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# The Companies Act 1956

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# Programme Educational Objectives

- *Our program will create graduates who:*
- *1. Will be recognized as a creative and an enterprising team leader.*
- *2. Will be a flexible, adaptable and an ethical individual.*
- *3. Will have a holistic approach to problem solving in the dynamic business environment.*

# Business Legislations Course Outcomes

- CO1 Given the circumstances, the learner will be able to infer legal aspects of doing business & plan business activities.
- CO2 In a given situation, the learner will be able make use of provisions of the Contract Act to evaluate a contract used in commercial practice with 70% accuracy.
- CO3 In a given situation, learner will be able to distinguish between various types of Companies and explain their comparative advantages and disadvantages

- CO4 The learner will be able to describe the legal process involved in formation of a company and identify the relationships amongst the various stakeholders of the company.
- CO5 When needed, the learner will be able to examine the various provisions of consumer protection act and determine steps to be taken in case of consumer related complaints.
- CO6 In a given situation, student manager will be able to make use of various legal provisions of Information Technology Act.

# INTRODUCTION

This Act may be called the Companies Act, 1956.

- It is a Business Law.
- It is a commercial Law & its roots are seen in English Company Law.
- Many provisions of it are incorporated in the Indian Companies Act of 1956.

# Applicability of Act

- Being a Central Government Act it is applicable to all the states of India including Union Territories.
- The provisions of this Act are applicable to all the class of companies in India.
- The provisions are also applicable to all the companies incorporated out of India but they have established places of business in India.

# Objectives of the Act

- To conduct the business smoothly with the help of limited liabilities & with limited shares.
- To serve the community by providing Quality products & services at reasonable cost.
- To earn the profit & distribute it among all the investors & Board of Directors in proportionate with their investments.
- To grow the business with the help of share capital & Ideas so that the part of it is contributed towards national prosperity.
- To create an employment opportunities for qualified and eligible person towards CSR.

# Definition

- As per **companies Act 1956.(Sec3(1)(i))**

It means a business organization formed as per the companies Act 1956 to achieve following objectives -

- a) To encourage the investors to do their investments.
- b) To ensure proper Administration
- c) To prevent Malpractices
- d) To allow for investigation if required.

## **Other Definitions:**

- A Company is a form of business organization in which the funds of a large number of investors are managed by a few persons for the purpose of earning profits which are shared by all the investors.

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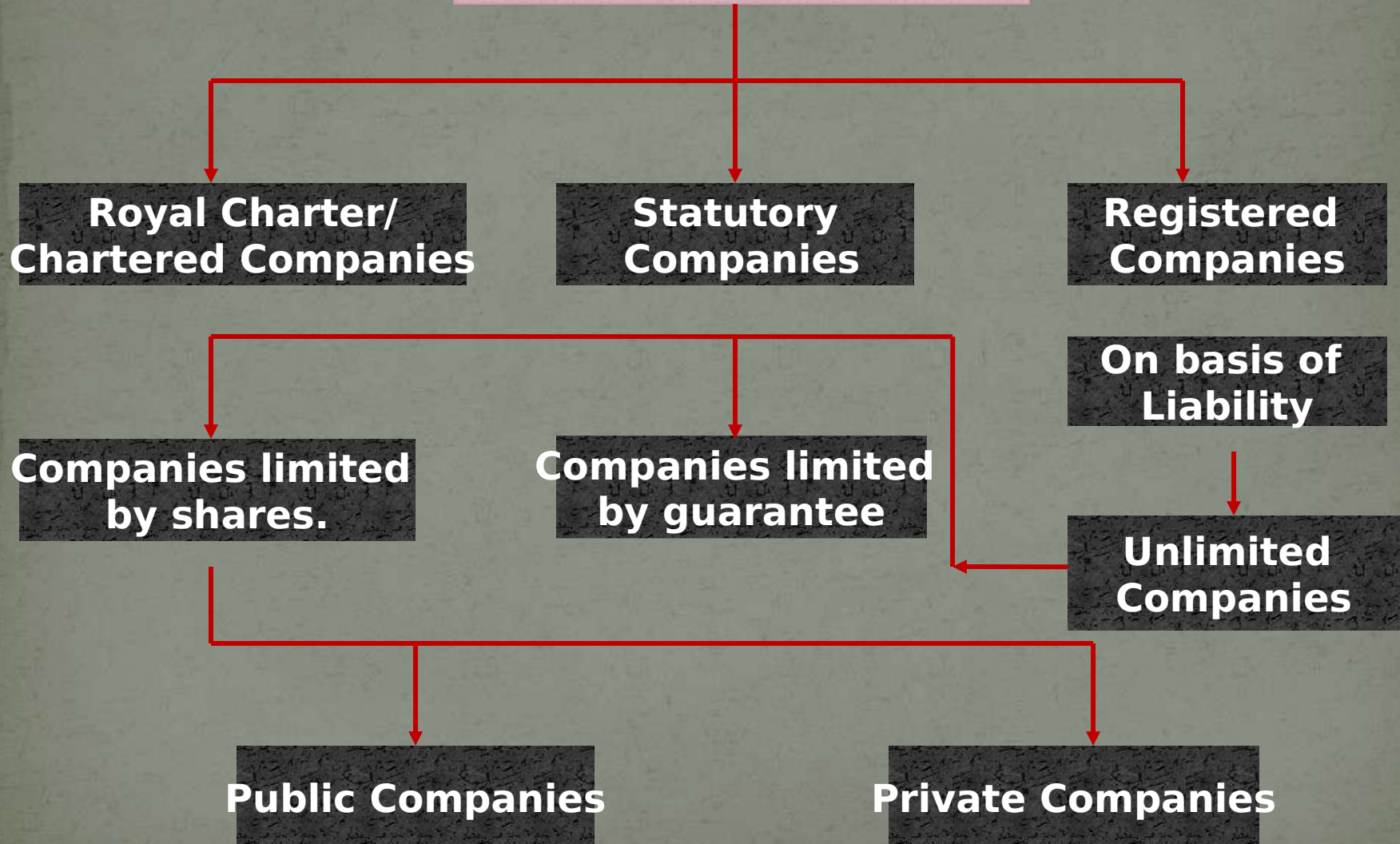
- It is an association of persons formed to achieve



