company to have whole time KMP. They shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.
2. ABC Limited, is a listed company having paid up share capital of Rs. 15 crores. Mr. A is the CEO of the company. Mr. A cannot hold office in XYZ Limited.
3. ABC Limited, is a listed company having paid up share capital of Rs. 12 crores. Mr. A is the managing director of the company. Mr. A can hold office in XYZ Limited which is a subsidiary of ABC Limited.
4. Mr. A is a managing director of the ABC Limited. He is appointed as managing director of XYZ Limited. Such appointment must be made or approved by a resolution passed at a meeting of the Board with the consent of all directors present at the meeting. Also, a specific notice of such meeting, and a resolution to be moved thereat must be given to all the directors.

Provisions as Specified Under the SEBI (LODR) Regulations, 2015

As per Regulation 30 read with Schedule III Part A of the SEBI (LODR) Regulations, 2015, the listed entity shall disclose to the stock exchange:

- Change in directors, key managerial personnel (Managing Director, Chief Executive Officer, Chief Financial Officer , Company Secretary etc.), senior management, Auditor and Compliance Officer;
- Fraud or defaults by a listed entity, its promoter, director, key managerial personnel, senior management or subsidiary or arrest of key managerial personnel, senior management, promoter or director of the listed entity, whether occurred within India or abroad.

Vacancy of KMP

Section 203 (4) of Companies Act 2013 states that if the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of 6 months from the date of such vacancy.

CASE LAW

In Re *Alpur* Solar *Private Limited (Petitioner) vs. Registrar of Companies, NCT of Delhi & Haryana, (Respondents) ROC/D/Adj/2022/Section 203/*Alpur*/6982-6988 dated 19.12.2022*

If the office of any whole-time key managerial personnel is vacated, the resulting vacancy shall be filled-up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

Facts of the Case:

The previous CS of the Company vacated the office on 28.01.2021 and such vacancy was filled on 24.01.2022 after a period of one year.

Decision:

The Company's officials pleaded that because of the COVID pandemic and the lockdown situation company faced difficulties in the appointment of CS. Under the circumstances, the ROC determined that the failure to appoint CS constituted a violation, and as a result, penalties were levied. Total Penalty of Rs. 16,50,000/- imposed on the company.

CASE LAW

In the case of *Achutha Rai vs. Registrar of Companies [1995 SCC Online Ker 90: (1906) 36 Comp Cas 598: 1966 Cri LJ 478]*, the Kerala High Court held that the petitioner (being the managing director) has two capacities combined in him, one that of a director and the other that of a manager or an officer. His capacity as manager cannot be terminated by mere sending of two resignations but it must be duly accepted by the company and he should be relieved of his duties and responsibilities.

In case a Managing Director who is also acting as Key Managerial Personnel under Section 203 of the Act vacate his position for any reason, such vacancy pursuant to provisions of section 203 (4) of the Act.

Non applicability of Section 203

As per Section 203 (4A) the provisions of sub-section (1), (2), (3) and (4) of this section shall not apply to a Managing Director or Chief Executive Officer or Manager and in their absence, a whole-time director of the Government Company.

Penalty for Contravention

If any company makes any default in complying with the provisions of this section, such company shall be liable to a penalty of five lakh rupees and every director and key managerial personnel of the company who is in default shall be liable to a penalty of fifty thousand rupees and where the default is a continuing one, with a further penalty of one thousand rupees for each day after the first during which such default continues but not exceeding five lakh rupees.

Intimations Regarding appointment of KMP

File with the Registrar the e-Form MGT-14 [Private Companies are exempted from filing e-form MGT-14 regarding appointment of KMP under section 117(3)(g) vide exemption notification dated June 5, 2015].

All companies need to file a return containing the particulars of appointment of key managerial personnel with the Registrar in e-form DIR-12 along with specified fees within thirty days of such appointment.

In case of listed entity, intimation to Stock Exchange about appointment of KMP as soon as reasonably possible and not later than twenty-four hours from the occurrence of event. [Regulation 30 SEBI (LODR) Regulations, 2015].

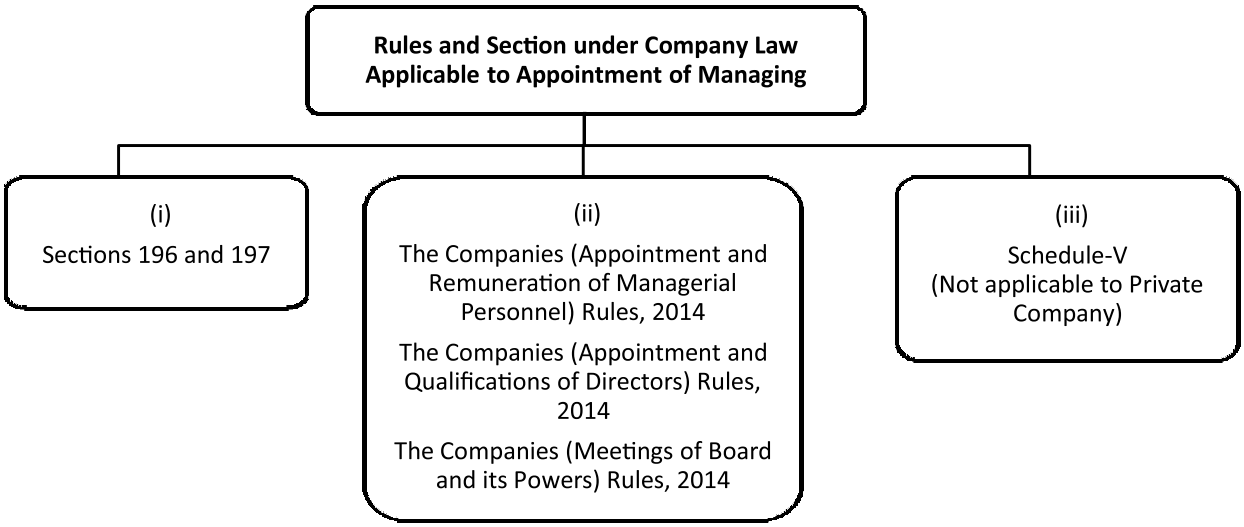
Role of KMP

The KMPs are responsible for taking crucial company decisions. They are also liable when the company does not follow the mandatory compliances laid down by the statutory provisions. The primary roles and responsibilities of the KMP are:

- Financial statement to be signed by CEO, if any, if director & by CFO & by CS.
- Prohibited from insider trading/forward dealing in securities.
- Included in officer/officer in default/related party along with relatives.

- Sign document/ proceedings/contract on behalf of company.
- Disclosure in annual return about KMP.
- Names fall under register of KMP & their shareholding in holding/subsidiary/associate.
- Disclose interest/concern & changes to company within 30 days of appointment/relinquishment.
- KMP has right to be heard in Audit Committee meetings when the committee considers auditor's report, but KMP shall not have right to vote.
- Nomination & Remuneration Committee to recommend policy for remuneration of KMP.
- Disgorgement of asset/personal liability, if undue benefit proved in inspection of company.
- Statement annexed to notice of general meeting to contain items of special business to show financial/ other interest. If such item relates to other company & KMP holds more than 2% shares in other company, disclosure of shareholding to be made. In case of Non-disclosure, KMP has to compensate company benefit received. Default punishable with Rs. 50000 or 5 times of benefit, whichever is higher.

APPOINTMENT OF MANAGING DIRECTOR, WHOLE-TIME DIRECTOR OR MANAGER



Section 196 of the Companies Act, 2013 provides the provision for appointment of Managing Director, Whole-Time Director, and Manager

Appointment of MD & Manager at the same time is not possible – Section 196 (1)

No company shall appoint or employ at the same time a managing director and a manager. If we go through the definition of Manager Sec 2(53) and Managing Director Section 2(54), we can infer that responsibilities, duties, and powers of both these positions are almost the same. The only difference is where these powers are coming from. In case of Manager, it is coming from board and in case of managing director it is coming from Articles or agreement.

Hence, it makes no sense to have two different people managing company having the exact same powers and duties. It will create conflicts, which will in turn lead to mismanagement.

Tenure - Section 196 (2)

Appointment of Managing Director, Whole-Time Director or Manager shall not be for a term exceeding five years at a time.

Re-appointment - Proviso to Section 196 (2)

The company may re-appoint them for next term before expiry of their present term but not earlier than one year before expiry of the current term. This means, company may re-appoint them for next term in last one year of current term.

Disqualification of managing Director, Whole-Time Director or Manager - Section 196 (3)

No company shall appoint or continue the employment of any person as managing director, whole-time director or manager who –

- is below the age of twenty-one years or has attained the age of seventy years.

  However, the appointment of a person who has attained the age of seventy years may be made by passing a special resolution in which case the explanatory statement annexed to the notice for such motion shall indicate the justification for appointing such person;

- is an undischarged insolvent or has at any time been adjudged as an insolvent;

- has at any time suspended payment to his creditors or makes, or has at any time made, a composition with them; or

- has at any time been convicted by a court of an offence and sentenced for a period of more than six months.

CASE LAW

In the case of *Sridhar Sundararajan vs. Ultramarine and Pigments Ltd. (2016) 4 Mah LJ 590*, the division bench of High Court of Bombay decided on the matter of disqualification for appointment or continuation as Managing Director of company. It held that a person who is below age of 21 years or who has attained age of 70 years cannot be appointed or could not be continued as MD and that a person who has been appointed as Managing Director before he was 70 years old is prohibited from continuing as Managing Director once he attained the age of 70 years.

Central Government approval - Section 196 (3) Second Proviso

Where no such special resolution is passed but votes cast in favour of the motion exceed the votes, if any, cast against the motion and the Central Government is satisfied, on an application made by the Board, that such appointment is most beneficial to the company, the appointment of the person who has attained the age of seventy years may be made.

This simply means that if a company wants to appoint a person as MD, WTD or manager but is unable to pass a special resolution as stated in Section 196 (3) First Proviso, in that case company may do so by passing an ordinary resolution along with consent of Central Government.

Approval for appointment of MD, WTD and Manager -Section 196 (4)

Subject to the provisions of section 197 and Schedule V, a managing director, whole-time director or manager shall be appointed and the terms and conditions of such appointment and remuneration payable be approved by the Board of Directors at a meeting which shall be subject to approval by a resolution at the next general meeting of the company and by the Central Government in case such appointment is at variance to the conditions specified in that Schedule specified in Part I of Schedule V.

Content of Notice - First proviso to Section 196 (4)

Provided that a notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any.

Return of Appointment - Second proviso to Section 196 (4)

A return in the e-form MR-1 shall be filed within sixty days of such appointment with the Registrar along with prescribed fees.

Consequence of irregular appointment - Section 196 (5)

Subject to the provisions of this Act, where an appointment of a managing director, whole-time director or manager is not approved by the company at a general meeting, any act done by him before such approval shall not be deemed to be invalid.

Exemption to private company for section 196 (4) & (5)

Vide notification dated 05.06.2015 Section 196(4) and Section 196(5) is not applicable to Private Company. Exemption is given to the private companies for Section 196(4) and Section 196(5). It may be further noted that filing of Form MR-1 is also not applicable.

Exemption to Government Company for section 196 (2), (4) & (5)

Vide notification dated 05.06.2015 Section 196 (2), (4) & (5) shall not apply to Government Company. Therefore, a Government Company may appoint Managing Director, Whole time Director or Manager in the manner prescribed in its Articles of Association. The term of appointment of Managing Director, Whole time Director or Manager may exceed five years.

Exemption to Specified International Financial Services Centres (IFSC) public company for section 196 (4)

Vide notification dated 04.01.2017 Section 196 (4) shall not apply to Specified IFSC public company. Therefore, a Specified IFSC public company may appoint Managing Director, Whole time Director or Manager in the manner prescribed in its Articles of Association.

Conditions to be fulfilled for the Appointment of Managing or Whole-Time Director or a Manager without the approval of the Central Government as Per Schedule V of the Companies Act, 2013 (Part I-Schedule V of the Companies Act, 2013)

No person shall be eligible for appointment as a managing or whole-time director or a manager of a company unless he satisfies the following conditions, namely:-

- The person had not been sentenced to imprisonment for any period, or to a fine exceeding one thousand rupees, for the conviction of an offence under any of the Acts as specified under Schedule V of the Companies Act, 2013.
- The person had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974.

  Provided that where the Central Government has given its approval to the appointment of a person convicted or detained mentioned above, as the case may be, no further approval of the Central Government shall be necessary for the subsequent appointment of that person if he had not been so convicted or detained subsequent to such approval.

- The person is resident of India.
- He has computed the age of 21 years and not attained the age of 70 years.

