

BASICS OF COMPANY LAW

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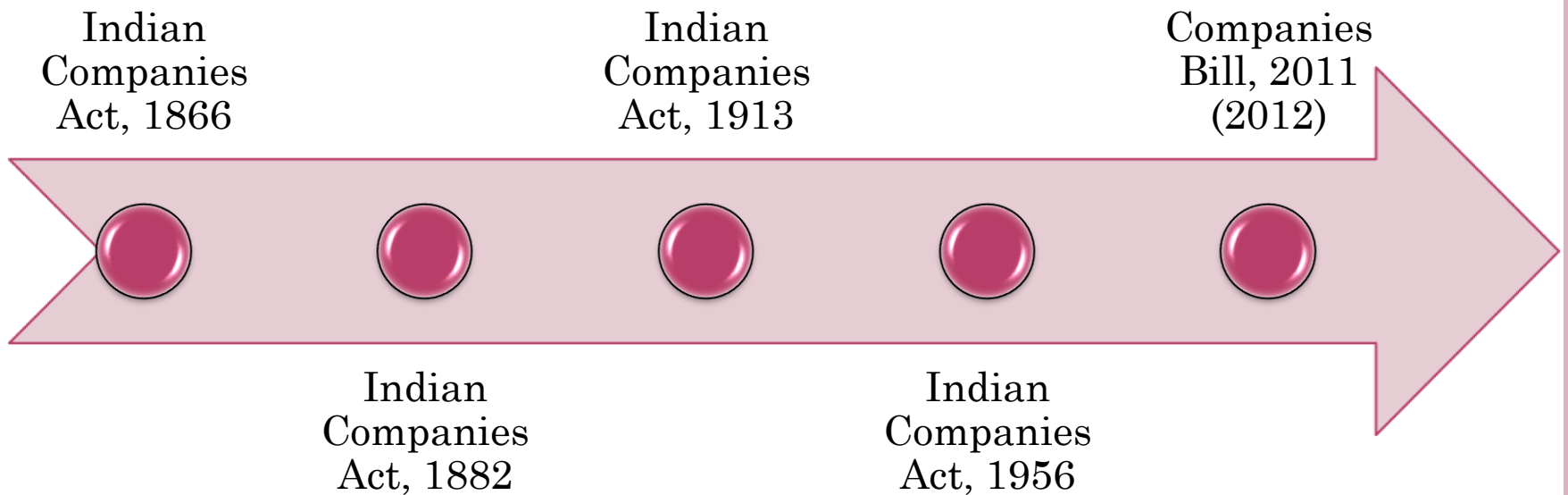
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HISTORY OF INDIAN COMPANY LAW



TYPES OF BUSINESS ENTITIES

Sole Proprietorship

Partnership

Joint Ventures

Company

Charitable Organization

SOLE PROPRIETORSHIP

No registration required



Unlimited liability



**Used for small business
or by Professionals**



No Separate Legal Entity

PARTNERSHIP

Section 11 of Companies Act, 1956

- No partnership consisting of more than 20 persons shall be formed

Indian Partnership Act, 1932

- Section 4 – Partnership is the relation between persons who have agreed to share profits of business carried on by all or any of them acting for all

Unlimited Liability

Registration not Compulsory

WHAT IS A COMPANY?

Special Features of Company:

- ❖ **Collective economic enterprise**
- ❖ **Separate Legal Entity**
- ❖ **It can sue and be sued in its own name**
- ❖ **Company is distinct from its shareholders**
 - ❖ The persons who form the company are the **shareholders** of the company. Shareholders are also called **members** of the company.
 - ❖ Initial shareholders who contributed to the initial capital of the company are **promoters**
 - ❖ **Directors** appointed to run and manage the company-power to appoint them is with the shareholders
- ❖ **It can hold property in its own name**
- ❖ separation of ownership and management – **trusteeship principle**
- ❖ **Common seal:** It is the insignia of companies. A company is an abstraction, artificiality.
- ❖ Until dissolved, the company continues forever – this feature is called **perpetual succession.**

WHAT IS A COMPANY? CONTD..