# Essential Characteristics of a Company.

- Registration- Should be registered under the Companies Act.
- Distinct Person- Separate legal entity.
- Perpetual succession- Never dies.
- Easy transfer of shares.
- Limited liability.
- Artificial person but not a citizen.
- Common Seal.
- Capacity to sue and be sued.
- Share holders are actual owners of Company
- Number of persons are as per MOA
- Separate Property
- Separation of ownership and Management
- Authority to raise share capital on large scale.
- To comply with statutory requirements on a regular basis
- Company is a Corporate Body

# Types of Companies



# Types of Companies

- **On the basis of Liability**
- **On the basis of Incorporation**
- **On the basis of Ownership**
- **Government Companies**
- **On the basis of Jurisdiction**
- **On basis of Control & Shareholding**
- **One Man Company**

# Types of Companies

## **A) On the basis of Liability**

- Limited by shares
- Limited by Guarantee
- Unlimited Company

## **B) On the basis of Incorporation**

- Chartered Company
- Statutory Company
- Registered Company

## **C) On the basis of Ownership**

- Private Limited Company
- Public Limited Company

# Types of Companies

## **D) Government Companies**

## **E) On the basis of Jurisdiction**

- Foreign Company
- MNC Company

## **F) On the basis of Control & Shareholding**

- Holding Company
- Subsidiary Company

## **G) One Man Company**

# A. On the basis of Liability

## Companies Limited by shares

- Companies limited by shares are the most commonly found companies.
- **Section 12 (2) (a)** implies that where the liability of the shareholders of a company is limited to the extent of the unpaid amount on the shares held by them, the company is known as a company limited by shares.
- In such companies, each share has a fixed nominal or face value which the shareholder is required to pay either at a time or in various installments. Whatsoever may be the liabilities of a company, shareholders are not bound to pay anything more than the face value of the shares held by them.
- Thus, the liability of each of the shareholders of such a company is always limited to the extent of the amount unpaid on his shares.