Appointment with the Approval of Central Government

In case the provisions of Part I of Schedule V of the Companies Act, 2013 are not fulfilled by company, an application seeking approval to the appointment of a managing director, whole-time director or manager shall be made to the Central Government, in E-Form No. MR-2 and shall be accompanied by fee as may be specified for the purpose.

Every such application seeking approval shall be made to the Central Government within a period of ninety days from the date of such appointment [Rule 7 of the Companies (Appointment and Remuneration of managerial Personnel) Rules, 2014].

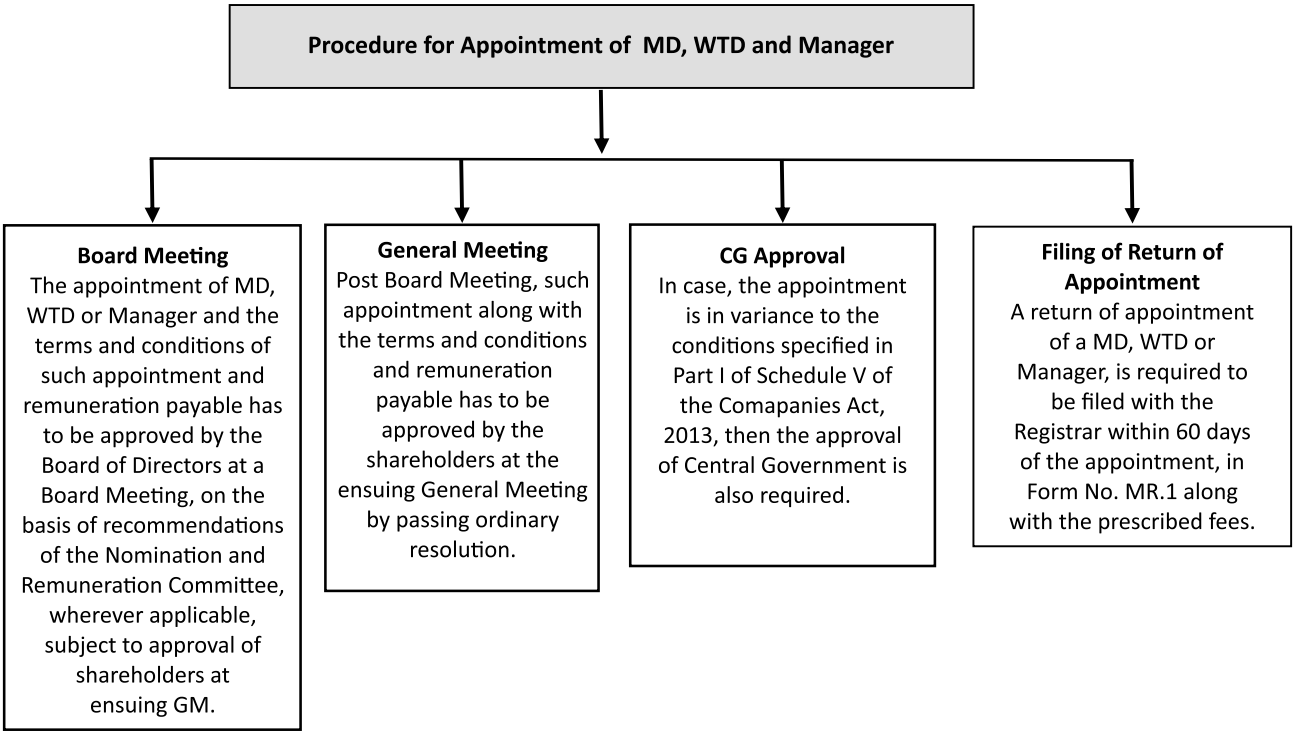
Issue of General Notice before making Application to Central Government

As per Section 201, before any application is made by a company to the Central Government under Section 196 of the Companies Act, 2013, there shall be issued by or on behalf of the company a general notice to the members thereof, indicating nature of application proposed to be made.

Such general notice shall be published in at least once in a newspaper in the principal language of the district in which registered office of the company is situated and circulating in that district, and at least once in English in an English newspaper circulating in that district indicating the nature of application proposed to be made to the Central Government.

The copies of the notices, together with a certificate by the company as to the due publication thereof, shall be attached to the application.

Procedure for appointment of Managing Director, Whole Time Director & Manager



1. Convene and hold a Board meeting after giving to all the directors due notice as required under Section 173 of the Companies Act, for transacting, inter alia, the following business:-

   (a) take a decision on the person to be appointed, on the basis of recommendations of the Nomination and Remuneration Committee, wherever applicable as managing director after fully ensuring that he does not suffer from any disqualification in Sections 164, 196, 203, Schedule V and any other provision of the Companies Act, 2013;

   The Nomination and Remuneration Committee shall identify persons who are qualified to become directors and who may be appointed in senior management in accordance with the criteria laid down, recommend to the Board regarding their appointment.

   (b) approve the draft agreement to be signed and executed by and between the company and the proposed managing director (it is not mandatory);

   (c) fix time, date and venue for holding a general meeting of the company;

   (d) approve notice of the general meeting along with the explanatory statement as required by Sections 101 and 102 of the Act after keeping in mind the requirements of Section 190 of the Act.

   (e) notice convening Board or general meeting for considering such appointment shall include the terms and conditions of such appointment, remuneration payable and such other matters including interest, of a director or directors in such appointments, if any.

   (f) authorise company secretary to issue notice of the general meeting on behalf of the Board.

2. Hold the general meeting and get the resolution passed approving appointment of the managing director/ Whole time Director/Manager.

3. In case the appointment of the Managing Director/Whole time Director/Manager is not in accordance with the provisions of Schedule V of the Act, the company is required to obtain approval of the Central Government as per Section 201 of the Act.

4. For getting the approval of the Central Government under Section 201 certain formalities are to be complied with:

   (a) As required by Section 201 of the Act, the Company shall give a general notice to the members of the company indicating the nature of the application proposed to be made.

   (b) This notice has to be published at least once in the principal language of the district in which the registered office of the company is situated and circulating in that district and also once in English in an English newspaper also circulating in that district.

   (c) The company shall attach a copy of this notice with the application together with certificate as to the due publication thereof.

   (d) The application should be filed electronically in E-Form MR-2 as per rule 7 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 accompanied by the prescribed fees.

   (e) The application should be made within 90 days from the date of such appointment with regard to compliance of Section 196 of Companies Act, 2013.

5. Execute the agreement, as approved by the Board, with the Managing Director.

6. Make necessary entries in the register of directors etc. and other records and registers of the company.

7. File the following documents with the ROC:

   (a) The company should file with the ROC return of appointment of the managing director, whole time director or manager in Form MR-1, within sixty days as per Section 196(4) of the appointment and the return must be certified by the auditors of the company or the company secretary or a secretary in whole-time practice.

   The Mandatory attachments for Form MR-1:

   i. Copy of Board Resolution;

   ii. Copy of Shareholders Resolution along with explanatory statement is mandatory in case passed for such appointment;

   iii. Copy of letter of consent to act as managing director, whole time director, or manager;

   iv. Copy of Central Government Approval;

   v. Copy of certificate by Nomination and Remuneration Committee.

   (b) Form DIR – 12 is to be filed with Registrar for particular of appointment of a key managerial personnel, within thirty days of the appointment.

   (c) Form MGT-14 to be filed with the Registrar.

8. Inform all concerned about the appointment of the managing director. It is advisable to issue a general notice in newspapers about the appointment of the managing director.

POWERS, DUTIES, AND RESPONSIBILITIES OF THE MANAGING DIRECTOR

Managing director oversees a company's business operations, liaise with stakeholders, drive strategic company growth, and are responsible for the overall performance of the business. Following are some powers, duties and responsibilities for which the managing director is entrusted with:

- Being a member of the board of directors participates in policy-making functions and formulating the objectives of the Board;
- Execute policies laid down by the Board of Directors;
- Act as the intermediary officer between the organization and the Board of Directors;
- Communicate and interpret the policies of the company to sub employees;
- To review and present the operations of the company to the Board periodically accounts and statistics showing the progress and the present position of the company;
- Appoint high officials of the company;
- Formulate the compensation and employment plan by the accepted policies of the company;
- Plan the expansion and development of the business;
- Organize meetings with department heads;
- Promote high morale among the employees of the company by creating a sense of belonging;
- Maintain contact with the government, trade unions, and community, chamber of commerce, at large;
- Maintain a balanced relationship between line and staff managers;

- Approve or disapprove development plans submitted by the senior executives and place before the Board for final approval;
- Build a system of budgetary control by which the actual performance of the company may be evaluated against the planned course of action;
- Supervise production and sales activities of the company;
- Give due attention to consumer satisfaction which is ensured by the continued supply of goods and services to the market.

CASE LAW

[In the matter of Shiv Kumar Jatia (Appellant) vs. State of NCT of Delhi (Respondent), The Supreme Court of India, dated 23/08/2019*]*

Shiv Kumar Jatia is the Managing Director of M/s. Asian Hotels which looks after Hyatt Regency Hotel. He had authorized Mr. PR. Subramanian to apply for lodging license of the hotel.

There was a contravention the condition of the lodging license which led to a hotel guest enter into a semi lit under-construction terrace for smoking. The guest fell from the terrace of 6th floor to the 4th floor and got injured. Case was brought before the High Court which ordered for prosecution of the Managing director along with the other three accused by relying on the case of *Sushil Ansal* vs. *State through CBI*.

The Apex Court held that vicarious liability on the part of Managing Director and the Directors would arise provided any provision exists in that behalf in the statute. Further, the allegations made on the Managing Director could not establish any active role coupled with criminal intent having direct nexus with the accused.

Court observed that an individual who has perpetrated the commission of an offence on behalf of the company can be made an accused, along with the company, if there is sufficient evidence of his active role coupled with criminal intent. Further it is also held that an individual can be implicated in those cases where statutory regime itself attracts the doctrine of vicarious liability, by specifically incorporating such a provision.

Though there are allegations of negligence on the part of hotel and its officers who are incharge of day-to-day affairs of the hotel, so far as appellant Mr. Shiv Kumar Jatia is concerned, no allegation is made directly attributing negligence with the criminal intent attracting provisions under Sections 336, 338 read with Section 32 of IPC. There is no reason and justification to proceed against him only on ground that he was the Managing Director of M/s Asian Hotels (North) Limited, which runs Hotel Hyatt Regency. The mere fact that he was chairing the meetings of the company and taking decisions, by itself cannot directly link the allegation of negligence with the criminal intent

The Court has held that the Penal Code does not contain any provision for attaching vicarious liability on the part of the Managing Director or the Directors of the Company, when the accused is a Company. The allegations made on the Managing Director was vague in nature and the criminal proceedings against Shiv Kumar Jatia as passed by the High Court, New Delhi were quashed.

Chief Executive Officer [Section 2(18)] and Chief Financial Officer [Section 2(19)]

"Chief Executive Officer" means an officer of a company, who has been designated as such by it.

It is a borrowed concept from United States of America (USA). The chief executive officer (CEO) is a top level executive of a company, who is responsible for developing and implementing strategies, taking major corporate decisions, managing the overall operations and resources of a company.

The term CEO is defined for the first time in the Act. Any person appointed as a CEO of the company shall be one of the key managerial personnel (KMP) as per definition of clause (51) of section 2 of the Act when such person is designated /appointed under section 203 the Act. Such officer shall be one of the officers who is in default under clause (60) of section 2 of the Act in the event of violation of provisions of the Act.

As per sub-section (1) of section 134 of Act, if CEO is also a director in the company, CEO is required to sign financial statements whether he is KMP or not.

On the other hand, "Chief Financial Officer" means a person appointed as the chief financial officer of a company. The CFO may be appointed either by the board of directors or by the managing director unless such person is designated as a key managerial person under section 203. He shall be a person who is occupying the position as CFO having involved in day to day financial affairs of the company. He has been also included as an officer in default due to his role and responsibility in the company.

As per the provisions of section 203 every public Company having a paid up share capital of Rs. 10 Crores or more shall have a whole time key managerial personnel, which includes whole time Chief financial officer.

The CFO need not be a director of the company. However, he has been recognised as a KMP under Section 203 and his designation is equated with other managerial personnel such as the managing director, the manager or in their absence, the whole time director. The remuneration payable to CFO shall not be subject to regulation under Section 197 of the Act read with Schedule V in the Act, unless he is part of the Board or he is appointed as a manager in addition to his designation as CFO. The Act does not prescribe any qualification for the appointment of CFO. Sub-section (1) of section 134 of the Act, requires the CFO to sign the financial statements whether he is KMP or not, as he is responsible for overseeing the financial activities of an entire company.

