MODEL ANSWER – COMPANY LAW

B. COM III Sem. AS - 2621

Ans 1. (i) Two ways of Appointment of Director:

- The first directors are appointed by the subscribers to the memorandum.
- Any person willing to be appointed by a director, and permitted by law to do so can be appointed by ordinary resolution of a general meeting or by resolution of the directors.

Ans 1. (ii) Secured Debentures: A "secured debenture" is backed by a specific piece of property, for example, a factory or a pipeline or a bunch of oil wells. If the company goes bankrupt, holders of secured debentures have a clear claim on the assets securing their bonds and no other creditors have a claim on those assets. That means that secured debentures have much higher recovery value in the event of a bankruptcy than unsecured debentures.

Ans 1. (iii) Deferred Shares: A share generally issued to company founders that restricts their receipt of dividends until dividends have been distributed to all other classes of shareholders.

Ans 1. (iv) Board Meetings: The primary reason for holding board meetings is to allow the board to make decisions. However, meetings also serve a range of other important functions, providing a forum where:

- Board members are regularly brought together to focus on their roles and responsibilities, identify problems and plan for the future.
- Members are encouraged and motivated.
- Ideas are shared and discussed and then discarded, improved or implemented.
- Tasks are allocated and reported on.
- Regular updates about relevant issues are provided.
- Members can get to know each other, professionally and personally.

Ans 1. (v) Promoters: Before a company can be formed, there must be some persons who have an intention to form a company and who take the necessary steps to carry that intention into operation. Such persons are called 'promoters'. The word 'promoter' has not been defined anywhere in the companies act. Section 62 of the companies act only refers to the liabilities of a promoter."The term promoter is a term not of law but of business, usefully summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence."

Ans 1. (vi) Perpetual Existence: In company law, perpetual succession is the continuation of a corporation's or other organization's existence despite the death, bankruptcy, insanity, change in membership or an exit from the business of any owner or member, or any transfer of stock,etc.

Perpetual succession, along with the common seal, is one of the factors explaining a corporation's legal existence as separate from those of its owners. This principle states that-

- any change in membership of a company does not anyway affect the status of the company,
- death,insolvency,insanity etc. of any member of a company does not affect the continuity of the company.thus the life of the company does not depend upon the life of its members.
- it shall continue forever irrespective of continuity of its members or directors.except in case of winding up or liquidation of a company.

Ans 1. (vii) A member is a person who has allowed his name to be listed in the membership register. You should be competent to enter into contracts in order to qualify for membership. Here are ways of acquiring membership of a company:

1.) Subscribers to the memorandum of association become original members of a company from the date of its incorporation. If you subscribe to the memorandum of association, then you become a member. You won't be required to apply for allotment of shares and entry of your name in the register of members.

2.) If you agree to purchase qualified shares or be appointed as the first director of a public company, then you attain membership.

Ans 1. (viii) Procedure of issue of shares

When company has been registered, the following procedure is adopted by the company to collect money from the public by issuing of shares:

Step-1 Issue of prospectus: When a Public company intends to raise capital by issuing its shares to the public, it invites the public to make an offer to buy its shares through a document called ‘Prospectus’. According to Section 60 (1), a copy of prospectus is required to be delivered to the Registrar for registration on or before the date of publication thereof.

Step-2 To receive application: After reading the prospectus if the public is satisfied then they can apply to the company for purchase of its shares on a printed prescribed form. Each application form along with application money must be deposited by the public in a schedule bank and get a receipt for the same.

Ans 1. (ix) Four features of a Private Company:

a. Minimum number of members – 2
b. Maximum number of members – 50
c. Minimum paid up capital – Rs. 100000
d. Minimum number of directors – 2

Ans 1. (x) Memorandum of Association: The memorandum of association of a company, often simply called the memorandum, is the document that governs the relationship between the company and the outside. It is one of the documents required to incorporate a company in the United Kingdom, Ireland, India, Bangladesh, Pakistan and Sri Lanka.

Ans 2. Memorandum of association: Memorandum of Association is one of the documents which has to filed with the registrar of companies at the time of incorporation of a company. Section 2(28)defines a memorandum to mean "the memorandum of association of a company as originally framed or as altered from time to time in pursuance of any previous company law or of this act." The definition, however, either does not give us any idea as to what a memorandum of association really is nor does it point out the role which it plays in the affairs of the company.

Different clauses:

A brief discussion of the various clauses are as follows:

Name clause:
A company may be registered with any name it likes. But no company shall be registered by a name which in the opinion of the central government is undesirable and in particular which is identical or which too nearly resembles the name of an existing company. Where a company is registered by a name so similar to that of another company, that the public are likely to be deceived, the court will grant an injunction restraining it from using that name.

Registered office clause:
This clause states the name of the state where the registered office of the company is to situate. The registered office clause is important for two reasons. Firstly, it ascertains the domicile and nationality of a company. This domicile clings to it throughout its existence. Secondly, it is the place where various registers relating to the company must be kept and to which all communications and notices must be sent. A company need not carry on its business at its registered office.