# A. On the basis of Liability

## Companies Limited by Guarantee

- Words 'Companies limited by Guarantee implies that the liability of members of such company is always limited to a fixed amount agreed by its members to contribute towards the assets of the company.
- **Section 12 (2) (b)** states that, a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in any event of its being wound up, such company in this Act is termed as a **company limited by guarantee**

# A. On the basis of Liability

## Unlimited companies

- It is obvious that where the liability of the members of a company is unlimited, it is called as an unlimited company. Section 12 provides that any seven or more persons in the case of a public company and 2 or more persons in the case of a private limited company can have such liability. Any company registered without limited liability is known as an unlimited company.
- The liability of members of such company is unlimited like an ordinary partnership firm and every member of such company is liable for debts of the company in proportion to his interest in the company. An unlimited company may or may not have a share capital. But if it has a share capital, it may be a public company or a private company



# B. On the basis of Mode of Incorporation

## Chartered Companies

- Chartered companies are also known as Royal charter companies. Such companies are incorporated under the Royal (special) charter granted by the King or the Queen. Such companies are given exclusive powers, rights and privileges under the Royal charter.
- They have to function in accordance with the terms and conditions of the Royal charter.
- The East India company, Bank of England, The Chartered Bank of Australia are some of the examples of chartered or Royal companies.
- However, such companies find no place in India after independence, since there is no monarchy in India now.

# B. On the basis of Mode of Incorporation

## **Statutory Companies**

- Companies which are created by special Acts of Legislature are known as statutory companies.
- A statutory company can be defined as a company which is incorporated by a special Act passed by whether the Central Legislature or state Legislature and such a company enjoys certain powers, rights, privileges as laid down in the Act.
- Therefore such companies do not require to have a Memorandum of Association. Companies Act 1956 is applicable to the statutory companies. Eg. Reserve Bank of India. LIC,UTI. Etc.

## **B. On the basis of Mode of Incorporation**

### **Registered companies**

- Under the Act Registered companies are those companies which are registered or incorporated with the Registrar of companies as per the provisions of the companies act.
- At present, in India, almost all companies are registered under the companies Act of 1956.

# C. On the Basis of ownership

## **Private company**

- Section 3 (1) (iii) defines a private company as-
- ‘Private company’ means a company which by its Articles –
  - a) Restricts the rights to transfer its shares, if any,
  - b) Limits the number of its members to fifty and
  - c) Not includes the persons who are in employment of the company;
  - d) 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; and

# C. On the Basis of ownership

## Private company (contd...)

- e) Prohibits any invitation to the public to subscribe for any shares in or debentures of the company.
- f) Thus, **the three features** i.e. restriction on right to transfer, limit on the number of members and invitation to the public to subscribe as mentioned above are the mandatory provisions of a private limited company words 'Private Limited' are required to be used at the end of the name of every company.

# C. On the Basis of ownership

## **Public company**

- section 3 (1)(iv) lays down that. ‘Public company means a company which is not a private company.’ Thus it can be said that a public company is a company which by its Articles, does not restricts the right to transfer its shares, if any,
- does not limit the number of its members and further does not prohibit any invitation to the public to subscribe for any shares in or debentures of the company.
- Any seven or more persons can come together and join hands to form a public company. However, there is no restriction on the maximum number of members.

# On the basis of Jurisdiction of functioning

The boundaries of the country wherein it is registered, such a company is called a multinational or transnational company

## **Foreign company**

It can be said that a foreign company is one which is incorporated outside India but has a place of business in India.

## **Multi National Company**

Companies incorporated outside India before/after the commencement of this act at many places, established a place of business within India and continue their business at established places within India at the commencement of this Act and after.

# On the basis of control and/or share holding

## **Holding company**

A holding company can be defined as a company which has a control over a subsidiary company through anyone of the several methods as explained in section 4(1).

## **Subsidiary company**

A company is a subsidiary of a holding company if a holding company controls the majority composition of its board of directors, having an object to control the management of the subsidiary or that other company i.e. holding company holds the majority of its shares or the holding company's subsidiary has its own subsidiary, it becomes the subsidiary of the first mentioned company



# Other types of Companies

## **One Man company**

One man company can be a public or a private company, but it is usually a private company wherein one man holds practically the whole of the share capital of the company. In other words, it can be said that where a single man holds almost all the shares of a company such a company is called as one man company. If one man company satisfies all the conditions and requirements of incorporation as laid down in the companies Act, it becomes a legal personality.

# On the basis of control and/or share holding

## One Man company (Contd..)

Generally for formation of one man company in order to meet the statutory requirements, certain persons are invited to become members who may hold a few shares. Such dummy members are usually nominees of the main shareholder who is the de-facto owner of the company and carries on the business with Limited Liability

e.g. **X and Y** register their company as a private company with a share capital of Rs 7,00,000 divided into 70000 shares of Rs. 10/- each. **X** holds 69,999 shares while **Y** holds only 1 share. This is nothing but an example of one man Co. company.