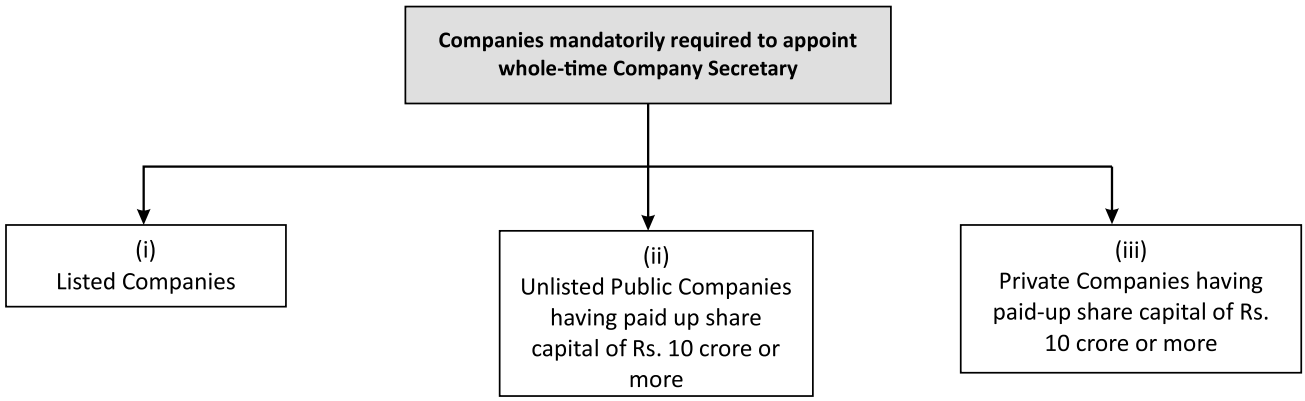
Some of the duties of CFO include the following:

- Financial planning and monitoring cash flow;
- The CFO being an internal person in the organization has responsibility towards presenting the financial statements truly and fairly which are subsequently audited by the statutory auditors of the Company;
- CFOs are required to protect the vital assets of the company, ensure compliance with financial regulations, close the books correctly, and communicate value and risk issues to investors and boards;
- CFOs have to operate an efficient and effective finance organization providing a variety of services to the business such as financial planning and analysis, treasury, tax, and other finance operations;
- To formulate financial strategies and influence the future direction of the company;
- CFOs are required to stimulate and drive the timely execution of change in the finance function of the Company;
- To discharge such other duties as have been specified under the Companies Act, 2013 or rules made thereunder.

APPOINTMENT OF COMPANY SECRETARY

A Company Secretary (CS) is the key managerial personnel of a company. A CS is entrusted with the compliance and legal aspects of a company. The Institute of Company Secretaries of India (ICSI) is the body that regulates and maintains the profession of Company Secretaries. As per clause (c) of Sub-section (1) of Section 2 of the Company Secretaries Act, 1980, a Company Secretary means a person who is a member of the Institute of Company Secretaries of India.

The primary role of the CS is maintaining the company's statutory books, registers, records, advising the board of directors relating to the legal and financial risks of the company and ensuring that the company complies with statutory regulations. A CS is also responsible for ensuring that the company adheres to all the corporate laws, taxes, and economic and industrial laws that apply to the business.



Areas where Company Secretary render services

Corporate Governance Services

- Advising on good governance practices and compliance of Corporate Governance norms as prescribed under various Corporate, Securities and Other Business Laws and regulations and guidelines made thereunder.

Corporate Secretarial Services

- Promotion, formation and incorporation of companies and matters related therewith
- Filing, registering any document including forms, returns and applications by and on behalf of the company as an authorized representative
- Maintenance of secretarial records, statutory books and registers
- Arranging board/general meetings and preparing minutes thereof
- All work relating to shares and their transfer and transmission

Secretarial/Compliance Audit and Certification Services

- Secretarial Audit
- Internal Audit
- Signing of Annual Return
- Other declaration, attestations and certifications under the Companies Act, 2013

Corporate Laws Advisory Services

Advising companies on Compliance of legal and procedural aspects, particularly under –

- SEBI Act, SCRA and rules and regulations made thereunder
- Foreign Exchange Management Act
- Consumer Protection Act
- Depositories Act
- Environment and Pollution Control Laws
- Labour and Industrial Laws
- Co-operative Societies Act
- Mergers and Amalgamations and Strategic Alliances
- Foreign Collaborations and Joint Ventures
- Setting up subsidiaries abroad
- Competition Policy and Anti-Competitive Practices
- IPR Protection, Management, Valuation and Audit
- Drafting of Legal documents.

Representation Services

Representing on behalf of a company and other persons before-

- National Company Law Tribunal
- Competition Commission of India
- Securities Appellate Tribunal
- Registrar of Companies
- Labour Courts
- Consumer Forums
- Telecom Disputes Settlement and Appellate Tribunal
- Tax Authorities
- Other quasi-judicial bodies and Tribunals

Arbitration and Conciliation Services

- Advising on arbitration, negotiation, and conciliation in commercial disputes between the parties
- Acting as arbitration/conciliator in domestic and international commercial disputes
- Drafting Arbitration/Conciliation Agreement/Clause

Financial Markets Services

- Public Issue, Listing and Securities Management
- Advisor/consultant in issue of shares and other securities
- Preparation of Projects Reports and Feasibility Studies
- Syndication of Loans from banks & financial institutions

- Drafting of prospectus/offer for sale/letter of offer/other documents related to issue of securities and obtaining various approvals in association with lead managers
- Loan Documentation, registration of charges, status and search reports
- Listing of securities/delisting of securities with recognized stock exchange
- Private placement of shares and other securities
- Buy-back of shares and other securities
- Raising of funds from international markets – ADR/GDR/ECB

Takeover Code and Insider Trading

- Ensuring compliance of the Takeover Regulations and any other laws or rules as may be applicable in this regard
- Acting as Compliance Officer and ensuring compliance with SEBI (Prohibition of insider Trading) Regulations, 1992 including maintenance of various documents.

Securities Compliance and Certification Services

- Compliance with rules and regulations in the securities market particularly –
- Internal Audit of Depository Participants
- Certification under SEBI (DIP) Guidelines
- Audit in relation to Reconciliation of shares
- Certificate in respect of compliance of Private Limited and Unlisted Public Company (Buy Back Securities) Rules

Finance And Accounting Services

- Internal Audit
- Secretary to Audit Committee
- Working capital and liquidity management
- Determination of an appropriate capital structure
- Analysis of capital investment proposals
- Business valuations prior to mergers and/or acquisitions
- Loan syndication
- Budgetary controls
- Accounting and compilation of financial statements

Taxation Services

- Advisory services to companies on tax management and tax planning under Income Tax, Excise and Customs Laws
- Preparing/reviewing various returns and reports required for compliance with a the tax laws and regulations
- Representing companies and other persons before the tax authorities and tribunals

International Trade And WTO Services

- Advising on all matters related to IPRs and TRIPs Agreement of WTO
- Advising on matters relating to antidumping, subsidies and countervailing duties
- International Commercial Arbitration
- Advising on and issuing certificates on Exim Policy and Procedures
- Advising on Intellectual Property licensing and drafting of Agreement
- Acting as registered Trade Mark Agent

Management Services

- General/Strategic Management
- Advising on Legal Structure of the organization
- Business policy strategy and planning
- Formulation of the organizational structure
- Acting as management representative to obtain ISO Certification

Corporate Communications and Public Relations

- Communication with shareholders, stakeholders, Government and Regulators, Authorities, etc.
- Advisory services for Brand equity and image building

Human Resources Management

- Manpower planning and development
- Audit of the HR function
- Performance appraisal
- Motivation and remuneration strategies
- Industrial relations
- Office management, work studies and performance standards
- Advising on industrial and labour laws

Information Technology

- Compliance with cyber laws
- Conducting Board Meetings through video-conferencing and teleconferencing
- Advising on software copyright and licensing
- Development of management reports and controls
- Maintenance of statutory records in electronic form
- Sending notices to shareholders by electronic mode
- Filing of forms/documents in electronic form with Registrar of Companies and other statutory authorities

COMPANY SECRETARY AS KEY MANAGERIAL PERSONNEL (KMP)

The Company Secretaries play an important role as governance professionals in all types of corporates, whether it is a private company, public company, section 8 company, government company or so. In the recent international development in corporate governance, the role of Company Secretaries is not limited to the doing compliance with laws, regulations, standards, and codes; it is also about creating cultures of good practice.

The Company Secretary acts as a bridge for information, communication, advice, and arbitration between the board and management and between the organization and its stakeholders including shareholders.

To fulfill this role, the Company Secretary needs to be fully aware of the powers, rights, duties, and obligations of his entire business portfolio. In addition to providing advice and communication, the corporate secretary often called on to create and manage relationships between these different players in the corporate governance system. To carry out this role effectively, a Company Secretary needs to act with the highest integrity and independence in protecting the interests of the organization, its shareholders, and others with a legitimate interest in the organization's affairs. This level of responsibility calls for a thorough knowledge of the business environment in which the organization operates as well as of the laws, rules, and regulations that govern its activities. Company Secretaries typically provide practical support to the chairman of the organization to ensure that board meetings are managed effectively. This typically would entail assisting the chairman with agenda development, ensuring that meetings are conducted in line with good governance and statutory and regulatory requirements, drafting minutes, and following up on implementation of decisions made by the board.

Company Secretary has been recognized as Key Managerial Personnel and has placed along with Managing Director (MD) or Chief Executive officers (CEO) or Manager, Whole time director(s) or Chief Financial Officer (CFO) under Section 203 of the Companies Act, 2013. Accordingly, every listed company and every other public company having paid-up share capital of ten crore rupees or more is required to appoint the whole time Company Secretary as the Key Managerial Personnel.

Test Yourself

Question: Which of the following rule of Companies (Appointment and Remuneration of Managerial Personel) Rules, 2014 provides the requirement of appointing a company secretary under Companies Act, 2013?

Options: (a) Rule 8; (b) Rule 8A; (c) Both (a) & (b); (d) None of these

Answer: (c)

Company Secretary as Compliance Officer

Under Regulation 6 of the SEBI (LODR) Regulations, 2015, a listed company is required to appoint a qualified company secretary as the compliance officer. The compliance officer of the Company is responsible for:

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit;

(b) co-ordination with and reporting to the Board, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in the manner as specified from time to time;

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations;

(d) monitoring email address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors:

However, the company secretary is also entrusted with the duties for ensuring compliance with SEBI (Prohibition of Insider Trading) Regulations, 2015 including maintenance of various documents and also to ensure compliance of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The requirement for appointment of Compliance officer is not applicable in case of units issued by mutual funds which are listed on recognised stock exchange(s) governed by the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations 1996.

Company Secretary as a part of Senior Management

The Regulation 16 of the SEBI (LODR) Regulations, 2015 provides that the "senior management" shall mean the officers and personnel of the listed entity who are members of its core management team, excluding the Board of Directors , and shall also comprise all the members of the management one level below the Chief Executive Officer or Managing Director or Whole Time Director or Manager (including Chief Executive Officer and Manager, in case they are not part of the Board of Directors) and shall specifically include the functional heads, by whatever name called and the Company Secretary and the Chief Financial Officer.

Accordingly, the role of Company Secretary in the various segments, is performed in different capacities. Broadly the Company Secretary is having the opportunities in the following two domains:

1. Company Secretary in Employment
2. Company Secretary in Practice

ROLE OF COMPANY SECRETARY

CS as a Business Supporter

The Companies Act gives specific right to a company secretary– to exercise promotion and incorporation of companies; to handle company audit and certification services; to sign annual returns; to handle corporate restructuring and takeovers; to scrutinize reports and voting procedures in a transparent manner; to administer revival of sick companies; to become a technical member of Company Law Tribunal; to investigate cases of taxation and corporate affairs.

CS as an Auditor

To ensure corporate discipline and compliance with the laws; the Companies Act confides a company secretary to annex a Secretarial Audit Report to the authorities in form MR-3 ensuring compliances of the company with procedures defined in general laws and legal acts; to report any offensive matter of fraud found to government.

CS as an Advising Agent

CS works as advising agent in cases of – issue of shares; drafting of prospectus/sale letter/issues related to securities/private placement and buyback of shares; raising funds from international markets; loan syndication and documentation; income tax planning; drafting of legal documents; in matters of intellectual property rights; guiding in policies of merger; amalgamation and joint ventures, etc.

Company Secretary Audit

A CS makes sure that the company is following the laws and guidelines explained in the memorandum in order to make the easy functioning of the organization, as per the rules mentioned in Section 204 of the

Companies Act, 2013. It is not only a role, but the duty of the CS to execute such audits of prescribed and listed companies.

Legal Advisor for Business

The Company Secretary knows the laws of the company very well and works as a legal advisor for the executives. During court of law matters, he advises on the company rights by taking the deep subject knowledge from the expert.