- ❖ Usually formed with **limited liability**:
 - ❖ Shareholders of the company will only be liable to suffer losses to the extent of the capital they have contributed. At worst, shareholders may lose all that they have contributed as capital
- ❖ As a company is recognized by law as a personality of its own, it may be called a **body corporate**, that is, a legally recognized person. It is not merely a “body aggregate”, such as a partnership firm.
- ❖ All companies are body corporate; all bodies corporate are not company

BASIS OF COMPANY LAW IS THE TRUSTEESHIP PRINCIPLE

- The principles for Trusteeship inter-alia includes incurring expenditure for the benefit of the people, not letting personal views or interests affect their conduct as trustees and to act prudently and reasonably for the benefit of the beneficiary
- Directors of the company act as trustees for the benefit of actual owners or the shareholders
- Directors are expected to guard themselves against any conflict of self interest with the interest of the Company and in cases of actual conflict they should disclose their interests properly
 - Section 299, 297
 - Section 292, 293 etc of the Companies Act have been enacted which attempts to limit the powers of the Directors in some specific company matters

PRIVATE & PUBLIC COMPANY : DIFFERENCE

PARTICULARS	PRIVATE COMPANY	PUBLIC COMPANY
Definition	Which by its article restricts: <ul style="list-style-type: none"> ▪ Numbers of members to 50 ▪ Transfer of shares ▪ Invitation of public to subscribe its debenture, shares etc. ▪ Acceptance of deposits from person other than its shareholders and directors 	Which is not a Private Company
Minimum No. of shareholders	2(Two)	7(Seven)
Maximum No. of shareholders	50(Fifty)	No limit
Minimum Paid up Capital	Rs. 1,00,000/-	Rs. 5,00,000/-
Transferability of Shares	Restricted	Freely. If company is listed then through stock exchange(s)
Minimum No. of Directors	2	3

OTHER CONCEPTS RELATING TO COMPANIES

- **Companies with limited liability**
 - Limited by shares – extent of liability is up to shareholders upfront capital contribution
 - Limited by guarantee - company does not need capital resources during its life – but guarantee to contribute capital when the company goes into winding up
 - Limited by both shares and guarantee
- **Companies with unlimited liability –**
 - Sometimes, in case of bankruptcy of the company
- **Closely held and widely held companies –**
 - held by a small group, generally private companies are closely held
 - Held by public in large, generally listed companies are widely held
- **One Person company (OPC)**
 - Recommended by JJ Irani Committee, now in Companies Bill, 2011
 - A private company having one member, director
 - subscriber to elect the nominee who will act as member in case of death of the subscriber
- **Government Companies**
 - Majority stake with government

CONSTITUTIONAL DOCUMENTS

Memorandum of Association (MoA)

- Defining objects as to why the company has been formed. In the MoA, the persons initially forming the company state the following:
 - Name of the company (**name clause**)
 - state of registered office of the company (**registered office clause**)
 - purpose of forming the company, that is, objects of the company (**object clause**)
 - the nature of the liability – limited, unlimited, or if limited, limited by capital or guarantee (**liability clause**)
 - the authorized capital of the company (**capital clause**)

Articles of Association (AoA or simply Articles)

- Like for any association, the rules of conduct, internal management, etc., are all laid down in the articles. Articles are byelaws of the company.

CHARITABLE ORGANIZATION

- **Trust:** To be registered under Indian Trusts Act
- **Society :** To be registered under Society registration Act of respective state
- **Section 25 Company:** Registration under Companies Act

These entities can do business and earn any amount of profits, but the distribution of profits cannot be made to Shareholders / trustee

JOINT VENTURES

- Contractual agreement or a business relationship between two or more persons for the purpose of executing a particular business undertaking or contract
- Partners are called JV partners and the agreement is Joint Venture Agreement
- International Accounting Standard 31 provides three broad types of joint ventures:
 - **Jointly controlled operations-** operation involves the use of the assets and other resources of the venturers individually rather than the establishment of a separate entity
 - **Jointly controlled assets-** joint ownership of resources but no separate entity is formed
 - **Jointly controlled entities-** a separate entity is incorporated and the contractual arrangement between the venturers establishes joint control over the economic activities of the entity formed

JOINT VENTURES VS. PARTNERSHIPS

- JVs may be seen as analogous to general partnerships formed for executing a single business activity combining the money, skill, knowledge and property of the partners (**Section 8 of Partnership Act**)
- Only difference is that JVs generally terminate on completion of the project for which it was formed. But a partnership is generally a continuing relationship and comes to an end either on the death of any partner or with mutual decision to revoke
- Partnership is governed by the Partnership Act; JVs do not have any specific act applicable to them, but in several cases in India and abroad, partnership principles have been applied to JVs

RAISING OF CAPITAL BY COMPANIES

Share capital:

Equity or preference.