## **Difference -Private Co. & Public Co.**

**1) A private company cannot have less than two members and more than fifty members**

**The minimum number of persons required to form a public company is seven. There is no restriction on the maximum numbers of members in a public company.**

**2) A private company cannot invite public to subscribe its share capital neither it can invite the people to buy its debentures**

**A public company invites the public to subscribe to share capital or to**

## Difference -Private Co. & Public Co.

3) In a private company, the right to transfer its shares is restricted by its Articles. Thus, if a private company has a share capital, it imposes certain restrictions on the right of its members to transfer the shares of the company they hold

In a public company, its shares are freely transferable.

4). A private company has to add the words "Private Limited" at the end of its name.

A Public company has to use the word 'Limited' at the end of its name.

## Difference -Private Co. & Public Co.

5)A private company enjoys certain privileges i.e. exemption from certain provisions of the companies Act. Of 1956.

A Public company does not enjoy any such privileges.

6)Directors of a private company need not file their consent with the Registrar to Act as director or sign an undertaking the take up qualification shares.

Directors of a Public company have to file their consent with the Registrar to Act as director or sign an undertaking to take up qualification shares.

# Difference -Private Co. & Public Co.

7) Legal controls on private companies are less.

Legal controls, restrictions on public companies are more and strict.

8) In private companies, restrictions on the remuneration of Director's are far less.

In public companies, there are restrictions on the remuneration of Directors. The remuneration of Directors cannot be more than 11 % of net profits of the company.

# Difference -Private Co. & Public Co.

9) Directors are allowed to borrow from the private companies

Directors cannot borrow from the public companies

10) In the case of a private company, unless the articles of the company provide for a large number, two members personally present are quorum for a meeting of the company.

11) A private company is not required to file a prospectus or a statement in lieu of prospectus with the registrar

A public company has to file a prospectus or a statement in lieu of prospectus with the Registrar.

# C. On the Basis of ownership

## **Government Company**

Section 617 of the companies Act of 1956 defines government company' as follows -

i) For the purpose of this Act Government company means any company in which more 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 others.

The Central Government and partly by one or more state governments and includes a company which is a subsidiary of a Government company as thus defined” In India, there are many companies in which 100% paid-up share capital or more than 51% of the paid up share capital is provided by the Central or State Government



# Steps for formation of a company

- Types of Company
- Availability of Name
- The Memorandum and Articles of Association duly signed, and stamped.
- The agreement, if any with any individual for appointment as its Managing or whole-time director.
- Consent of directors in Form 29.
- Notice of Registered address in Form 18 to be given within 30 days of the date of incorporation.
- Particulars of Directors in Form 32.

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# Steps for formation of a company

- Payment of Registration Fees.
- Power of attorney, to fulfill various legal and other formalities.
- Statutory Declaration in Form No. 1 that all requirements of the Companies Act and the rules thereunder have been complied with.
- The declaration should be made by either an advocate of Supreme Court / High Court, a practicing Chartered Accountant or a director, or a manager or a secretary named in the Articles of the proposed

# THE MEMORANDUM AND ARTICLES OF ASSOCIATION

## **Definition of Memorandum**

The purpose of the memorandum is to enable the members of the company, its creditors, and the public to know what its powers are and what is the range of its activities. The memorandum contains rules regarding the capital structure, the liability of the members, the objects of the company, and all other important matters relating to the company.

## **Definition of Articles of Association**

The Articles of Association is a document which contains rules, regulations and bye-laws regarding the internal management of the company. Articles must not violate any provision of the memorandum or any provision of the Companies Act.

# THE MEMORANDUM AND ARTICLES OF ASSOCIATION

## Relationship between The Memorandum & Articles

Lord Cairns in Riche, described the relationship between the memorandum and the articles in this language: "The memorandum is as it were, the area beyond which the actions of the company cannot go; inside the area, the shareholders may make such regulations for their own government as they think fit".

- The Articles are subordinate to Memorandum.
- The Memorandum must be read in conjunction with the Articles.
- The terms of the Memorandum cannot be modified or controlled by the Articles.
- The Memo and Articles are public documents, which may be inspected by anybody at the office of the Registrar of Companies.