Link Between Inter and Intra Company Works

A Company Secretary plays a role of connectors between the investors, board of directors, and authorities who work in the direction of the company's functioning and regulation.

Keep Record Of Legal Works

The professional company secretary of India maintains the information regarding investors, shares, directors, and members in a record.

PROCEDURE FOR APPOINTMENT OF A WHOLE TIME COMPANY SECRETARY

The following procedural steps should be taken for appointing a whole-time company secretary:

1. Advertise the post, collect applications, hold interview, short list the individuals for the position and finalise the terms of appointment.
2. Convene a Board meeting after giving notice to all the directors of the company as per section 173 of the Act. At the board meeting, place the proposal of appointing Company Secretary with the details of the person finalized and pass a resolution appointing the company secretary and approving the terms and conditions of his appointment.
3. File return of appointment of company secretary with the Registrar in Form DIR-12 within thirty days from the date of appointment (date of joining office) and in case of public company copy of Board Resolution also needs to be filed in Form MGT-14 along with such fee as specified in Companies (Registration of Offices and Fees) Rules, 2014. The particulars of Company Secretary, Income-tax PAN, Membership details (will be validated from ICSI records), residential details, date of appointment, e-mail ID of the person for communication purpose are required to be filled in the Form.
4. A Company Secretary shall not hold office in more than one company except in its subsidiary company at the same time.
5. Make entries in the Register of directors and key managerial personnel under Section 170 of the Act.
6. Inform the Stock Exchange(s) where the company is listed.
7. Since key managerial personnel are included in 'related party' as defined in section 2(76) of the Act, verify whether the company secretary so appointed involved in any related party transactions within the provisions of Section 188 of the Act. If yes, then comply with the requirements in this regard.

Duties of a Company Secretary in India

According to section 205 of the Companies Act, 2013 and rule 10 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the company secretary must perform the following functions and duties:

1. to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

2. to ensure that the company complies with the applicable secretarial standards;
3. to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;
4. to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;
5. to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;
6. to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;
7. to assist the Board in the conduct of the affairs of the company;
8. to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices;
9. to discharge such other duties as have been specified under the Act or rules; and
10. such other duties as may be assigned by the Board from time to time.

REMOVAL OF COMPANY SECRETARY

A company secretary can be removed or dismissed like any other employees of the organization. Since he is appointed by Board, the Board of directors of a company has absolute discretion to remove a company secretary or to terminate his services at any time for any reason or without any reason. However, principles of natural justice like show cause notice, hearing, reasoned order etc. must be followed.

Procedure for Removal/Resignation of Company Secretary

1. A Company Secretary can be removed in accordance with the terms of appointment and the Board can record the same.
2. Convene a Board meeting after giving notice to all the directors of the company as per section 173, place the matter of removal/resignation of the Company Secretary and pass a resolution to the effect.
3. Obtain Resignation Letter duly dated and signed and in case of removal a reasonable opportunities of being heard shall be giving.
4. File Form DIR-12 in electronic mode within thirty days with the Registrar of Companies together with requisite filing fees. Evidence of Cessation (for example Resignation Letter) is an optional attachment.
5. Inform the stock exchange where the company is listed within 24 hours of Board Meeting.
6. Make entries in the Register maintained for recording the particulars of Company Secretaries under section 170.
7. Issue a general public notice, if it is so warranted, according to size and nature of the company.
8. The resulting vacancy shall be filled up by the Board at a meeting of the Board within a period of six months from the date of such vacancy.

OFFICER WHO IS IN DEFAULT

Officer [Section 2(59)]

"Officer" includes any director, manager or key managerial personnel or any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act.

One of the key concepts of the Companies Act is the meaning of the term "officer who is in default." Under the act, liability for default by a company has been imposed on an officer who is in default.

By virtue of their positions in the company, the managing director, the whole-time director, and the company secretary directly fall within the scope of this term.

Officer who is in Default [Section 2(60)]

As per Section 2(60), "officer who is in default", for the purpose of any provision in this Act which enacts that an officer of the company who is in default shall be liable to any penalty or punishment by way of imprisonment, fine or otherwise, means any of the following officers of a company, namely:—

(i) whole-time director;

(ii) key managerial personnel;

(iii) where there is no key managerial personnel, such director or directors as specified by the Board in this behalf and who has or have given his or their consent in writing to the Board to such specification, or all the directors, if no director is so specified;

(iv) any person who, under the immediate authority of the Board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default;

(v) any person in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act, other than a person who gives advice to the Board in a professional capacity;

(vi) every director, in respect of a contravention of any of the provisions of this Act, who is aware of such contravention by virtue of the receipt by him of any proceedings of the Board or participation in such proceedings without objecting to the same, or where such contravention had taken place with his consent or connivance;

(vii) in respect of the issue or transfer of any shares of a company, the share transfer agents, registrars and merchant bankers to the issue or transfer.

CASE LAW

[In the matter of Shiv Kumar Jatia (Appellant) vs. State of NCT of Delhi (Respondent), The Supreme Court of India, dated 23/08/2019]

Shiv Kumar Jatia is the Managing Director of M/s. Asian Hotels which looks after Hyatt Regency Hotel. He had authorized Mr. PR. Subramanian to apply for lodging license of the hotel.

There was a contravention the condition of the lodging license which led to a hotel guest enter into a semi lit under-construction terrace for smoking. The guest fell from the terrace of 6th floor to the 4th floor and got injured. Case was brought before the High Court which ordered for prosecution of the Managing director along with the other three accused by relying on the case of *Sushil Ansal vs. State through CBI.*

The Apex Court held that vicarious liability on the part of Managing Director and the Directors would arise provided any provision exists in that behalf in the statute. Further, the allegations made on the Managing Director could not establish any active role coupled with criminal intent having direct nexus with the accused.

Court observed that an individual who has perpetrated the commission of an offence on behalf of the company can be made an accused, along with the company, if there is sufficient evidence of his active role coupled with criminal intent. Further it is also held that an individual can be implicated in those cases where statutory regime itself attracts the doctrine of vicarious liability, by specifically incorporating such a provision.

Though there are allegations of negligence on the part of hotel and its officers who are incharge of day to day affairs of the hotel, so far as appellant Mr. Shiv Kumar Jatia is concerned, no allegation is made directly attributing negligence with the criminal intent attracting provisions under Sections 336, 338 read with Section 32 of IPC. There is no reason and justification to proceed against him only on ground that he was the Managing Director of M/s Asian Hotels (North) Limited, which runs Hotel Hyatt Regency. The mere fact that he was chairing the meetings of the company and taking decisions, by itself cannot directly link the allegation of negligence with the criminal intent

The Court has held that the Penal Code does not contain any provision for attaching vicarious liability on the part of the Managing Director or the Directors of the Company, when the accused is a Company. The allegations made on the Managing Director was vague in nature and the criminal proceedings against Shiv Kumar Jatia as passed by the High Court, New Delhi were quashed.

REMUNERATION OF MANAGERIAL PERSONNEL

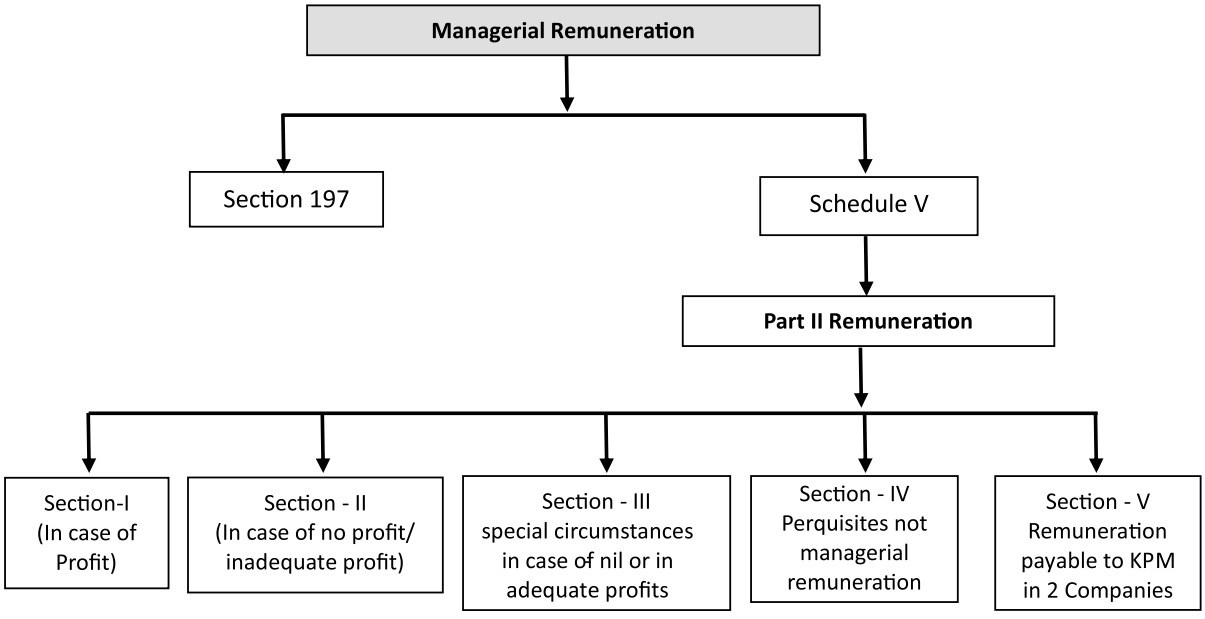
"Remuneration" section 2(78)

"Remuneration" means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961.

In simple words, remuneration is any type of compensation that an individual or employee receives as payment for services rendered to organization or company.

Managerial Remuneration

Though the term Managerial Remuneration is not defined anywhere in the Companies Act, 2013, the term is used interchangeably with remuneration to a managerial person. In general parlance Managerial remuneration means remuneration paid by the company to its Key Managerial Personnel (KMPs) and other directors. Section 197 of the Act provides provisions relating to overall maximum managerial remuneration payable by a public company and the managerial remuneration payable by it in case of inadequate profits.



Overall Maximum Managerial Remuneration - Section 197 (1)

Section 197(1) of the Companies Act, 2013, lays down the provisions for overall maximum managerial remuneration. The total managerial remuneration payable by a public company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year shall not exceed 11% of the net profits of that company for that financial year computed in the manner laid down in section 198 of the Companies Act, 2013, except that the remuneration of the directors shall not be deducted from the gross profits.

The Company may pay the remuneration to the managerial personnel exceeding total limit of 11% of net with the approval of members at the general meeting. However, limit of remuneration shall be as per Schedule V.

Note: The Section applies only to Public Companies and hence Private Companies are free to pay remuneration at any rate to such directors in case of adequacy or inadequacy of profits.

Remuneration in excess of Section 197(1)- First Proviso to Section 197 (1)

Provided that the company in general meeting may, authorise the payment of remuneration exceeding eleven per cent. of the net profits of the company, subject to the provisions of Schedule V.

Individual Limit for each director- Second Proviso to Section 197 (1)

Provided further that, except with the approval of the company in general meeting, by a special resolution—

(i) the remuneration payable to any one managing director; or whole-time director or manager shall not exceed five per cent. of the net profits of the company and if there is more than one such director remuneration shall not exceed ten per cent. of the net profits to all such directors and manager taken together;

(ii) the remuneration payable to directors who are neither managing directors nor whole-time directors shall not exceed,-

A. one per cent. of the net profits of the company, if there is a managing or whole-time director or manager;

B. three per cent. of the net profits in any other case.

S. No.	*Persons entitled for remuneration*	*Maximum remuneration in any financial year*	*If remuneration exceeds maximum remuneration in any financial year as provided under column (b)*
	(a)	*(b)*	*(c)*
(i)	Directors including Managing Director, Whole time Director and Manager of public companies	11% of the net profits of the company for that financial year	Company in general meeting subject to provisions of Schedule V may pay remuneration in excess of 11% of the net profits of the company.
(ii)	One Managing director/ Whole time director/ manager	5% of the net profits of the company for that year	With the approval by a special resolution of the company in general meeting this limit may be exceeded.
(iii)	More than one Managing Director/ Whole time Director/ Manager	10% of the net profits to all such Directors and Manager taken together	With the approval by a special resolution of the company in general meeting this limit may be exceeded.
(iv)	Directors who are neither Managing Director nor Whole time Directors	1% of the net profits of the company if there is a Managing Director or a Whole time Director or Manager	Approval by a special resolution of the company in general meeting is required.
(v)	Directors who are neither Managing Director nor Whole time Directors	3% of the net profits of the company if there is no Managing Director or Whole time Director or Manager	Approval by a special resolution of the company in general meeting is required.