Shareholders subscribe to the capital of the company and take the risk of losing all their capital.

As long as the company runs, shareholders are entitled to distribution of earnings of the company, called **dividends**.

Loan Capital:

either a straight one-to-one loan, for example, a loan from a bank or issue of a debt instrument

ANOTHER WAY OF RAISING FUNDS: DEPOSITS

- Companies are also allowed to access deposits, that is, short-term loans, from the public, often called public deposits
- Public companies and NBFCs can accept deposits
 - Public companies to comply with Companies (Acceptance of Deposit Rules) which enumerates
 - restriction on the maximum amount of public deposits that companies may raise;
 - restrictions on the tenure for which deposits may be raised – not less than 6 months and not more than 36 months (the lower-tenure restriction is to prevent companies from raising deposits repayable on demand or very short term, to save asset-liability mismatches)
 - rate of interest that companies may pay
 - requirements as to advertisement for raising public deposits and contents thereof (note that the provisions of civil and criminal liability in case of prospectus apply to such advertisement too)
 - maintenance of liquid assets, so as to ensure a minimum liquidity with companies to be able to repay deposits, and so on.
 - NBFCs to comply with RBI Directions

EQUITY AND PREFERENCE SHARES

Preference Shares

- As regard dividend and refund of capital in case of winding up preference share holders get paid before the equity share holders;
- Since they carry a preference, they are entitled only to a fixed rate of dividend ;
- Can be converted in to equity shares after some years, if terms of issue provide so ;
- No right to participate in the management of the company. They do not carry voting rights as such, except in case of matters concerning their interests. ;
- Preference shares, however, may have a stated redemption period.

Equity Shares

- Dividend on the basis of performance of Company, no dividend in case of loss;
- Cannot be converted in to preference shares
- Have voting rights and also to participate in the affairs of the management;
- Equity shares are permanent capital – there is no provision in law for redemption or repayment of equity shares except in exceptional cases like reduction of capital, or buy-back of shares.

PROSPECTUS

Companies need to make disclosures – about the company, promoters, project, manner of utilization of the proceeds of the issue, estimates of profitability, etc.

- These disclosures are made in a document called **prospectus**.
- The prospectus must have mandatory contents laid down in the Act, as also prescribed by the securities regulator.

Statements made in the prospectus become the basis for people to put in money into the company- hence, there are provisions for civil and criminal liabilities for misstatements in the prospectus.

- Civil liabilities – defaulter to compensate the investors who might have relied upon such statements and suffered a loss.
- Criminal liability means liability by way of penalty and/or imprisonment.

ISSUE OF CAPITAL

Process of issue of capital: the process is more controlled by securities regulations than by company law. However, if we were to focus on the company law side, the following process for public offers for securities emerges:

- **The Company:**
- files a prospectus with the Registrar of Companies.
- makes an application for listing of the securities with a recognized stock exchange. Listing has been made mandatory in case of public offers – so the members of public are given an exit opportunity.
- issues the prospectus either through a newspaper ad or otherwise generally
- starts receiving applications for securities (opening of subscription list)
- stops receiving applications for securities (closing of subscription list).
- determines whether the minimum subscription has been received.
- If minimum subscription has been received, and listing application from the stock exchange(a) has been granted, the company makes an allotment.
- Upon allotment, the allottee becomes a shareholder member of the company.

NB: The requirements above are largely the same whether the public offer is the first public offer, commonly known as **initial public offer (IPO)** or subsequent public offer, called **further public offer (FPO)**.

OFFER TO PUBLIC

Public Offer

- The word “public offer” does not mean offer to every citizen of the country.
- If the company invites people in general to subscribe to an offer, that is a public offer; offer to more than 49 person-deemed public offer
- Public offer can be of any security
- Prospectus is to be issued for every public offer and is required to be registered with the RoC

Private Placement

- When it is not a public offer, it is called a **private placement**.
- If it is a private placement, then the regulatory formalities of a public offer, including the intervention of the securities regulator, is not applicable.

RIGHTS ISSUE AND PREFERENTIAL ISSUE

Rights Issue

- If a company issues shares, and these shares are not offered to existing equity holders, the existing equity holders face a dilution of control, as new shareholders come in with voting rights.
- To ensure that dilution of control does not happen unless the existing equity holders specifically decide to do so, issues other than rights offers are possible only if the existing equity holders consent to the same with a special resolution.