Objects clause:
The objects clause is the most important clause in the memorandum of association of a company. It is not merely a record of what is contemplated by the subscribers, but it serves a two-told purpose:

(a) It gives an idea to the prospective shareholders the purposes for which their money will be utilized.

(b) It enables the persons dealing with the company to ascertain its powers.

Liability clause:
This clause states that the liability of the members of the company is limited. In the company is limited. In the case of a company limited by shares, the member is liable only to the amount unpaid on the shares taken by him. In the case of a company limited by guarantee the members are liable to the amount undertaken to be contributed by them to the assets of the company in the event of its being wound up. However, this clause is omitted from the memorandum of association of unlimited companies.

Capital clause:
The memorandum of a company limited by shares must state the authorized or nominal share capital, the different kinds of shares, the authorized or nominal share capital, the different kinds of shares, and the nominal value of each share. The capital clause need not state anything else and it is usually better that it should not do so.

Association or subscription clause:
This clause provides that those who have agreed to subscribe to the memorandum must signify their willingness to associate and form a company. According to section 12 of the act, at least seven persons are required to sign the memorandum in the case of a public company, and at least two persons in the case of a private company.

Articles of Association: In corporate governance, a company's articles of association (called articles of incorporation in some jurisdictions) is a document which, along with the memorandum of association (in cases where the memorandum exists) form the company's constitution, defines the responsibilities of the directors, the kind of business to be undertaken, and the means by which the shareholders exert control over the board of directors.

The Articles can cover a number of topics, not all of which is required in a country's law. Although all terms are not discussed, they may cover:

- the issuing of shares (also called stock), different voting rights attached to different classes of shares
- valuation of intellectual rights, say, the valuations of the IPR of one partner and, in a similar way as how we value real estate of another partner
- the appointments of directors - which shows whether a shareholder dominates or shares equality with all contributors
- directors meetings - the quorum and percentage of vote
- management decisions - whether the board manages or a founder
- transferability of shares - assignment rights of the founders or other members of the company do
- special voting rights of a Chairman, and his/her mode of election
- the dividend policy - a percentage of profits to be declared when there is profit or otherwise
- winding up - the conditions, notice to members

Prospectus: A prospectus, in finance, is a disclosure document that describes a financial security for potential buyers. It commonly provides investors with material information about mutual funds, stocks, bonds and other investments, such as a description of the company's business, financial statements, biographies of officers and directors, detailed information about their compensation, any litigation that is taking place, a list of material properties and any other material information. In the context of an individual securities offering, such as an initial public offering, a prospectus is distributed by underwriters or brokerages to potential investors.

Ans 3. Dismissal of Company Secretary

The Secretary of a company of the company, therefore like any other employee, he can be removed his office under any law governing the master-servant relationship.

However, where the articles of a company empowers the board of directors to dismiss him, then the board only may terminate the service of a company secretary by passing a resolution to this effect by giving him notice in this regard.

- Notice is a must.
- Dismissal without proper entitles a secretary to compensation in lieu thereof.
- A Proper notice prior to dismissal need not be given those cases where the act of the secretary justifies his instant dismissal under general law.
- For instance, for misconduct, fraud, willful disobedience, etc. a company secretary can be removed without giving him proper notice.

Restrictions on the Powers and Rights of Company Secretary

A Company secretary enjoys certain rights and power but there are some restrictions to his rights and power, which are given below:

- **Distribution and transfer of shares:** A company secretary can't distribute or transfer any share if he is not authorized by the board of directors.
- **Company agent:** A company secretary cannot attend any meeting as a company agent without any consent of board of directors. He requires authority from the board of directors to sign any contract on behalf of the company.
- **Taking loan:** A company secretary cannot take loan in the name of the company. If he does so, company will not be liable for such loan.

Ans 4. Features of a Company

Incorporated association: A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation. It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

Artificial legal person: A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders. It was rightly pointed out in Bates V Standard Land Co. that: "The board of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them".

Separate Legal Entity: A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members. Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and nor for the personal benefit of the shareholders. On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up. At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act.

Perpetual Existence: A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder or director. Law creates it and law alone can dissolve it. Members may come and go but the company can go on for ever. "During the war all the member 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 i". The company may be compared with a flowing river where the water keeps on changing continuously, still the identity of the river remains the same. Thus, a company has a perpetual existence, irrespective of changes in its membership.

Common Seal: As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself. It acts through natural person who are called its directors. But having a legal personality, it can be bound by only those documents which bear its signature. Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company.

Limited Liability: A company may be company limited by shares or a company limited by guarantee. In company limited by shares, the liability of members is limited to the unpaid value of the shares. For example, if the face value of a share in a company is Rs. 10 and a member has already paid Rs. 7 per share, he can be called upon to pay not more than Rs. 3 per share during the lifetime of the company. In a company limited by guarantee the liability of members is limited to such amount as the member may undertake to contribute to the assets of the company in the event of its being wound up.

Transferable Shares: In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles. However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain bona fide and reasonable restrictions on the right of members to transfer their shares. But absolute restrictions on the rights of members to transfer their shares shall be ultra vires. However, in the case of a private company, the articles shall restrict the right of member to transfer their shares in companies with its statutory definition. In order to

make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares.