Remuneration payable by companies having profits- Schedule V, Part II, Section I

It states that subject to the provisions of section 197, a company having profits in a financial year may pay remuneration to a managerial person or persons or other director or directors not exceeding the limits specified in such section.

Consent from Creditors in case of default in payment – Third Proviso to Section 197 (1)

Provided also that, where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting.

Sitting Fees not to be included in % Limit of Managerial Remuneration - Section 197 (2)

Section 197 (2) states that the percentages aforesaid shall be exclusive of any fees payable to directors under sub-section (5).

Sub Section 5 talks about sitting fees. Sitting fees is payment of a fee to a director of the company for attending a meeting of the board of directors or committee thereof.

Remuneration in case of Absence or Inadequacy of Profits - Section 197 (3)

Notwithstanding anything contained in sub-sections (1) and (2), but subject to the provisions of Schedule V, if, in any financial year, a company has no profits or its profits are inadequate, the company shall not pay to its directors, including any managing or whole time director or manager, or any other non-executive director, including an independent director by way of remuneration any sum exclusive of any fees payable to directors under sub-section (5) hereunder except in accordance with the provisions of Schedule V.

Remuneration payable by companies having no profit or inadequate profit. Schedule V, Part II, Section II

Where in any financial year during the currency of tenure of a managerial person or other director, a company has no profits or its profits are inadequate, it may, without Central Government approval , pay remuneration to the managerial person not exceeding, the limits under (A) and (B) given below:-

(A)

	(1)	*(2)*	*(3)*
Sl. No.	***Where the effective capital (in rupees) is:***	***Limit of yearly remuneration payable shall not exceed (in rupees) in case of a managerial person***	***Limit of yearly remuneration payable shall not exceed (in rupees) in case of other Directors***
(i)	Negative or less than 5 crores.	60 lakhs	12 lakhs
(ii)	5 crores and above but less than 100 crores.	84 lakhs	17 lakhs
(iii)	100 crores and above but less than 250 crores.	120 lakhs	24 lakhs
(iv)	250 crores and above.	120 lakhs plus 0.01% of the effective capital in excess of Rs.250 crores	24 Lakhs plus 0.01% of the effective capital in excess of Rs.250 crores

If Company wants to make payment of remuneration more than above mentioned limit than company can do the same by passing of "Special Resolution" in General Meeting of the Company.

Explanation – It is hereby clarified that for a period less than one year, the limits shall be pro-rated.

Illustration:

Ms. Jyoti is the Managing Director of Wise (India) Ltd. incorporated under the Companies Act 2013. Board of Directors of the company presents the following financial data extracted from the company's financial statements as 31st March, 2023:

Particulars	*(INR in Crore)*
Authorised equity share capital	60
Paid-up equity share capital	10
Debenture redemption reserve	10
Securities premium account	20
Profit & loss (Loss)	(10)
Revaluation Reserve	20

Due to loss in the financial year 2022-23, the company is not in a position to pay any remuneration to Ms. Jyoti, Managing Director of the company. As per the agreement of service between Ms. Jyoti & the company, in case of losses or inadequacy of profits in any financial year, she is to be paid remuneration on the basis of effective capital of the company.

Based on provisions of Companies Act 2013, decide the maximum remuneration payable to Ms. Jyoti for the financial year 2022-23 without the approval of Central Government.

Considering the Provisions of Companies Act 2013 & Schedule V Ms. Jyoti, Managing Director of Wise (India) Limited can be remunerated in the following ways without approval of Central Government.

i) The Company's effective capital is between INR 5 crores and above but less than INR 100 crores, Ms. Jyoti can be paid annual remuneration of 84 lakhs i.e. monthly remuneration of 7 lakhs.

ii) If Company pass a Special Resolution, remuneration can be doubled i.e INR 168 lakhs per annum, i.e. INR 14 kakhs per month can be paid.

(B) In case of a managerial person or other director who is functioning in a professional capacity:

If a managerial personnel or other director is functioning in professional capacity, remuneration as per item (A) may be paid, if the following conditions is satisfied:

- They are not having any interest in the capital of the company or its holding company or any of its subsidiaries directly or indirectly or through any other statutory structures; and
- not having any, direct or indirect interest or related to the directors or promoters of the company or its holding company or any of its subsidiaries at any time during the last two years before or on or after the date of appointment; and
- possesses graduate level qualification with expertise and specialised knowledge in the field in which the company operates.

Any employee of the company will not be deemed to be a person having interest in the capital of the company in the following circumstances:

(i) if he holds shares of the company not exceeding 0.5% of its paid up share capital under any scheme formulated for allotment of shares to such employees including Employees Stock Option Plan; or

(ii) by way of qualification shares.

The benefits of the limits specified under items (A) and (B) can be availed if the following further conditions are satisfied-

(i) Payment of remuneration is approved by a resolution passed by the Board and, in the case of a company covered under sub-section (1) of section 178 also by the Nomination and Remuneration Committee;

(ii) The company has not committed any default in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, and in case of default, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining the approval in the general meeting;

(iii) an ordinary resolution or a special resolution, as the case may be, has been passed for payment of remuneration as per item (A) or a special resolution has been passed for payment of remuneration as per item (B), at the general meeting of the company for a period not exceeding three years;

(iv) a statement along with a notice calling the general meeting referred to in clause (iii) is given to the shareholders containing the following information, namely:-

I. General information:

(i) Nature of industry;

(ii) Date or expected date of commencement of commercial production;

(iii) In case of new companies, expected date of commencement of activities as per project approved by financial institutions appearing in the prospectus;

(iv) Financial performance based on given indicators;

(v) Foreign investments or collaborations, if any.

II. Information about the appointee:

(1) Background details;

(2) Past remuneration;

(3) Recognition or awards;

(4) Job profile and his suitability;

(5) Remuneration proposed;

(6) Comparative remuneration profile with respect to industry, size of the company, profile of the position and person (in case of expatriates the relevant details would be with respect to the country of his origin);

(7) Pecuniary relationship directly or indirectly with the company, or relationship with the managerial personnel, if any.

III. Other information:

(1) Reasons of loss or inadequate profits;

(2) Steps taken or proposed to be taken for improvement;

(3) Expected increase in productivity and profits in measurable terms.

IV. Disclosures

The following disclosures shall be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the Financial statements:

(i) all elements of remuneration package such as salary, benefits, bonuses, stock options, pension, etc., of all the directors;

(ii) details of fixed component and performance linked incentives along with the performance criteria;

(iii) service contracts, notice period, severance fees; and stock option details, if any, and whether the same has been issued at a discount as well as the period over which accrued and over which exercisable.

*Explanation***:** For the purposes of Section II of this part, "Statutory Structure" means any entity which is entitled to hold shares in any company formed wider any statute.

Determining Remuneration of Director, MD, WTD and Manager - Section 197 (4)

The remuneration payable to the directors of a company, including any managing or whole-time director or manager, shall be determined, in accordance with and subject to the provisions of this section, either by the articles of the company, or by a resolution or, if the articles so require, by a special resolution, passed by the company in general meeting and the remuneration payable to a director determined aforesaid shall be inclusive of the remuneration payable to him for the services rendered by him in any other capacity.

Exception to Section 197 (4) - Proviso

It states that any remuneration for services rendered by any such director in other capacity shall not be so included in remuneration if following conditions are satisfied:

- the services rendered are of a professional nature; and
- in the opinion of the Nomination and Remuneration Committee, if the company is covered under sub-section (1) of section 178, or the Board of Directors in other cases, the director possesses the requisite qualification for the practice of the profession.

Illustration:

Heal Limited owes a chain of hospitals in Mumbai. Dr. Aman, a practicing surgeon, has been appointed by the company as its non- executive ordinary director and want to pay him fees on case to case basis for surgeries performed by him on patients at hospital. In the view of above facts, Heal Limited can pay fees to Dr. Aman for his professional services if Nomination & Remuneration Committee is of the opinion that the director possess the requisite qualification for the practice of the profession for which additional remuneration is payable.

Sitting Fees - Section 197 (5)

A director may receive remuneration by way of fee for attending meetings of the Board or Committee thereof or for any other purpose whatsoever as may be decided by the Board:

Provided that the amount of such fees shall not exceed the amount as may be prescribed:

Provided further that different fees for different classes of companies and fees in respect of independent director may be such as may be prescribed.

Rule 4 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules,2014 states that a company may pay a sitting fee to a director for attending meetings of the Board or committees thereof, such

sum as may be decided by the Board of directors thereof which shall not exceed one lakh rupees per meeting of the Board or committee thereof:

Provided that for Independent Directors and Women Directors, the sitting fee shall not be less than the sitting fee payable to other directors.

Manner of Payment of Remuneration- Section 197(6)

A director or manager may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other.

Computation of Net Profit For Calculating Remuneration- Section 197 (8)

The net profits for the purposes of this section shall be computed in the manner referred to in section 198.

Consequence of Remuneration in Excess of Prescribed Limit- Section 197 (9)

If any director draws or receives, directly or indirectly, by way of remuneration any such sums in excess of the limit prescribed by this section or without approval required under this section, he shall refund such sums to the company, within two years or such lesser period as may be allowed by the company, and until such sum is refunded, hold it in trust for the company.

Waiving off Amount Receivable under Sub Section 9- Section 197 (10)

The company shall not waive the recovery of any sum refundable to it under sub-section (9) unless approved by the company by special resolution within two years from the date the sum becomes refundable.

Provided that where the company has defaulted in payment of dues to any bank or public financial institution or non-convertible debenture holders or any other secured creditor, the prior approval of the bank or public financial institution concerned or the non-convertible debenture holders or other secured creditor, as the case may be, shall be obtained by the company before obtaining approval of such waiver.

Increasing Amount of Remuneration in case of Inadequacy of Profit- Section 197 (11)

In cases where Schedule V is applicable on grounds of no profits or inadequate profits, any provision relating to the remuneration of any director which purports to increase or has the effect of increasing the amount thereof, whether the provision be contained in the company's memorandum or articles, or in an agreement entered into by it, or in any resolution passed by the company in general meeting or its Board, shall not have any effect unless such increase is in accordance with the conditions specified in that Schedule.

Remuneration payable by companies having no profit or inadequate profit in certain special circumstances – Schedule V, Part II, Section III

Section III of Part II of Schedule V envisages further special circumstances where remuneration can be payable to a managerial person or other director in excess of the amounts provided in Section II above. These circumstances are enumerated as below:

(a) where the remuneration in excess of the limits specified in Section I or II is paid by any other company and that other company is either

- a foreign company; or
- has got the approval of its shareholders in general meeting to make such payment, and treats this amount as managerial remuneration for the purpose of section 197 and the total managerial

remuneration payable by such other company to its managerial persons including such amount or amounts is within permissible limits under section 197.

(b) Managerial remuneration up to any amount permissible under Section II can be paid to the managerial persons or other directors of the following class of Company:

(i) newly incorporated company, for a period of seven years from the date of its incorporation, or

(ii) sick company, for whom a scheme of revival or rehabilitation has been ordered by the Board for Industrial and Financial Reconstruction for a period of five years from the date of sanction of scheme of revival, or

(iii) company in relation to which a resolution plan has been approved by the National Company Law Tribunal under the Insolvency and Bankruptcy Code, 2016 for a period of five years from the date of such approval.

(c) Where remuneration of a managerial person or other director exceeds the limits in Section II but the remuneration has been fixed by the BIFR or the NCLT, provided that the limits under this section shall be applicable subject to meeting of all the conditions specified under Section II and the following additional conditions:—

(i) except as provided in para (a) of this Section, the managerial person is not receiving remuneration from any other company;

(ii) the auditor or Company Secretary of the company or where the company has not appointed a Secretary, a Secretary in whole-time practice, certifies that all secured creditors and term lenders have stated in writing that they have no objection for the appointment of the managerial person as well as the quantum of remuneration and such certificate is filed along with the return as prescribed under sub- section (4) of section 196.

(iii) the auditor or Company Secretary or where the company has not appointed a secretary, a secretary in whole-time practice certifies that there is no default on payments to any creditors, and all dues to deposit holders are being settled on time.

Disclosure by Listed Companies- Section 197(12)

Section 197(12) provides that every listed company shall disclose in the Board's report, the ratio of the remuneration of each director to the median employee's remuneration and such other details as may be prescribed.

Disclosure in Board's Report [Rule 5 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014]

(1) Every listed company shall disclose in the Board's report-

(i) the ratio of the remuneration of each director to the median remuneration of the employees of the company for the financial year;

(ii) the percentage increase in remuneration of each director, Chief Financial Officer, Chief Executive Officer, Company Secretary or Manager, if any, in the financial year;

(iii) the percentage increase in the median remuneration of employees in the financial year;

(iv) the number of permanent employees on the rolls of company;

(v) average percentile increase already made in the salaries of employees other than the managerial personnel in the last financial year and its comparison with the percentile increase in

the managerial remuneration and justification thereof and point out if there are any exceptional circumstances for increase in the managerial remuneration;

(vi) affirmation that the remuneration is as per the remuneration policy of the company.