Preferential Issue

- The term preferential issue refers to any subsequent issue, which is not a rights offer nor a public offer.
- Its an offer of securities to a preferential group
- Since all issues other than rights offers require **special resolution** of shareholders, every preferential issue also requires a special resolution.
- In case of listed companies preferential issues are also subject to several conditions of SEBI's regulations.

PREFERENCE SHARES AND PREFERENTIAL ISSUE OF SHARES

Preference shares

Shares carrying a preferential right of dividend

Shares carrying preferential right to repayment of capital on winding up

Preferential issue of shares

Issue of shares on private placement basis to select group of persons

Other than through public, rights or bonus issue, ESOP or QIP.

REDUCTION OF CAPITAL

In special situations, a company may actually reduce capital following a legal process.

Reduction of capital may be achieved by several ways – for example,

- reducing par value of the shares by deciding not to call uncalled capital,
- writing down capital to the extent of losses,
- returning capital not needed by the company i.e. buy back, etc.

Such a reduction can be achieved only by a special resolution, and approval of the court.

Since it is a judicial process, presumably the court will take into consideration the interest of the creditors and lenders while approving the scheme of reduction.

WHAT ARE CHARGES?

- The word “charge” has narrower meaning in property laws, but in company law, the word charge has an all-pervasive meaning, including all forms of security interests
- A security interest exists when any of the assets or receivables of the company are earmarked to be made available to a lender or creditor as security for a loan or a debt
- Registration of every secured charge is compulsory
 - There is no need for registration of a pledge, which is a possessory security interest
- Unregistered charges are as if the charge does not exist at all.
 - However, if the company has failed to register the charge in time laid by law, it can get the delay in filing condoned, in which case the charge gets revived from the date of its filing.

TYPES OF CHARGES

- **Fixed**
 - On identifiable and defined property-generally on fixed assets of the company
 - Property during the subsistence of charge cannot be disposed off
 - If disposed, dues of the charge-holder is to be cleared on priority basis
- **Floating**
 - On property of a circulating and fluctuating nature – like on stock, debtors etc
 - Company may deal in ordinary course of business
 - Remains dormant until the undertaking ceases to be a going concern or is crystallized
- ❖ **Crystallization of floating charge:**
 - Simply meaning conversion into fixed charge
 - May be triggered in following situations:
 - When the company ceases to be a going concern and appoints a receiver
 - When the company proceeds to wind up and appoints a liquidator
 - On happening of any event specified in charge instrument

WINDING UP & DISSOLUTION

Winding Up

- Winding up is the process that leads to dissolution. Winding up and **liquidation** may be used interchangeably.
- Compulsory winding up
- Voluntary Winding up
 - Member's Voluntary Winding up
 - Creditors Voluntary Winding up

Dissolution

- It is the last step up to put an end to the existence of a company.

CORPORATE GOVERNANCE

- Corporate Governance:
 - a set of systems, processes and principles which ensure that a company is governed in the best interest of all stakeholders
- A good corporate governance ensures:
 - Adequate disclosures and effective decision making to achieve corporate objectives
 - Transparency in business transactions;
 - Statutory and legal compliances;
 - Protection of shareholder interests;
 - Commitment to values and ethical conduct of business