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

Ans 5. Articles of Association: In corporate governance, a company's articles of association (called articles of incorporation in some jurisdictions) is a document which, along with the memorandum of association (in cases where the memorandum exists) form the company's constitution, defines the responsibilities of the directors, the kind of business to be undertaken, and the means by which the shareholders exert control over the board of directors.

Contents of articles:

The articles usually contain the following matter:

- Exclusion wholly or in part of Table A.
- Adoption of preliminary contracts.
- Number and value of shares.
- Allotment of shares.
- Calls on shares.
- Lien on shares.
- Transfer and Transmission of shares.
- Forfeiture of share.
- Alteration of capital.
- Share certificates.
- Conversion of share into stock.
- Voting rights and proxies.
- Meeting.
- Directors their appointment etc.
- Borrowing powers.
- Dividends and reserves.
- Accounts and audit.
- Winding up.

Ans 6. Equity Shares: An equity share, commonly referred to as ordinary share also represents the form of fractional or part ownership in which a shareholder, as a fractional owner, undertakes the maximum entrepreneurial risk associated with a business venture. The holders of such shares are members of the company and have voting rights.

Features of Equity Shares:

(i) **Right to Income:** As you know, equity shareholders have a claim to the residual income, that is, the income left after paying expenses, interest charges, taxes, preference dividend, if any. Usually, a part of the residual income is distributed in the form of dividend to the shareholders and other part called retained earnings is reinvested in the business. Retained earnings are ultimately benefit the shareholders in the form of firm's enhanced value and earning power and ultimately increase dividend and capital gain of the shareholders. Thus, dividends benefit the shareholders in the form of immediate cash flows whereas the retained earnings give them benefit in the form of capital gains but not immediately.

(ii) **Claim on Assets**: In case of liquidation of the company, equity shares are the last ones to be paid. They are paid after the claim of debt-holders and preference shareholders have been satisfied. In case of liquidation due to bad financial state of affairs, the equity shareholders generally remains unpaid

(iii) **Right to Control:** Right to control here means the power to take decisions, frame major policies and power to appoint directors. Equity shareholders have the legal power to elect directors on the board and also to replace them if the board fails to protect interest of the shareholders.

(iv) **Voting Rights:** Each equity share carries one vote. Directors are elected in the annual general meeting by the majority votes. Thus, every shareholder can participate in the vital affair of election of directors and cast his vote depending on the number of shares held by him. Shareholders are entitled to vote in person or by proxy,

(v) **Limited Liability:** In a company limited by shares, an equity shareholder's liability is limited to the amount of investment in his respective share. If his shares are fully paid up, he doesn't have to contribute anything in the event of financial stress or winding up of his company. Whereas in case of a sole-trader concern or a partnership firm, the liability of owner/owners is unlimited which requires them to sell their personal assets and satisfy the claims of creditors in the event of insolvency of these firms.

Ans 7. Liabilities of Company Secretary

Statutory liabilities: A company secretary is legally bound to following liabilities:

1. Register all files and documents of the company.
2. Arrange statutory meeting and preparing statutory report and submit it to the Registrar of joint stock company in due time.
3. Arrange annual general meeting in due time.
4. Sending notice of the meeting to the participant.
5. Writing minutes of various meetings and maintaining minute books.

Contractual liabilities: Such liabilities arise from his service contract made with the company, which are given below:

1. Abide by all terms and conditions of service contract.
2. Follow the order instructions and act as per authorization of the board of directors.
3. Maintain secrecy of the company affairs.
4. Perform duties with due care and skills.

5. Never act beyond his authority and not to make any secret profit through any illegal activity.

Ans 8. Types of Preference Shares

In general, there are four different types of preference shares (preferred stocks):

1) Cumulative and Non cumulative shares:

Cumulative preference shares give the right to the preference shareholders to claim the dividends that are not paid in the previous year and they are paid in preference to ordinary dividends.
For non-cumulative or simple preference shares, any dividends that are unpaid or accrued in the previous year cannot be carried forward to the subsequent year or years in respect of that year, and that is considered lost by the shareholders.

2) Redeemable and Non-redeemable:

A redeemable preference share is issued on the terms where they are liable to be redeemed at either a fixed time, or the company's option or at the shareholders option. In other words, the company can buy back preference shares at an agreed time and price.
Non-redeemable or Irredeemable preference shares need not be repaid by the company except on winding up of the company. The company is not offering to buy back the securities.

3) Convertible and Non-convertible shares:

Convertible Preference Shares are corporate fixed-income securities that the shareholders have the option of converting them into a certain number of ordinary shares after a predetermined time span or on a specific date.
Non-Convertible Preference Shares are those which do not have the option of their conversion into the equity shares.

4) Participating and Non-participating:

Participating Preference Shares are entitled to a fixed preferential dividend and have the right to participate further in the surplus profits after payment of certain rate of dividend on equity shares.
A non-participating share is entitled to fixed rate of dividend only. They do not have such rights to participate or claim for a part in the surplus profits of a company.

Prepared by:

Vineet Singh

Assistant Professor

Dept. of Commerce