Explanation.- For the purposes of this rule.- (i) the expression "median" means the numerical value separating the higher half of a population from the lower half and the median of a finite list of numbers may be found by arranging all the observations from lowest value to highest value and picking the middle one; (ii) if there is an even number of observations, the median shall be the average of the two middle values.

(2) The board's report shall include a statement showing the names of the top ten employees in terms of remuneration drawn and the name of every employee, who-

(i) if employed throughout the financial year, was in receipt of remuneration for that year which, in the aggregate, was not less than one crore and two lakh rupees;

(ii) if employed for a part of the financial year, was in receipt of remuneration for any part of that year, at a rate which, in the aggregate, was not less than eight lakh and fifty thousand rupees per month;

(iii) if employed throughout the financial year or part thereof, was in receipt of remuneration in that year which, in the aggregate, or as the case may be, at a rate which, in the aggregate, is in excess of that drawn by the managing director or whole-time director or manager and holds by himself or along with his spouse and dependent children, not less than two percent of the equity shares of the company.

(3) The statement referred to in sub-rule (2) shall also indicate -

(i) designation of the employee;

(ii) remuneration received;

(iii) nature of employment, whether contractual or otherwise;

(iv) qualifications and experience of the employee;

(v) date of commencement of employment;

(vi) the age of such employee;

(vii) the last employment held by such employee before joining the company;

(viii) the percentage of equity shares held by the employee in the company within the meaning of clause (iii) of sub-rule (2) of Rule 5 above; and

(ix) whether any such employee is a relative of any director or manager of the company and if so, name of such director or manager:

Provided that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than sixty lakh rupees per financial year or five lakh rupees per month, as the case may be, as may be decided by the Board, shall not be circulated to the members in the Board's report, but such particulars shall be filed with the Registrar of Companies while filing the financial statement and Board Reports:

Provided further that such particulars shall be made available to any shareholder on a specific request made by him in writing before the date of such Annual General Meeting wherein financial statements for the relevant

financial year are proposed to be adopted by shareholders and such particulars shall be made available by the company within three days from the date of receipt of such request from shareholders:

Provided also that in case of request received even after the date of completion of Annual General Meeting, such particulars shall be made available to the shareholders within seven days from the date of receipt of such request.

Disclosure of Remuneration in Board's Report Under the SEBI (LODR) Regulations, 2015

Regulation 17(6)(ca)- Remuneration payable to a single Non Executive Director

Approval of shareholders by special resolution shall be obtained every year, in which the annual remuneration payable to a single non-executive director exceeds fifty per cent of the total annual remuneration payable to all non- executive directors, giving details of the remuneration thereof.

Regulation 17(6)(e)- Remuneration payable to executive directors who are promoters or members of the promoter group

Requires the listed entity to obtain the approval of the shareholders by Special Resolution in General Meeting, in case of fees or compensation payable to executive directors who are promoters or members of the promoter group, if-

(i) the annual remuneration payable to such Executive Director exceeds rupees 5 crore or 2.5 per cent of the net profits of the listed entity, whichever is higher; or

(ii) where there is more than one such director, the aggregate annual remuneration to such directors exceeds 5 per cent of the net profits of the listed entity. Also, the approval of the shareholders under this provision shall be valid only till the expiry of the term of such director.

Explanation: For the purposes of this clause, net profits shall be calculated as per section 198 of the Companies Act, 2013.

The following disclosures are required to be mentioned in the Board of Director's report under the heading "Corporate Governance", if any, attached to the Financial statement as per Schedule V of the Companies Act, 2013:

Insurance Premium not part of Remuneration- Section 197(13)

Where any insurance is taken by a company on behalf of its managing director, whole-time director, manager, Chief Executive Officer, Chief Financial Officer or Company Secretary for indemnifying any of them against any liability in respect of any negligence, default, misfeasance, breach of duty or breach of trust for which they may be guilty in relation to the company, the premium paid on such insurance shall not be treated as part of the remuneration payable to any such personnel.

However, if such person is proved to be guilty, the premium paid on such insurance shall be treated as part of the remuneration.

Receipt of any Commission from the Company- Section 197 (14)

Subject to the provisions of this section, any director who is in receipt of any commission from the company and who is a managing or whole-time director of the company shall not be disqualified from receiving any remuneration or commission from any holding company or subsidiary company of such company subject to its disclosure by the company in the Board's report.

Illustrations:

1. A Managing Director of a company stood as a surety for repayment of Loan taken by such company for which he was paid guarantee commission. Does this Commission amounts to Managerial Remuneration?

   In a decided case Law of *Sussen Textile Bearing Ltd v. Union of India (1984),* it was held that the guarantee commission received by the director is for personal liability which the director undertakes and hence it should not be considered as remuneration within the meaning of Sec 197 of Companies Act 2013.

2. A is the Manager of ABC Limited and he has received a commission of Rs 2 Lacs in the capacity of a Director. He is also Managing Director of that company. He can received remuneration of Rs. 2 Lacs from XYZ Limited, i.e. subsidiary company of ABC limited, provided that it shall be disclosed in the company in its Boards Report.

Penalty For Contravention - Section 197 (15)

If any person makes any default in complying with the provisions of Section 197, he shall be liable to a penalty of one lakh rupees and where any default has been made by a company, the company shall be liable to a penalty of five lakh rupees.

Statement by the Auditor- Section 197 (16)

The auditor of the company shall, in his report under section 143, make a statement as to whether:

(i) the remuneration paid by the company to its directors is in accordance with the provisions of Section 197;

(ii) whether remuneration paid to any director is in excess of the limit laid down under this section and give such other details as may be prescribed.

Calculation of Net Profit for the Purpose of Managerial Remuneration (Section 198)

Section 198 of the Companies Act, 2013 lays down the manner of calculations of net profits of a company any financial year for purposes of Section 197. Sub- Section (2) specifies the sums for which credit shall be given and sub-section (3) specifies the sums for which credit shall not be given while calculating the net profit.

Similarly, sub-section (4)/(5) of Section 198 specifies the sums which shall be deducted/not deducted while calculating the net profit.

Recovery of Managerial Remuneration in Certain Cases (Section 199)

Section 199 of the Companies Act, 2013 provides for recovery of remuneration including stock options received by the specified Managerial Personnel, where the benefits given to them are found to be in excess of what is reflected in the restated financial statements.

It states that without prejudice to any liability incurred under the provisions of the Companies Act, 2013 or any other law for the time being in force, where a company is required to re-state its financial statements due to fraud or non- compliance with any requirement under the Companies Act, 2013 and the rules made there under, the company shall recover from any past or present managing director or whole-time director or manager or Chief Executive Officer (by whatever name called) who, during the period for which the financial statements are required to be re-stated, received the remuneration (including stock option) in excess of what would have been payable to him as per restatement of financial statements.

Additional compliances for payment of Managerial Remuneration in Case of No Profits/ Profits are Inadequate (Section 200)

In respect of cases where the company has inadequate or no profits, a company may fix the remuneration within the limits specified in the Companies Act, 2013, at such amount or percentage of profits of the company, as it may deem fit. While doing so, the company shall have regard to —

(a) the financial position of the company;

(b) the remuneration or commission drawn by the individual concerned in any other capacity;

(c) the remuneration or commission drawn by him from any other company;

(d) Professional qualifications and experience of the individual concerned;

(e) such other matters as may be prescribed.

As per Rule 6 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 for the purpose of item (e) of section 200, the company shall have regard to the following matters while granting approval.

Parameters for consideration of remuneration

The company shall have regard to the following matters, namely:-

(1) Financial and operating performance of the company during the three preceding financial years.

(2) Relationship between remuneration and performance.

(3) The principle of proportionality of remuneration within the company, ideally by a rating methodology which compares the remuneration of directors to that of other directors on the board who receives remuneration and employees or executives of the company.

(4) Whether remuneration policy for directors differs from remuneration policy for other employees and if so, an explanation for the difference.

(5) The securities held by the director, including options and details of the shares pledged as at the end of the preceding financial year.

Compensation for Loss of Office of Managing or Whole-Time Director or Manager (Section 202)

Section 202 provides that a company may make payment to a managing or whole-time director or manager, but not to any other director, by way of compensation for loss of office, or as consideration for retirement from office or in connection with such loss or retirement.

However, No payment shall be made in the following cases:—

(a) where the director resigns from his office as a result of the reconstruction of the company or of its amalgamation with any other body corporate or bodies corporate, and is appointed as the managing or whole-time director, manager or other officer of the reconstructed company or of the body corporate resulting from the amalgamation;

Example: Mr. A is a manager of ABC Limited, who resigns as a result of the amalgamation of it with XYZ Limited, and is appointed as manager of XYZ Limited. No compensation shall be given to Mr. A.

(b) where the director resigns from his office otherwise than on the reconstruction/ amalgamation of the company;

Example: Mr. A is a manager of ABC Limited, who resigns. As there was neither reconstruction of the company to its amalgamation so no compensation shall be given to Mr. A.

(c) where the office of the director is vacated under Section 167(1);

Example: Mr. A is a director of ABC Limited, and his office is vacated on the ground that he incur any disqualification, or he remains absent from all meeting of Board or at the order of Tribunal, etc. No compensation shall be given to Mr. A.

(d) where the company is being wound up, whether by an order of the Tribunal or voluntarily, provided the winding up was due to the negligence or default of the director;

Example: Mr. A is a director of ABC Limited, which is being wound up, whether by an order of Tribunal or voluntarily and the winding up was due to the negligence or default of the director. No compensation shall be given to Mr. A.

(e) where the director has been guilty of fraud or breach of trust or gross negligence or mismanagement of the conduct of the affairs of the company or any subsidiary company or holding company; and

Example: Mr. A is a director of ABC Limited, and he guilty of fraud or breach of trust in relation to, or of gross negligence or gross mismanagement of the conduct of the affairs of the company etc. No compensation shall be given to Mr. A.

(f) where the director has instigated, or has taken part directly or indirectly in bringing about, the termination of his office.

Any payment made to a managing or whole-time director or manager shall not exceed the remuneration which he would have earned if he had been in office for the remainder of his term or for three years, whichever is shorter, calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which he ceased to hold office, or where he held the office for a lesser period than three years, during such period. (Sub-section 3 of Section 202)

Provided that no such payment shall be made to the director in the event of the commencement of the winding up of the company, whether before or at any time within twelve months after, the date on which he ceased to hold office, if the assets of the company on the winding up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital, including the premiums, if any, contributed by them.

However, Section 202 not prohibit the payment to a managing or whole-time director, or manager, of any remuneration for services rendered by him to the company in any other capacity. (Sub-section 4 of Section 202)

Illustration:

A whole time Director of a company made an invention during the course of his employment with the Company. He patented the invention in his own name and appropriated the benefits to himself. Can he do so?

In the decide case of *Cranleigh Precision Engineering Ltd. v. Bryan (1964)* it was held that the directors are liable to the company for all personal profits or gain made by them taking advantage of their position as a directors.

A director was held liable when a director patented and registered in his own name an invention made during the course of his employment with the company.

Amount of Compensation {Section 202(3)}

Any payment made to a managing or whole-time director or manager in pursuance of section 202 (1) shall not exceed the remuneration which he would have earned if he had been in office for:

- the remainder of his term; or
- for three years,

whichever is shorter.

Also, such amount of compensation shall be calculated on the basis of the average remuneration actually earned by him during a period of three years immediately preceding the date on which he ceased to hold office, or where he held the office for a lesser period than three years, during such period.

Example: Mr. A is a manager of ABC Limited, who retires under the normal circumstances on 31.03.2022 where 2 years period was left. The average remuneration earned by him during the period of three years is Rs. 25 Lacs p.a.. The company shall give sum Rs. 50 Lacs as compensation.

However, no such payment shall be made to the director in the event of the commencement of the winding up of the company, whether before or at any time within twelve months after, the date on which he ceased to hold office, if the assets of the company on the winding up, after deducting the expenses thereof, are not sufficient to repay to the shareholders the share capital, including the premiums, if any, contributed by them.

Example: Mr. A is a manager of ABC Limited, who retires under the normal circumstances on 31.03.2022 and where 4 years period was left. The average remuneration earned by him during the period of one year is Rs. 25 lacs p.a.. The winding up of the company started in July 2022 and the assets of the company on the winding up, after deducting the expense thereof, are not sufficient to repay to the shareholders the share capital including the premiums. The company shall not be liable to give Mr. A any compensation.