# DIFFERENCE BETWEEN THE MEMORANDUM AND ARTICLES OF ASSOCIATION

1. The distinction between the memorandum and the articles of association can be summed up as follows:
2. The memorandum is determining the company's constitution and objectives; the articles are rules regarding internal management.
3. Any rule in the articles contrary to the memorandum is invalid.
4. Articles can be altered easily, the memorandum can be altered only after the adoption of certain formalities.
5. Certain clauses of memo cannot be altered without the sanction of the Central Government and of the Court e.g., the object clause and the liability clause. Other clauses can be altered easily e.g., the name clause. Articles can be altered by passing a special resolution.
6. The memo defines the powers of the company and the relationship between the company and the members and-also non members, Articles define and regulate the relationship between the company and the members.
7. Acts beyond the powers of memo (ultra vires) are void Such an act cannot be ratified by the members. But acts done by a company beyond the articles can be ratified by the shareholders provided they are within (intra vires) the powers of Memo.
8. If an act is within the powers given by the memo (irrrtra vires the memo) but contrary to some provision of the articles (ultra vires the articles) the members can change the articles and ratify the act.

# Form & Content

## **MEMORANDUM OF ASSOCIATION**

The Act lays down that the memorandum of a association of every company shall contain the following particulars :

- 1. Name Clause;**
- 2. Situation Clause;**
- 3. Objects Clause;**
- 4. Area of Operation Clause;**
- 5. Liability Clause;**
- 6. Capital Clause;**
- 7. The Association and Subscription Clause**

## **ARTICLES OF ASSOCIATION**

The Articles of Association contain rules, regulations and bye-laws regarding the internal management of companies. An unlimited company, a company limited by guarantee and a private company limited by shares must file their articles of association at the time of registration of the company.

# Name Clause

- A company not to be registered under a name which is undesirable, identical or too nearly resembles another company. [Section 20]
- It must not be misleading or intended to deceive with reference to its object.
- A mere similarity of name does not give right to injunction, there should be likelihood of deception or confusion.
- The name and address must be printed or affixed outside every office in English and local language.
- Inadvertent mistake in name can be changed by passing an ordinary resolution and by obtaining written approval of Central Government.

# Situation Clause

- Only the state in which the Registered Office is situated is mentioned.
- Exact address can be filled with RoC separately in Form 18 within 30 days of incorporation.



# Object Clause

- Must divide object clause into two sub-clauses - Main Objects and Other Objects.
- It determines the purpose and capacity of the company hence carry great importance.
- Acts beyond this ambit are ultra vires and hence void. Even the entire body of shareholders cannot ratify such acts.
- Subscribers enjoy unrestricted freedom to choose the objects.

# Doctrine of ultra vires

- An act or transaction, which may not be illegal, is beyond company's power by not being within the object of the Memorandum.
- An act ultra vires the company is incapable of ratification.
- Act which is intra vires the company but outside the authority of directors may be ratified by the company in proper form.
- The shareholders can ratify an act ultra vires the directors.

# Effect of ultra vires transaction

- Injunction to restrain the company from doing an ultra vires act.
- Personally liability of the directors.
- Ultra vires contract are void ab initio.
- An ultra vires borrowing does not create a relationship of a debtor and creditor.

# Liability Clause

- The Memorandum of a company limited by shares or by guarantee shall state that the liability of its members is limited.
- Where the liability is limited by shares, a member can be called upon to pay only the unpaid balance on his shares.
- In case the company is limited by guarantee the members are liable up to the maximum amount which they have guaranteed.
- Where the company is limited by both share and guarantee the liability of members is dual.

# Capital Clause

- Shares must be of fixed value.
- Nominal, authorised or registered capital.
- Not authorised to issue capital beyond its authorised capital unless the Memorandum is altered.
- In case of unlimited company having share capital, the liability is unlimited as against creditors only in case of winding up.
- In case of going concern, liability is limited to shares subscribed.

# Articles of Association

- Articles are by-laws or rules and regulations for the govern the management of its internal affairs and conduct of business.
- It also includes regulation contained in Table A of Schedule I.
- Deals with the rights of the members inter se.
- Articles are subordinate to and controlled by Memorandum.

# Articles of Association

- Unlimited companies, companies limited by guarantee and private companies must have their own Articles of Associations.
- Must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to Memorandum and duly witnessed.

# Articles of Association

## Form of Articles

The Articles shall:

- a) be printed ;
- b) be divided into paragraphs numbered consecutively ; and
- c) be signed by each subscriber of the memorandum of association, in the presence of at least one witness who shall attest the -signature.



# Alteration of Articles

- Subject to the provisions of the Act and Memorandum, a company, by special resolution alter the Articles. [Section 31]
- The alteration binds members in the same way as original Articles.
- A company cannot in any manner deprive itself of the powers to alter its Articles.