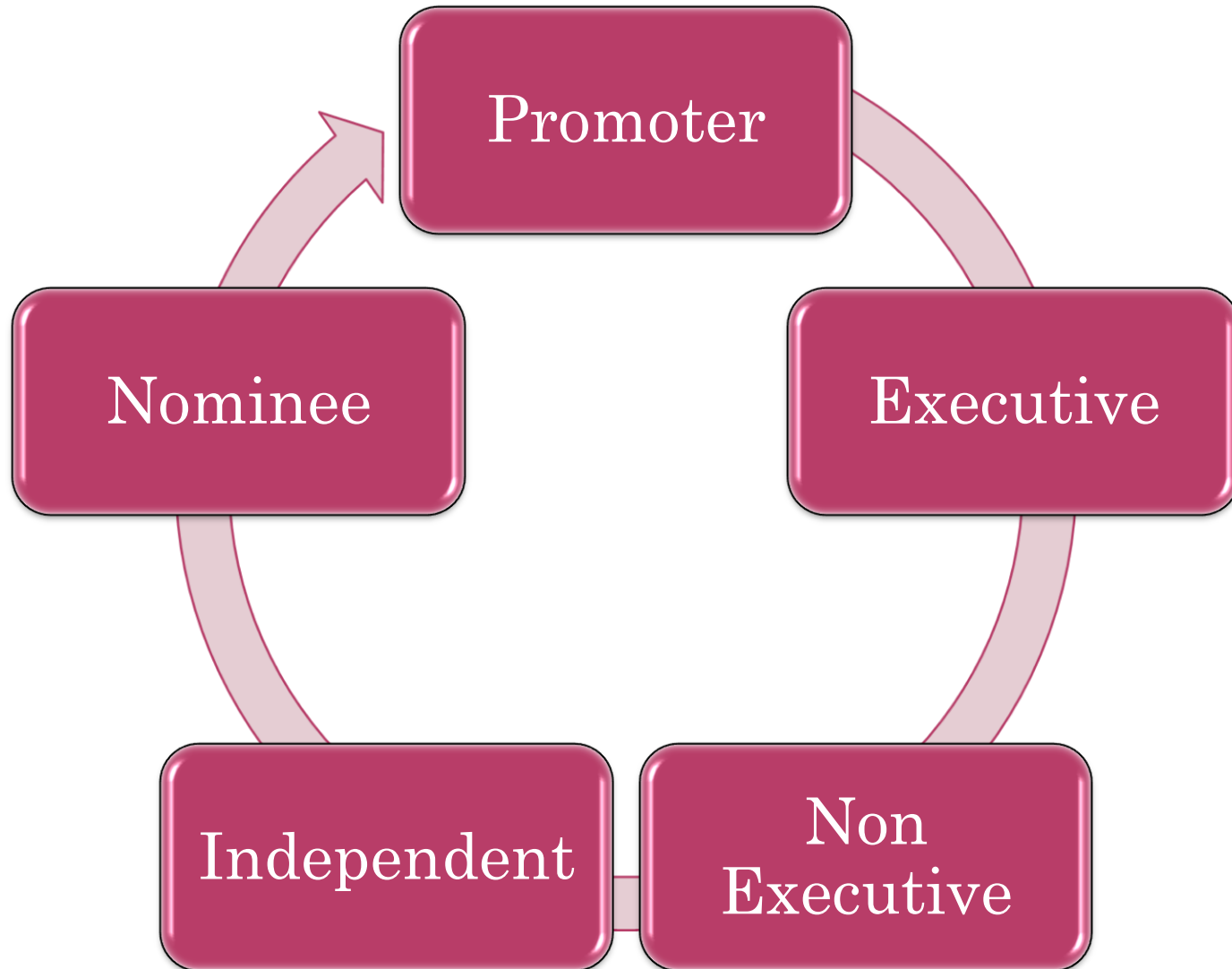
WHY CORPORATE GOVERNANCE?

- The need for corporate governance arises with need to balance interests of parties
- The key is:
 - Separation of ownership and management
- If the one who owns the company is also the one who governs the company, governance is purely proprietary
- However, the moment there is separation of ownership and management, several governance questions arise:
 - Conflict of interest: the manager may not best respect the interests of the owner
 - Once there are variety of stakeholders, balancing of claims of different stakeholders arises

TYPES OF COMPANIES FROM VIEWPOINT OF CORPORATE GOVERNANCE

- Widely-held companies
 - Every listed company is, by presumption, a widely held company
 - Types of listing:
 - Equity-listed
 - Debt listed
- Public unlisted companies
- Private limited companies
 - Family companies
 - Quasi-partnerships
- Other private limited companies
 - Those with external investors
 - Those without external investors
- JV companies
- Public sector companies

DIRECTORS



COMMITTEES OF BOARD



MEETINGS

- Statutory Meetings
 - Once in a life time of a public companies
- Board Meetings
 - One in a quarter at least
 - Committee meeting
 - Not regulated except audit committee meetings
- General Meetings
 - Annual General Meeting
 - Once in every FY
 - To transact ADDA
 - Extra Ordinary General Meeting
 - Any special business

SPECIAL BUSINESS AND SPECIAL RESOLUTION

- Every business apart from ADDA are special business
 - Special business can be conducted in AGMs also
- Special resolution is the super majority of shareholders in a meeting
 - SR is required for certain businesses as per the Act
- Special business may not necessarily require special resolution
 - Example- Alteration of object clause in MOA

Thank You!