Any remuneration for services rendered by him to the company in any other capacity {Section 202(4)}

This section shall not be deemed to prohibit the payment to a managing or whole-time director, or manager, of any remuneration for services rendered by him to the company in any other capacity.

Example: Mr. A is a manager of ABC Limited, who retires under the normal circumstance on 31.03.2022. Before, retirement Mr. A has given a legal advice to the company. He is entitled for remuneration for the services rendered by him.

SPECIMEN RESOLUTIONS:

Resolution for Appointment of Whole Time Directors

CERTIFIED TRUE COPY OF THE RESOLUTION PASSED BY THE BOARD OF DIRECTORS (No. _____) OF _____ HELD ON _____ AT THE REGISTERED OFFICE OF THE COMPANY AT _____ A. M. /P.M

"RESOLVED THAT pursuant to Sections 196, 203 and other applicable provisions of Companies Act, 2013 (including corresponding provisions, if any of the Companies Act, 1956) and the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, approval of the Board be and is hereby accorded for the appointment of Mr. _____ as Whole Time Director of the Company for a period of _____ years from _____, on the remuneration and on such terms and conditions as set out below with liberty and authority to the Board of Directors to alter and vary the terms and conditions of the said appointment from time to time within the scope of Schedule V of the Companies Act, 2013, or any amendments thereto or any re-enactment thereof as may be agreed to between the Board of Directors and Shri .....

i. Salary at the rate of Rs. _____ (Rupees _____ only) per month w.e.f _____, which may be reviewed by the Board.

ii. The company shall provide the rent free furnished accommodation and will pay electricity and water charges;

iii. The Whole Time Director shall be entitled to use the company's car, all the expenses for maintenance and running of the same including salary of the driver to be borne by the Company. iv. The Whole Time Director shall be entitled to participate in provident fund, gratuity fund or such other schemes for the employees, which the company may establish from time to time. Draft Board Resolution for appointment of Whole Time Director. v. Reimbursement of medical and hospitalization expenses of the Whole Time Director and his family in accordance with the Company policy.

vi. Leave Travel Allowance for the Whole Time Director and his family once in a year in accordance with the Company policy.

Vii. Bonus for the financial year, at the discretion of the board.

Viii Reimbursement of expenses incurred by him on account of business of the Company in accordance with the Company policy.

ix. Reimbursement of any other expenses properly incurred by him in accordance with the rules and policies of the Company.

The Whole Time Director shall be entitled to such increment from time to time as the Board may by its discretion determine.

RESOLVED FURTHER THAT in the event of loss or inadequacy of profit in any financial year during the currency of tenure of services of Mr. _____, the payment of salary, perquisites and other allowances shall be governed by the limits prescribed under Section II of Part II of Schedule V of the Companies Act, 2013;

RESOLVED FURTHER THAT the Board of Directors of the Company be and is hereby authorized to take such steps as may be necessary, desirable or expedient to give effect to this resolution."

Resolution For Appointment of Whole Time Company Secretary under Listed Company

RESOLUTION FOR APPOINTMENT OF COMPANY SECRETARY / COMPLIANCE OFFICER OF THE COMPANY FOR LISTED COMPANIES

"RESOLVED THAT Pursuant to the provision of section 203 (1) of the Companies Act, 2013 read with rule 8 and 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules 2014 and any other applicable provisions of the Act and Rules framed thereunder, including any amendments thereto or re-enacted thereof from time to time Mr_____ Membership No._____ be and is hereby appointed as the "Company Secretary" of the company on the terms and condition including the terms of remuneration as per appointment letter placed before the meeting, as recommended by the nomination and remuneration committee.

FURTHER RESOLVED THAT pursuant to regulation 6 and 30 read with clause 7 of para A of part A of schedule III of SEBI (Listing Obligation And Disclosure Requirement) Regulation 2015, Mr._____ be and is hereby for the designated and appointed as the "Compliance Officer" of the company and authorised to make all the compliances as may be applicable to the company under the SEBI (Listing Obligations And Disclosure Requirement) Regulation 2015 various other SEBI Regulation, Securities Contract Regulation Act 1956 Industrial and labour laws as may be applicable to the company from time to time.

FURTHER RESOLVED THAT the company secretary and compliance officer be and is hereby authorised to sign various documents and file forms returns on behalf of the company as may be necessary and to do all such acts, deeds, things, and matters incidental to the position as per the act and rules made thereunder and under proper instruction/ authorisation from the managing director or chairperson of the company.

FURTHER RESOLVED THAT Mr._____, managing director of the company be and is hereby authorised to sign and submit necessary forms, returns, for the appointment of company secretary with the Registrar Of Companies_____ to intimate the same to the appropriate authorities regulatory bodies and to do all such acts and deeds as may be necessary in this regard."

LESSON ROUND-UP

- KMP are included in the definition of 'officer' under section 2 (59) of the Act;
- KMP are included in the definition of 'officer who is in default' under section 2 (60) of the Act;
- The nature of concern or interest of KMP on the matters proposed to be transacted in a meeting, are to be disclosed in the explanatory statement to the notice of such meeting, in terms of section 102 of the Act;
- A KMP or his relative cannot be appointed as an independent director under section 149 of the Act;
- KMP shall have a right to be heard in the meetings of the Audit Committee when it considers the auditor's report but shall not have the right to vote in terms of section 177;
- The Nomination and Remuneration Committee shall formulate and recommend to the Board a policy, relating to the remuneration for the KMP in terms of section 178;
- The appointment or removal of KMP shall be made in a board meeting in terms of section 179 of the Act;
- Every KMP shall, within a period of thirty days of his appointment, or relinquishment of his office, disclose to the company his concern or interest in the other associations or such other information relating to himself as may be prescribed in terms of section 189;
- For appointment of KMP, a return in form DIR-12 & MR-1 is required to be filed with the Registrar of Companies within 60 days of appointment in terms of section 196 r/w section 170 of the Act;
- Appointment of whole-time KMP is mandatorily in certain prescribed class of companies in terms of section 203;
- A whole-time KMP shall not hold office in more than one company except in its subsidiary company at the same time in terms of section 203;
- If the office of any whole-time KMP is vacated, the resulting vacancy shall be filled-up by the Board at a meeting within a period of six months from the date of such vacancy in terms of section 203;
- Every company secretary is expected to adhere not only to the letter of the law but also ensure that the spirit of the law is followed;
- A Company Secretary exercises supervisory and checking role so as to prevent any chance of negligence in implementing various laws applicable to a particular company;
- Role of company secretary is three-fold, namely, as a statutory officer, as a coordinator, and as an administrative officer;
- A director may receive remuneration by way of fee for attending the Board/Committee meetings or for any other purpose as may be decided by the Board. However, the amount of such fees shall not exceed the amount as may be prescribed.

GLOSSARY

Turnover: "Turnover" means the gross amount of revenue recognised in the profit and loss account from the sale, supply, or distribution of goods or on account of services rendered, or both, by a company during a financial year. [Section 2(91)] of Companies Act, 2013.

Whole-time director: "Whole-time director" includes a director in the whole-time employment of the company; [Section 2(94)] of Companies Act, 2013.

***Vis-a-vis*:** with regard to.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. Explain the term Key Managerial Personnel under the Companies Act, 2013. Is it necessary for every company to appoint a Key Managerial Personnel?
2. If a company proposes to pay remuneration exceeding 5% to one MD or WTD but within the overall limit of 11%, is there a need to obtain shareholder's approval?
3. Discuss the role of Company Secretary.
4. Write a short note on Managerial Remuneration.
5. Can a company pay remuneration to managerial personnel in case of inadequate profits?
6. Can a company pay remuneration to managerial personnel in excess of limits specifies in Section 197?
7. In what circumstances a managerial personnel is required to refund remuneration.
8. The company secretary of a company, having a paid up share capital of more than Rs. 10 crores, resigned and left the company. The company has not appointed his successor. Meanwhile, it has started incurring losses. Its sales have declined and financial position became weak. Can it be a valid reason for not appointing a whole-time secretary ?
    (a) Company has not appointed a new Company Secretary on the ground that it has started incurring losses, its sales have declined and financial position has become weak. The argument will not find favour with the authorities
    (b) Company has not appointed a new Company Secretary on the ground that it has started incurring losses, its sales have declined and financial position has become weak, is valid argument
    (c) Company has to appointed a new Company Secretary when the business becomes profitable
    (d) None of these.
9. Vishwakarma Ltd. wants to remove Abhay, Company Secretary of the Company because he has cheated to the Company for Rs. 50.00 lakhs during the course of his employment of last three years. Choose the correct option for removing the Company Secretary from his employment:
    a. Convene a Board meeting and serving notice of termination as per appointment terms or the policy of the company
    b. Filing of E Form DIR-12 within 30 days of passing the resolution and intimation to stock exchanges
    c. Filing of E Form MR-1 and MGT-14 to ROC

d. Intimation to ICSI for professional misconduct

e. Entry under statutory register of the company

Choose:

(i) a, b, c and d

(ii) a, b, d and e

(iii) a, c, d and e

(iv) All the above

LIST OF FURTHER READINGS

- Company Law Exploring Procedural Dimensions VOL I / II / III – by ICSI
- ICSI Premiere on Company Law
- Bare Act- The Companies Act, 2013

OTHER REFERENCES (Including Websites/Video Links)

- https://www.mca.gov.in/content/mca/global/en/acts-rules/ebooks/acts.html?act=NTk2MQ==

WARNING

Regulation 27 of the Company Secretaries Regulations, 1982

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo-moto or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as a student, or debar him from re-registration as a student, or take such action as may be deemed fit.

It may be noted that according to regulation 2(ia) of the Company Secretaries Regulations, 1982, 'misconduct' in relation to a registered student or a candidate enrolled for any examination conducted by the Institute means behaviour in disorderly manner in relation to the Institute or in or around an examination centre or premises, or breach of any provision of the Act, rule, regulation, notification, condition, guideline, direction, advisory, circular of the Institute, or adoption of malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with writing of any examination conducted by the Institute, or tampering with the Institute's record or database, writing or sharing information about the Institute on public forums, social networking or any print or electronic media which is defamatory or any other act which may harm, damage, hamper or challenge the secrecy, decorum or sanctity of examination or training or any policy of the Institute.

EXECUTIVE PROGRAMME
COMPANY LAW & PRACTICE – TEST PAPER
GROUP 1 • PAPER 2

(*This test paper is for practice and self-study only and not to be sent to the Institute*)

Time allowed: 3 hours *Maximum Mark: 100*

Total number of questions: 6

Note : 1. Answer all Questions

2. All references to the sections relate to Companies Act 2013, unless stated otherwise.

PART I : COMPANY LAW - PRINCIPLES & CONCEPTS

1(a) Sun Moon Ltd. has registered office at Delhi and branch office in California. The company is mainly working under processed food manufacturing segment. The Board of directors of the company have very sound knowledge of processed food segment, management and finance. The company planned to set up an Agro Cluster Food Park in India in due course of time.

After some time, the board noticed chaos among themselves on the issue of positions and holdings in the company. Consequently, it was observed that the company had not been reporting true and fair view of the state of affairs of its financial statements since more than ten years and the mis-reporting of financial statements had not came to the notice of none of the stakeholders.

The situation of the Company went from bad to worse and it had no option but to file an application for initiating corporate insolvency resolution process with the Adjudicating Authority. Meanwhile one of the director of the company has released a press statement that there is a disparity between actual and reported financial statements due to accounting errors which was prevailing since many years.

The first question from shareholders of the Company was, as to why the auditors of the company had not spotted and corrected the fundamental accounting errors? Subsequently, the shareholders holding 75% of the paid up share capital of the company have approached to the Central Government as per the provisions of the Companies Act, 2013 for investigating into the affairs of the company and Central Government ordered for investigation into the affairs of company.

The investigation report stated that the auditors of the Company (one of the largest audit firms in the country) had compromised its independence by charging a huge amount of audit fee and also consultancy income worth several times the audit fee. Auditors had knowingly signed inaccurate accounts in order to protect the management of the Company. Investigation revealed significant deficiencies in internal control system, external reporting processes and non-adherence of relevant accounting standards.

Based on the above facts, answer the following with reasons:

(i) Whether the Sun Moon Ltd. required to adhere to provision(s) of the Companies Act, 2013 pertaining to keeping and maintenance of proper books of accounts of branch office situated outside India?

(ii) Whether the above case highlights importance of independence of auditors?

(iii) Whether the shareholders holding 75% of the paid-up share capital of the company can approach to the Central Government for order an investigation into the affairs of the company? Whether Central Government *suo-moto* order for an investigation into the of affairs of the company?