# Contents of Articles

Articles usually contain provisions in respect of the following matters :

- (1) share capital, rights of shareholders, payment of commissions, share certificates;
- (2) lien on shares;
- (3) calls on shares;
- (4) transfer of shares;
- (5) transmission of shares;
- (6) forfeiture of shares;
- (7) conversion of shares into stock;
- (8) share warrants;
- (9) alteration, of capital;
- (10) general meetings and voting rights of members;
- (11) appointment and remuneration of directors, board of directors, managers and secretary;
- (12) dividends and reserves;
- (13) accounts and audit and borrowing powers;
- (14) capitalisation of profits; and
- (15) winding up.

# The Doctrine of Indoor management

Persons dealing with the company are only required to see that the company is apparently complying with the Memorandum and Articles. They may presume that the directors of the company are acting lawfully. The company can be held responsible even if some internal formalities are found incomplete.

# Prospectus

- "Any document described or issued as a prospectus and includes
- any notice,
- circular,
- advertisement, or
- other document
- inviting deposits from the public or
- for the subscription or purchase of any shares in, or debenture of a body corporate." [(Section 2(36))]

# Protection of minority rights

## Protection under common law-

1. any act which is ultra virus of the company
2. any act which is fraud on minority
3. any act which amounts to oppression of minority or mismanagement of the company
4. any act which amounts to breach of duty by directors

## Protection under Company Act 1956

1. Variation of class rights
2. Reconstruction and amalgamation
3. Investigation into affairs of the company
4. Prevention of Oppression and Mismanagement

# Promoters

## Promoters

Before a company can be formed ,there must be some persons who have an intension to form a company and who take the necessary steps to carry that intention into operation.

The promoters of a company decide the scope of its business activities.

They provide a registration fees and carry out other duties involved in the formation of company.

# Members

The terms members refer to a person whose name appears on the register of the company. On the other hand ,the term 'shareholders' refer to a person who holds shares in a company.

Section-41 of the companies act defines a member as:

1. The subscriber of the memorandum of a company shall be deemed to have agreed to become members of the company and on its registration shall be entered as member in its register of members.

# Members (Contd..)

2. Every other person who agrees in writing to become a member of a company and whose name is entered in its register of member shall be a member of the company.
3. Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to a member of the concerned company.



# Difference between Shareholder & Member

1. A holder of a share warrant is a shareholder but not a member as his name is struck off the register of members immediately after the issue of such share warrant.
2. A registered shareholder is a member but a registered member may not be a shareholder, because the company may not have a share capital.
3. The transferor or the deceased person is a member so long as his name is on the register of members whereas he cannot be termed a shareholder.
4. Similarly a shareholder by transfer is not a member until his name is entered in the

# Association Clause

- Must be signed by each subscriber in presence of one witness.
- Each subscriber must take at least one share.
- A subscriber cannot, after registration of company, repudiate his liability even on the ground that he was induced to sign by misrepresentation.

# Winding up/liquidation/dissolution

Winding up of a company is a process of putting an end to the life of a company. It is a proceeding by means of which a company is dissolved and in the course of such a dissolution its assets are collected, its debts are paid off out of the assets of the company or from contribution by its members.

# A Share & A Stock

A Share or a debenture must be an immovable property of a Company, transferable in a manner as specified in the Articles of the company. A stock consists of a bundle of rights and obligations.

A stock means a bundle of fully paid shares put together for convenience, so that it may be divided into any amount and transferred into any subdivisions with regard to the original face value of shares.

# Share Capital

- Authorized Share Capital : maximum a company can raise.
- Issued Capital: actually issued or allotted
- Subscribed Capital: Paid up value of the authorized Capital.
- Called up Capital
- Uncalled Capital
- Paid-up Capital
- Reserve Capital: Security to Creditors, only used in case of winding up.

# Kinds of Share

- **Preference Shares:**
  - **Cumulative- Non-Cumulative**
  - **Participating - Non participating**
  - **Convertible - Non Convertible**
  - **Redeemable - Irredeemable**
- **Equity shares:**
  - **With voting rights**
  - **With differential rights**
- **Bonus Shares**

# Principal of Majority rule

Majority must prevail is the fundamental principal of company law. Except the power vested in board of directors the overall power are exercised through general meeting and question relating to management are decided either by a simple majority or special majority of the votes of shareholders.

The group of shareholder who are not a part of the majority can be called the minority. It can be single dissident shareholder or group of a shareholder.