(Marks 4+4+4=12)

(b) XYZ Limited is planning to issue bonus shares. The company hired professionals like Practicing Company Secretaries and other administrative staff in order to execute the plan. Mr. Y finance head working in the company advised that the company shall first pass unanimous board resolution and then call a general meeting to pass the special resolution in order to move ahead for issuance of bonus issue. Referring to the provisions of the Companies Act, 2013, comment on the statement and elucidate the conditions required to be fulfilled before a company can issue bonus shares to shareholders of the company.

(3 Marks)

2(a) ABC Private Limited was incorporated on 10.04.2023. To understand the working parameters and other legal matters applicable to a private company, the promoters of the company organized a meeting with practicing company secretary Mr. CS. Mr. A one of the director of ABC Private Limited placed below mentioned concerns before Mr. CS:

(i) Articles of Association of a company limited by guarantee provides that entire income of the company shall be applied towards promotion of the objects of the company.

(ii) For a company limited by guarantee, the liability of the members is restricted by the amount each member has agreed to contribute at the time of incorporation.

Assuming yourself as Mr. CS, comment on the statements. **(5 Marks)**

(b) Skyhigh Dwellings Private Ltd. is in the business of real estate. It has received an amount of Rs. 90,000/- as an advance from its customers during the course of business on which no interest is payable to its customers. Referring to the provisions of the Companies Act, 2013, decide whether this receipt should be treated as an 'advance' by the company in its books of accounts or note?

(5 Marks)

(c) Galaxy Ltd. received a transfer deed for registration of transfer of shares to Manu, daughter of Satyam. After registering the transfer, the company sent the certificate to another Manu (similar name), daughter of Tarun.Manu, daughter of Tarun, refused to part with share certificate and pledged the certificate to ISD Bank. Discuss the remedy, if any, available to Manu, daughter of Satyam, in this case.

(5 Marks)

3(a) SSS Limited is listed company and going to allot securities to public. The company was not able to receive the minimum amount of subscription as mentioned in the prospectus. A Company Secretary in Practice advised the company that "If a company does not receive minimum subscription, it should refund money received from applicants within such time as may be prescribed''. Explain the above statement with suitable comments.

(4 Marks)

(b) Yamuna Ltd. wants to shift its registered office from Chennai, Tamil Nadu (ROC, Chennai) to Coimbatore, Tamil Nadu (ROC, Coimbatore) since the company is facing operational difficulties due to the current location of the registered office. As a company secretary, apprise the Board of directors about the desired process?

(4 Marks)

(c) Mr. Raj Kumar a press reporter by profession, holding merely 1.5% shares of the ABC Limited, wishes to inspect the Register of members of the company. Company has declined such demand taking the base that he may use the information for creating some news. Is the contention of ABC Limited is valid?

(4 Marks)

(d) Town Builders Ltd. is a listed company. The managing director of the company is a company secretary and always intend to follow good governance in the operations and functions of company with a noble belief "People, Profit and Planet". The board of directors wishes to appoint Manager Finance, as an internal auditor also. Referring to the relevant provisions of the Companies Act, 2013 advise the company, whether it can do so or not?

(3 Marks)

Attempt all parts of either Q. No. 4 or Q. No. 4A

4(a) The name of Success Ltd was struck off by the Registrar of Companies (ROC) during the month of July, 2022 as the company had not been carrying on business or nor in operations for two immediately preceding financial years and the company had not obtained the status of dormant company under Section 455 of the Companies Act, 2013. The Sucess Ltd filed an appeal before NCLT claiming that it had not been served with Notice under Section 248(1) of the Act and the Registrar of Companies (ROC) had proceeded to issue notice under Section 248(5) of the Act and the name of the Success Ltd was then struck off. The appellant claimed that the company had been doing business and was in operation and audited financial statements for the year financial year 2012-13 to FY 2019-20 were filed. In view of the aforesaid facts, state whether Success Ltd claim is correct or RoC's action is justified? Give reasons in support of your answer.

(4 Marks)

(b) An appeal was filed by Mr. Ram, a minority shareholder against Pinnacle Limited alleging oppression and mismanagement by majority shareholders. As per the shareholding pattern, Mr. Ram and another shareholder held less than 10% and the rest by shareholders who individually held more than 10%. The National Company Law Tribunal passed an Order, granting waiver in favour of Mr. Ram under proviso to Section 244(1) of the Companies Act, 2013 for the petition alleging oppression and mismanagement in the Company. An appeal was preferred against the said Order by Pinnacle Limited. Evaluate the validity of the appeal.

(4 Marks)

(c) A public limited company has only seven shareholders. Being all the shares paid in full, one such shareholder purchased all the shares of another shareholder in a private settlement between them reducing the number of shareholders to six. The company continues to carry on its business thereafter. Discuss with reference to the Companies Act, 2013 the implications of this transaction on the functioning of the company.

(4 Marks)

(d) A newly appointed Company Secretary of BCD Ltd. having its headquarter in Mumbai discovered that, four months ago the company, had created a floating charge on its assets located in Bhutan for raising a new loan and to continue its expansion of business smoothly. However, there was no filing of form CHG-1 and the officers believe that the charge created related to properties in Bhutan and hence no formalities were needed with ROC in India. Evaluate the stand taken and what are the options available with the Company Secretary now in this regard.

(3 Marks)

OR (Alternate question to Q. No. 4)

4A(i) The recognised trade union of Lime Light Ltd. made an application before the Tribunal seeking order for investigation of the company on the ground that the company has defaulted in the payment of dues of the workmen since long and the business of the company is being conducted otherwise for a fraudulent or unlawful purpose. In response, the company objected to the application and claimed that the recognised trade union not being the members or creditors of the company has no locus standi to make such application and is liable for dismissal. Examine the admissibility of the application of recognised trade union submitted before the Tribunal seeking investigation of the company.

(4 Marks)

(ii) ZZZ Ltd. had borrowed Rs. 50 crore from a scheduled bank and repaid entire loan amount along with interest thereon. The company wants to file satisfaction of charge with the Registrar only after receiving no due certificate and a release letter from the bank. If company delays the filing of satisfaction of charge for the default of bank in not issuing these documents, whether the company will be liable for late filing of satisfaction of charge under the Companies Act, 2013 ? Discuss.

(4 Marks)

(iii) Rainbow Limited has on its Board, four directors viz A, B, C and D. In addition, the company has Mr. R as the Managing Director. The company also has a full time Company Secretary, Mr. Ram, on its rolls. The financial statements of the company for the year ended 31st March, 2023 were authenticated by two of the directors, Mr. A and Mr. B under their signatures. Referring to the provisions of the Companies Act, 2023 :

(i) Examine the validity of the authentication of the Financial Statement including Balance Sheet and Statement of Profit & Loss etc. and the Boards Report.

(2 Marks)

(ii) What would be your answer in case the company is a One Person Company (OPC) and has only one Director, who has authenticated the Financial Statement including Balance Sheet and Statement of Profit & Loss and the Board's Report ?

(2 Marks)

(iv) The period of 10 years is over from taking over X Ltd. (the transferor company) by Y Ltd. (the transferee company) by acquiring its shares and hence, a Board resolution has been passed by the transferee company in the meeting held in June, 2023 to destroy the books and papers (the record) of the transferor company considering the provisions relating to preservation of books of account of the company. Referring to the provisions of the Companies Act, 2013, Decide the validity of the decision of the Board of the transferee company.

(3 Marks)

PART II: COMPANY ADMINISTRATION AND MEETINGS

5(a) Apex Global Limited (listed company) was a diversified Company having a complex group structure with more than 20 subsidiaries. Each company had its own Finance department which would report to a Central Finance Team headed by the group CFO Mr. Avnish. All the Companies and different units of Apex GLobal Limited were functioning in silos, wherein each one was unaware of the performance of other companies. There were inter-corporate loan arrangements between Companies in the group and

related party transactions. The top management consisted of few professionals and family members. All the top executives were being paid higher remuneration in comparison with the industry benchmarks including high number of stock options.

Apex Global Limited had a whistle blower policy monitored by the Audit Committee. Mr. Ravish, a qualified Senior Accountant, working in the Company had approached the Director (Finance) with concerns about the financial statements but he could not get satisfactory answers and so threatened to inform the press. When his threat came to the attention of the Board, he was intimidated to keep quiet.

Another employee Mr. Ram had written to Mr. Shankar (independent director) stating that the books of the Company had been manipulated. Although this letter was circulated to the Board, no action was taken. The audit committee also failed to take any action.

When the group was not able to repay its loan to banks, there were concerns from bank and consequently forensic audit was initiated. The forensic audit revealed a fraud within the Company and the share price of the Company plummeted.

Based on the above facts, answer the following with reasons:

(a) Whether the role of Independent Directors and Audit Committee is required for effective oversight of matters pertaining to Whistle blower complaints?

(b) Whether there are challenges for effective implementation of a Whistle blower policy in a company such as Apex Global Limited?

(c) Whether there are certain provisions to be taken care of before considering for inter-corporate loans and advances under the Companies Act, 2013? Critically examine.

(d) "Disclosures in respect of fraud to be mentioned in Board's Report and Annual Report". Is the statement true? Explain.

(Marks 2+2+2+2=8)

5(b)(i) The date of approval of Financial Statements by the Board of Directors of XYZ Ltd. is 17th July, 2021 and the date of notice of Annual General Meeting (AGM) is 25th August, 2021. CFO of XYZ Ltd. has advised that the time gap between date of approval of financial statements by the Board of Directors and the date of Notice of AGM should be 30 days. The Directors have approached you as Company Secretary to advise them regarding the same with specific reference to the provisions of Companies Act, 2013.

(3 Marks)

(ii) Vishwakarma Ltd. wants to remove Mr. A, Company Secretary of the Company because he has cheated to the Company for Rs. 50 lakhs during the course of his employment of last three years. Advise the process for removing the Company Secretary from his employment.

(3 Marks)

(iii) Board of directors of Jagatguru Ltd. proposes to appoint Mr. Sriram as managing director. Mr. Sriram has recently celebrated his 72nd birthday. Mr. Sriram has spent his entire career in the sector in which the company operates and will be a strategic fit for Jagatguru Ltd. The Company Secretary of the company suggests that Mr. Sriram can only be appointed through special resolution. Do you agree with the Company Secretary? Discuss.

(3 Marks)

(iv) Wellness Ltd wants to pay sitting fees to its women directors (Mrs. Anima and Ms. Gauri), less than the sitting fees payable to other directors of the Company and also want to appoint Ganpati Kumar as its Managing Director of the company for a term exceeding five years at a time. Guide the company on the above proposals.

(3 Marks)

Attempt all parts of either Q. No. 6 or 6A

6. (a) Draft the minutes of Annual General Meeting of Green Ltd. at which adoption of accounts, appointment of auditors and the appointment of additional director as regular director featured for consideration and decision.

(5 Marks)

(b) Big Brothers Ltd. wishes to sell one of its undertakings for which it decides to call an Extra-ordinary General Meeting (EGM) and to pass a resolution thereat. State the material facts to be set out in the explanatory statement to be annexed to the notice of the EGM on this special business to be transacted at the meeting.

(5 Marks)

(c) During the financial year 2021-22, the Board of Directors of Huge Power Limited has issued shares to employees under Employees Stock Option Scheme. Ms. Tanu has recently joined the Board of the company and asks you, being the Company Secretary of the company, as to what details are to be disclosed in the Board's Report in this regard. Advise her.

(5 Marks)

(d) ABC Limited has crossed the threshold limit mentioned under the section 135 of the Companies Act, 2013 and therefore it is planning to spend the calculated amount of CSR. In this regard the Board of directors of the company have consulted the Company Secretary Mr. Ram for the same. Mr. Ram advised the company on below mentioned matters:

(i) What are the different modes of implementation of CSR activities?

(ii) Which entities are eligible to actas an implementing agency for undertaking CSR activities?

(5 Marks)

OR (Alternate questions to Q. No. 6)

6A. (i) Amber Realtors Ltd., a Delhi based company, started a make shift hospital in Delhi to provide temporary Covid care facilities, which include creating health infrastructure for Covid care, establishment of medical oxygen plants etc. Can these expenditures qualify for Corporate Social Responsibility (CSR) spending? What are the government guidelines in this regard?

(5 Marks)

(ii) According to SS-1 the Company Secretary cannot summon a Meeting on his own, unless authorised by the Board of Directors or the Articles to do so. Comment.

(5 Marks)

(iii) The Board of directors of Vedic Ltd. desirous of transacting certain matters through video conferencing, seek your advice on the matters which cannot be dealt with through video conferencing. Advise the Board.

(5 Marks)

(iv) "Listed companies are required to comply with the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and should provide a separate section on 'corporate governance' in the annual report of the company". Discuss this statement and suggest list of items related to disclosure pertaining to the Board of Directors to be included in such report?

(5 Marks)